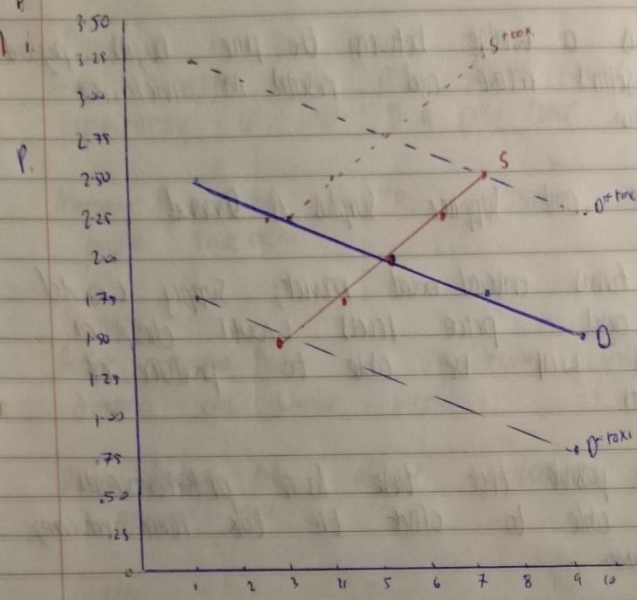1. i.

Price is 2.00 per coffee and 500 is consumed

ii. - This market is efficient.
- (Consumer Surplus and Supplier Surplus) is maximised.
- There is no deadweight loss.
- Equilibrium has been reached

iii. If tax is on Supply   New equilibrium is 300 units at 2.25 each
       seller pays 50c tax,   buyer pays 25c tax.

If tax is on demand: new equilibrium is 1.50 and 300 may's.
       Seller pays 75c tax   buyer pays 50c tax

iv. A tax drives a wedge between the price buyers pay and the price sellers receive and result in inefficient under-production.

Both consumer and supplier surplus is shrunken

v. If other firms entered exited market; supply would increase and price levels would drop as other firms will be able to produce at lower costs

It may be possible that these lower production costs will be able to offset the tax hence returning to equilibrium

2010 economist

b)

3a. Price:
Perfect competition: lowest price possible without creating any inefficiency or loss is a price taker

Monopoly: Price where $MC = MR$. Inefficient, increase their profit. Price maker

Quantity:
Perfect competition: Produce at equilibrium quantity, maximizing consumer and supplier surplus

Monopoly: Produce below efficient equilibrium quantity to maximise profit

Quality:
Perfect competition: Good quality products at low price

Monopoly: High quality only from producing these products

Economic Profit:
Perfect competition: little to no economic profit: highly competitive
normal profit

Monopoly: strong profit; they decide quantity sold and thus decide their profit

Consumer surplus
Perfect competition: maximized

Monopoly: Smaller than that of P.C. leading to inefficiency

Social welfare:

Perfect competition: there to serve society and produce at lowest possible cost.

Monopoly: In it to make profit by exploiting their position

Natural monopoly

Perfect competition: little/no barriers to entry/exit into market. Firms must be competitive to survive

Monopoly: hold monopoly, high barriers to entry. Little to no threat from other firms

b.i)

Fast		Speed	
		Comply	Cheat
	Comply	30 \ 30	-10 \ 45
	Cheat	45 \ -10	0 \ 0

ii. Nash equilibrium is for both to cheat.

Speed: if Fast cheats, Speed should cheat to minimise loss
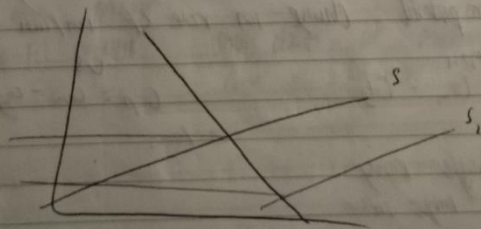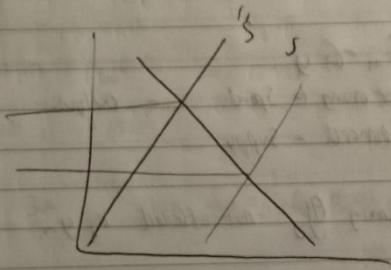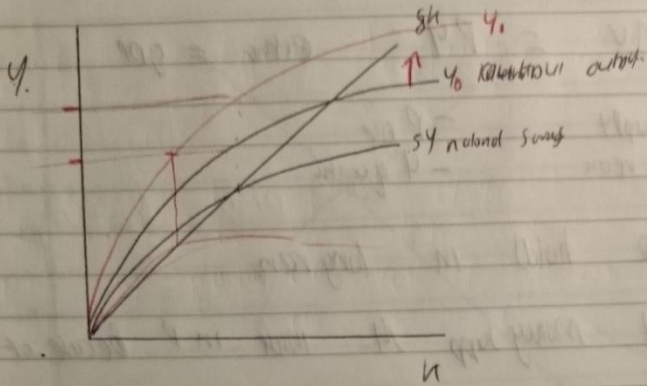if Fast complies, Speed should cheat to get profit of 45m

Vice versa for Fast.

iii. Firms will realise that by both cheating they are missing out on 30m profit each. They may form a cooperative equilibrium.

If one firm cheats the other has the opportunity to get back during the next move.

Econ 2010

Q4

Quantity Theory Money

$$MV = PY \qquad \text{either} = g_{DP}$$

- M - Money Supply
- V - Money veou

- P rise
- Y quantu

- Assume holds in long run

Increated Money supp M = increase in P because of inflation

$$G_V = 0 \qquad \text{growth velocity} = 0.$$

$$G_p = G_m - G_y$$

more money to spend — output

Inflation = demand - supply

$$\frac{G_p}{G_m} = 1 \qquad \text{assuming } g_y \text{ not affected by } g_m.$$

5 i. In the long run, change in money growth induce proportional change in rate of inflation

Japan
$$G_p = G_m - G_y$$
higher infl

Japan higher money
In Jap higher inflation

US
$$G_p = G_m - G_y$$
low

nominal = real + inflation
Japan higher Nominal

2010

4 b
$$G_p = G_m - G_y$$
inflation = 8 - 1 = 7%
Nominal inflation + real
$$7 + 2 = 9\%.$$

2010

Q5 i. euro appreciated.
        dollar to euro rates increased or pound

    ii. Strong exchange rate for europe
        would   devalue current account balance
        euro was less competitive - decreased net exports

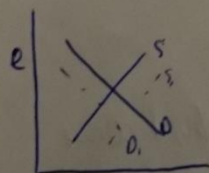   iii. PPP say $P = \frac{P*}{e}$

    real exchange $= \frac{P}{P*/e} = \frac{eP}{P*}$ exchange rate $\left(\frac{\text{Price dom}}{\text{Price forg}}\right)$

    if $P_{\text{rate one}} = \frac{P*_{\text{euro}}}{e}$ was adjusting until this was

    true i.e europe became "cheaper" then current
    account would not decade

    iv. It would increase supply of euro to weaken currency
        i.e. print more money

    v.

        vale devalued euro
        demand clearer
        or S₁ increased

b

$$P = \dfrac{\frac{A}{P^x}}{e}$$

$$4 = \frac{1}{e} \qquad 10 = \frac{20}{2}$$

$$4e = 1$$
$$e = 0.25 \qquad \cancel{1.04}$$
$$10.04 = \dfrac{20.02}{e}$$

A inflat = 4%

B = 1%

(A)

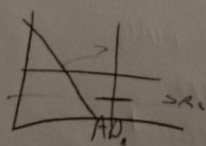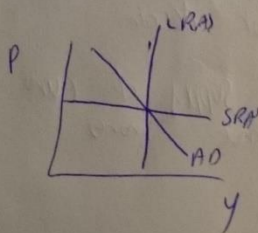Inflation causes domestic price level to rise

PPP predict e will fall

Unattract to foreign customers
exchange rate must fall

* Higher domestic prices lower demand for our goods
and hence our currency, causing it to depreciate

AS - AD model   The price is not right!

output = demand
$$Y = AD$$

P

LRAS

SRAS

AD

Y

AD₁

SRAS₂

SRAS drops down
Interest rate causing higher
prices, leading to decreased
output as Y adjusts
to Yn

Fisher effect: real interest rate equal nominal ray minus expected inflation.

Therefore real interest fall w/ inflation increase, unless nominal rate) increase at the same rate as inflation

Purchasing Power Parity:
- If price of goods cost same in both countries then
$$P = \frac{P^*}{e}$$
- According to PPP, exchange rate adjust until this hold
- Predict exchange rate adjust until bundle of good cost the same way denominated by the same currency

PPP predicts real exchange rate $e = 1$.

Taylor Rule:

Goal of monetary policy is to keep output at potential and to maintain inflation at target (2-3%.)

Manipulation of money supply through interest rate

example $y < y_n$:

Rule dictates banks should lower interest rate by reducing cost of borrowing (people more money to spend) so AD should rise to clear output gap.

TED Spread

A rise in Ted Spread will lead to fall in money supply AD