Tutorial: Economies of scale, Imperfect competition and International trade

March 31, 2004

Problem 1: Multiple Choice Questions

1. Economies of scale exist when
   - a average costs of production increase as more output is produced
   - b more than one product can be produced using the same production process
   - c average costs of production decrease as more output is produced
   - d resources become more productive
2. With monopolistic competition
   - a firms do not have any price setting ability
   - b firms set prices without any threat of competition
   - c firms set prices and are constrained by the existence of close substitutes for their product.
   - d firms produce identical goods.
3. Dumping includes all of the following choices except
   - a setting marginal revenue equal to marginal cost when demand elasticities differ across markets.
   - b charging a price lower than cost.
   - c charging a price lower than marginal revenue.
   - d charging a higher price in one market than in another market.
4. With external economies of scale, the PPF is characterized by
   - a absence of opportunity costs
   - b decreasing opportunity costs
   - c constant opportunity costs
   - d increasing opportunity costs

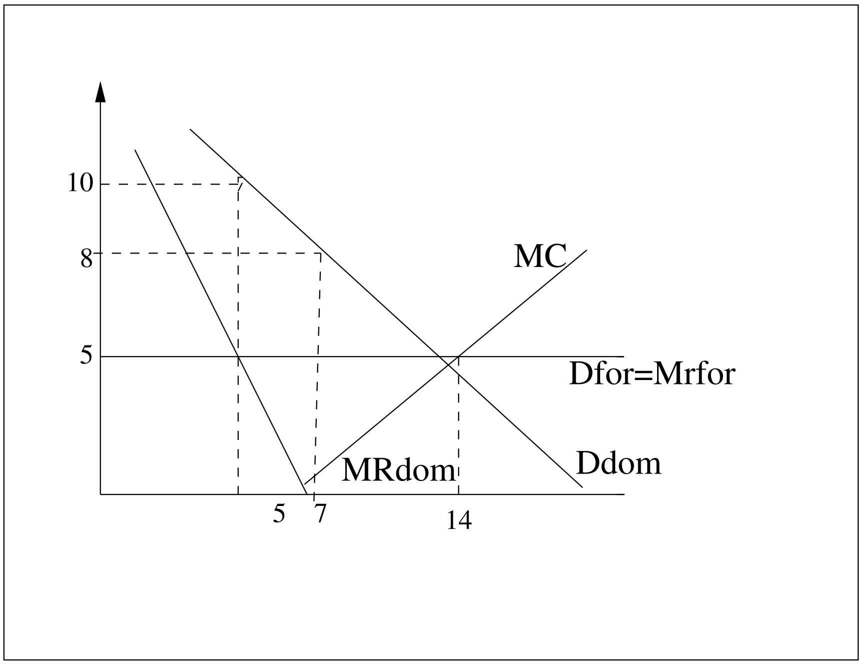

Figure 1: Demand and Cost functions of an Indian Steel Firm

Problem 2

If Firm A sells steel in several countries. The demand for the steel in India is more elastic than in China. What type of prices will you expect Firm A to charge in these two markets?

Problem 3

Suppose the Chinese computer industry has lower average total costs than the Japanese computer industry. The Japanese industry is established first. Will the Chinese industry be able to compete? If it will not be able to compete, what could be the reason?

Problem 4

Explain how trade can erode a firm's economic profit, lowering price and increasing product variety in the case of monolopistic competition

Problem 5

Figure 1 represents the demand and cost functions facing an Indian steel production monopolist. Answer the following questions

1. If the monopolist were unable to export, and was constrained by its domestic market, what quantity would it sell at what price?

2. The monopolist discovers that it can export as much as steel as he likes at the world price of Rs.5/ton. What will the monopolist do in such a situation? How much steel will he sell and at what price?

3. Is the Indian firm engaged in dumping? Why?