1. (8) The article stated that Yale was a major employer in New Haven while Harvard was one of many employers in the Boston area. Thus, Yale has some monopsony power and Harvard is a price taker in the labor market. The marginal expenditure and marginal value for each firm is illustrated below. Note that since Yale has monopsony power, the marginal expenditure is upward sloping while Harvard competes in a perfectly competitive labor market, making its marginal expenditure horizontal (it is a price taker in the labor market). When each school sets its marginal marginal value of labor equal to the marginal expenditure, Yale is able to offer a lower wage (noted by the supply of labor of willingness to work at each wage).

Yale wage = \( w_0 \)
Yale hires \( Q_y \)

Harvard wage = \( w_1 \)
Harvard hires \( Q_H \)
2. (9) Answers will vary. Need to choose an example where firms separate consumers into groups. This can be done with identification or requirements to be net to receive a given price. Necessary conditions are 1) must have market power 2) must be more profitable for firm than single price 3) must be able to separate into groups 4) must prevent resale. Intertemporal pricing separates consumers by charging a high price initially (when demand is highest) and then a lower price later (when demand is lower). Peak load pricing – charging higher prices at high demand times as a reflection of increased marginal cost at high demand times. Thus incentive to price higher is due to a reflection of costs, rather than to capture consumer surplus. Real world examples will vary.

3. (4) According to the manager EWEB should return to the single rate because it is easier to understand (thus reducing customer calls questioning bills), easier to create the billing statement, and a single rate is better for older people who live on a fixed income and for people in lower income classes (due to the fact that older people and poorer people live in older, less efficient homes and consequently will use more electricity). This is different than our normal analysis because usually the firm is simply concerned with maximizing profits and will thus only consider the profits of either billing method (instead of equity issues or conservation).

4. (7) With no barriers to entry, there will be entry until profits equal zero (which requires price to be equal to average total cost). If the average total cost simply intersected the demand curve, rather than being tangent, then there would be another quantity selection for the firm where profits would be greater than zero (implying that the firm is not profit maximizing). This contradicts our statement that setting marginal revenue equal to marginal cost maximizes profit. Each firm faces a downward sloping firm specific demand because there are differentiated products. If the firm raises its prices, it will only lose some of its quantity demanded (rather than all of it like a perfectly competitive market) because there will be consumers who prefer the product over another firm’s product. Most economics textbooks do not recommend regulation because the costs of regulation appear to be greater than the benefits. A government could regulate entry to achieve the result of MB=MC, however this would be reducing the choices available to the consumer. Also, a government could pass regulations that require a product standard, creating a homogenous product. Once again, a homogenous product would be limiting the choices available to consumers (consumers value the ability to choose between products due to differences in tastes and preferences). Finally, given a relatively elastic firm specific demand, the actual deadweight loss could be relatively small.