

INSTRUCTIONS:

Answer any *five* (5) questions from the Basic Theory section and any *ten* (10) from the Applications section. We have talked about some of these in class, but not all. They are all covered in one form or another in the book, lecture notes, and/or the provisional text. Still, they will require thoughtful expression on your part. Try to make your answers simple, straightforward, and responsive. No more than one page per question. Email your answers to me by Monday, April 3rd, 9am. Normal formatting: single space, name included in the document, page number, and also make sure to include the question number.

BASIC THEORY QUESTIONS:

- 1) The problems that we address in this class presume a reasonable understanding of basic price theory.
 - a) Describe the stylized model of perfect competition.
 - b) Why is competition good and monopoly bad?
- 2) I drive a big, fat truck that uses a lot of gasoline and, no doubt, to some extent increases the price of gasoline that you must pay. Am I making you worse off?
- 3) Why is the concept of U-shaped average cost a good characterization of the nature of production within a firm?
- 4) In the very short run practically all costs are fixed. Does that mean that marginal cost is zero? Why or why not?
- 5) Very few industries (maybe none) exhibit the theoretical conditions of perfect competition. Even so, competition from the fringe seems to be common in most markets. Sometimes this is called contestability. Discuss the competitiveness of the fast-food industry in this light.
- 6) Under what circumstances does a company go into bankruptcy? Under what circumstances does a firm dissolve and cease doing business? Is it normal for a bankrupt firm to shut down?
- 7) If all fixed costs for a particular firm are entirely avoidable, i.e. are not sunk and vary with production, will the firm choose to shutdown at the minimum of average variable cost? If not, why not?
- 8) Are positive economic profits inconsistent with a long-run competitive equilibrium? Why or why not?
- 9) What is the hold-up problem? How is it associated with asset specificity? Why do we say that the firm faces a tradeoff between the hold-up problem and the problem of separation of ownership and control?
- 10) What is the contracting-cost nature of the firm? What constrains the growth of the firm? What promotes the growth of the firm? How does the concept of shirking fit into the organization of the firm?
- 11) Are large firms more likely to have monitoring problems? If so, why do large firms exist?
- 12) What did Coase mean when he described the firm as the suspension of the price mechanism? Discuss.

APPLICATIONS:

- 13) How do the profits of a dominant firm and a monopoly compare? How do they both compare to the profits of a cartel? Make an attempt to graphically illustrate your points.
- 14) Describe the entry of Wal-Mart into the Clemson business area in terms of the dominant firm model and explain the costs and benefits to the consumers and producers who were here before Wal-Mart.
- 15) Look up the most recent concentration ratios and Herfindahl (HHI) indices for the following industries: beer; aluminum; breakfast cereal; petroleum refineries. Discuss the competitive nature of these industries.
- 16) Discuss the various theories of oligopoly.
- 17) Recount the evidence that the U.S. Steel merger of 1901 was a merger for monopoly. What evidence is there to the contrary?
- 18) What are some of the key assumptions underlying the Cournot model of a non-cooperative oligopoly? How do rival firms react to one another and what is the structure of their production levels and respective profits?
- 19) According to the game theory strategy posed by the prisoners' dilemma, how should firms choose their strategies? Feel free to present a sample scenario. Consider the case of a single game and the case of repeated interactions.
- 20) *Car Wars*: How do you explain that in a single year (1955 to be exact) American passenger automobile production rose by 45 percent, but then fell by nearly the same amount in 1956? In addition, how do you think the average prices of these cars evolved over these three years, and why?
- 21) What evidence would constitute proof of predatory pricing as opposed to straightforward competition? Use the example of Standard Oil (c. 1900) as an example. Why are price differentials based on cost differences not predatory pricing?
- 22) Discuss the theory of limit pricing. What are the predictions of this model? What evidence exists to support the relevance of this model?
- 23) a) Describe the process of two-tier or multipart pricing. b) Describe how block booking can be a form of price discrimination.
- 24) How does competition expunge price discrimination? How can price discrimination exist in otherwise competitive markets? Give some examples of competition in competitive settings; comment on the nature of competition in these cases.
- 25) The Walker Golf Course at Clemson charges several different sets of prices to students. Students can pay a flat fee of \$250 per semester and play as much as they like for free (if they walk; to ride a cart costs extra). Alternatively, they can pay \$15 per round on weekdays and \$25 per round on the weekend. Explain how the Walker Course makes money by using this pricing scheme.
- 26) *Electric Conspiracy*: What motives led several electrical equipment manufacturers to produce the same exact bids for Tennessee Valley Authority contracts in the 1950s? What characteristics of the electric industry in particular facilitated this behavior? Why was the

electric conspiracy a likely candidate for price collusion. Is it likely that automobile companies collude on price?

- 27) Officials of the ADM corporation were found guilty of conspiring to fix prices on a food additive. Give an account of this and speculate on what you think might have been the total loss to society if the government had not found out about this conspiracy.
- 28) I claim that the grocery industry (Ingles, Bi-Lo, Publix, etc.) is competitive because the national brands in the food processing industry wouldn't have it any other way. What do you think of this argument? (Discuss.)
- 29) Many monopolies are created and supported by government. What are the causes and consequences of this?
- 30) The Structure/Conduct/Performance paradigm argues that concentration leads to collusion that leads to excess profits. This argument is supported by a strong correlation between profits and concentration. Brozen-Peltzman-Demsetz object to this by claiming that the causality goes in the opposite direction. What is the compelling evidence of their research? How does the Wal-Mart example fit into this discussion?
- 31) What are the efficiency arguments for vertical integration of production? In what way might vertical integration be anticompetitive?
- 32) How can the phenomenon of not-for-profit institutions be explained within the rubric of the evolution of the firm? Specifically, compare not-for-profit institutions with stock corporations. What characteristics on the demand and supply sides of the market make not-for-profit institutions dominate production in some settings and stock corporations in others?
- 33) Why do people paint their houses before they sell them? Is it correct to say that because the practice survives that it is efficient? (Compared to what alternative?) Is painting a house before selling it the same as women wearing makeup?
- 34) If people can't tell the difference between products like Coke and Pepsi in blind taste tests, what is the point of brand names for these products?
- 35) Religious schism teaches us an important lesson about brand names. What is it?