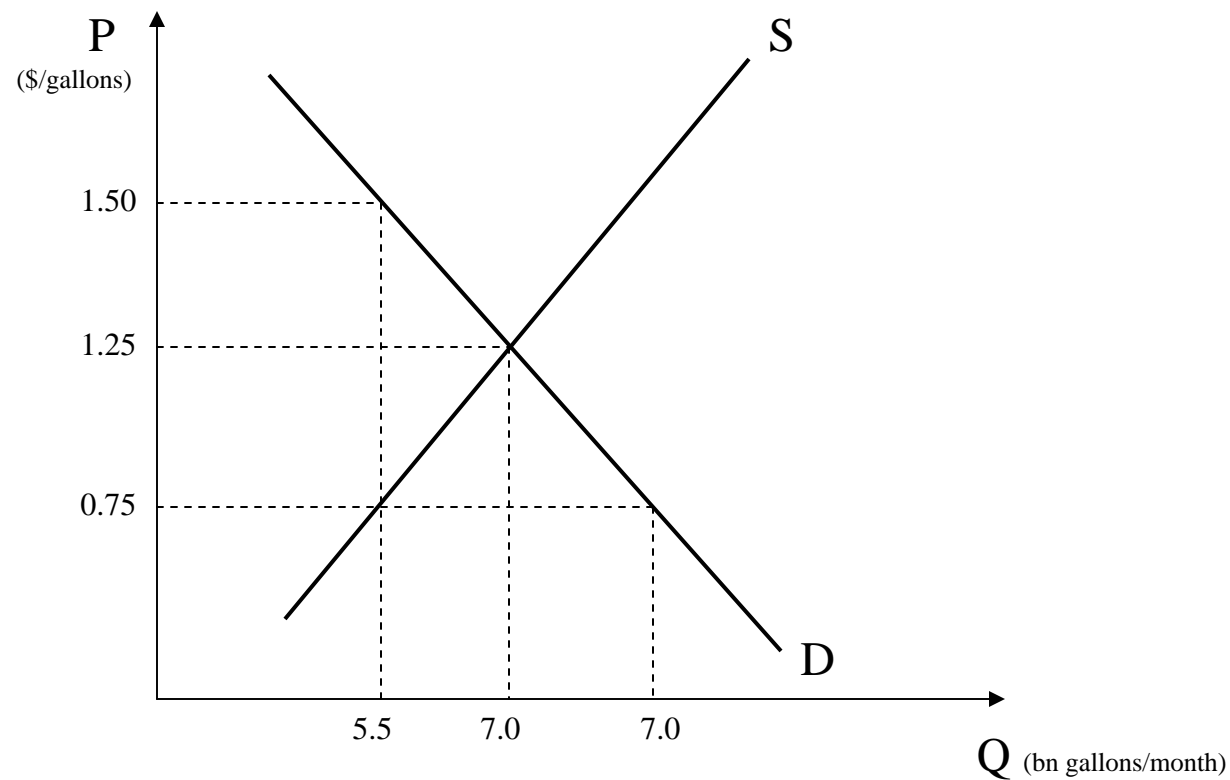


# Answers to Motivating Questions

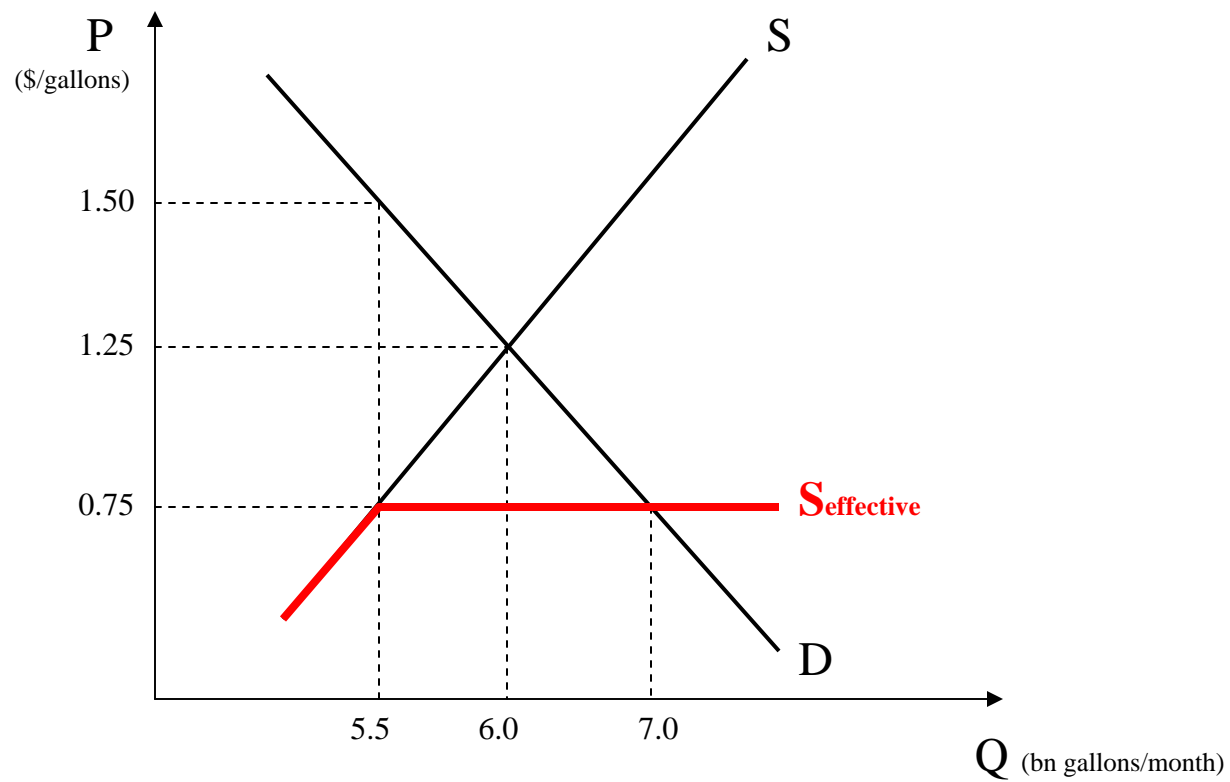
Eugenio J. Miravete

## M.Q.: Oil Embargo

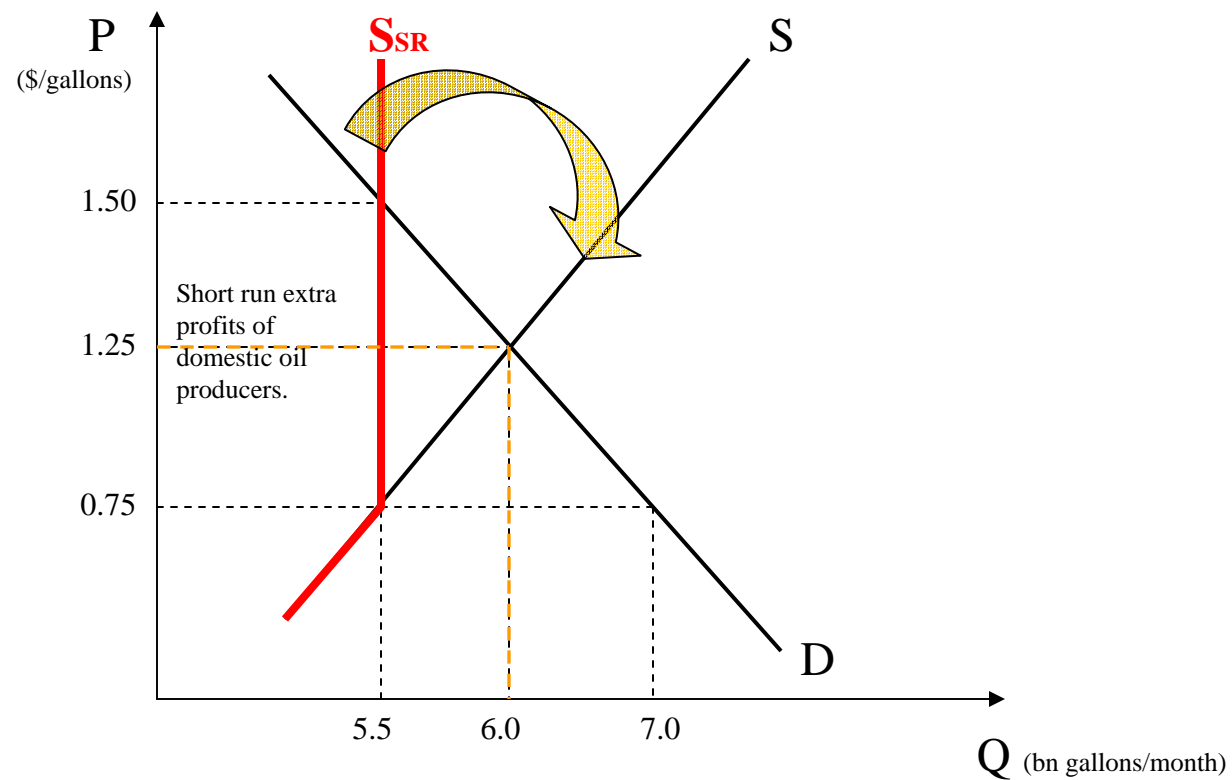
- It is key to distinguish domestic from foreign supply, long run from short run and firms' vs. actual market supply.



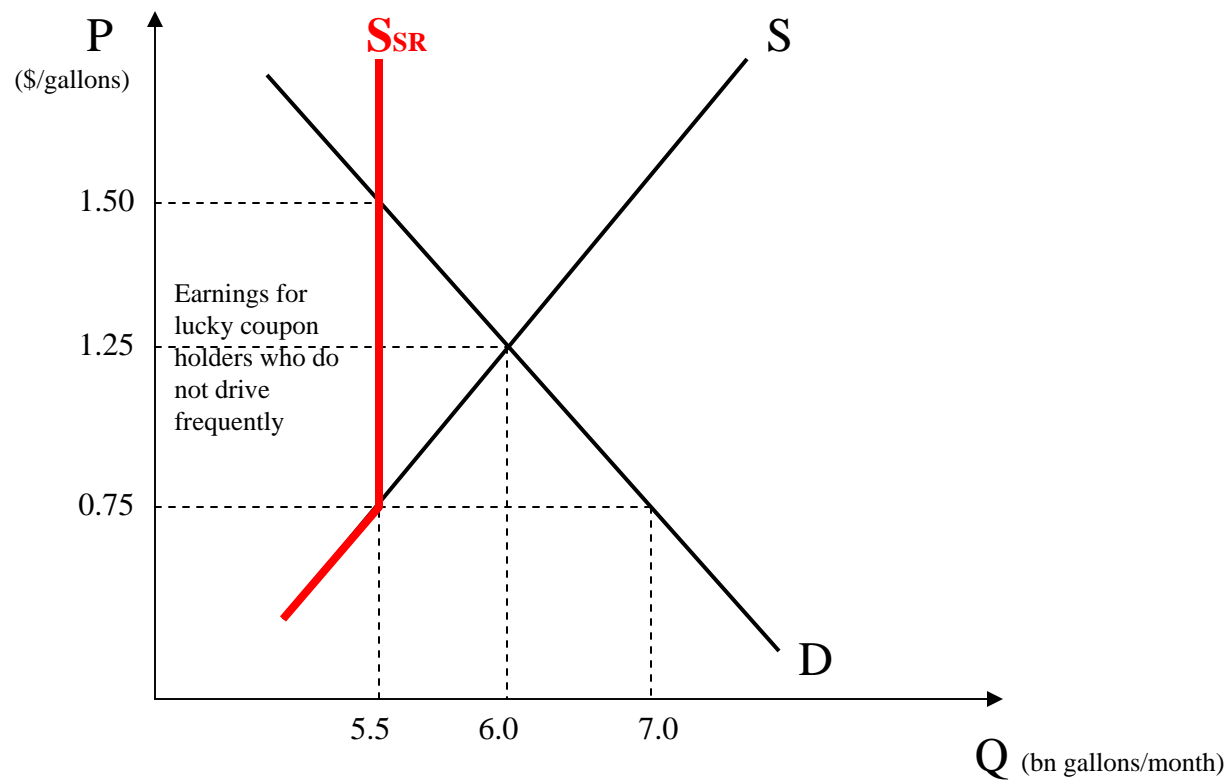
- Equilibrium in an open economy.
- a.- Domestic production = 5.5; Imports = 7.0; Price = 0.75.



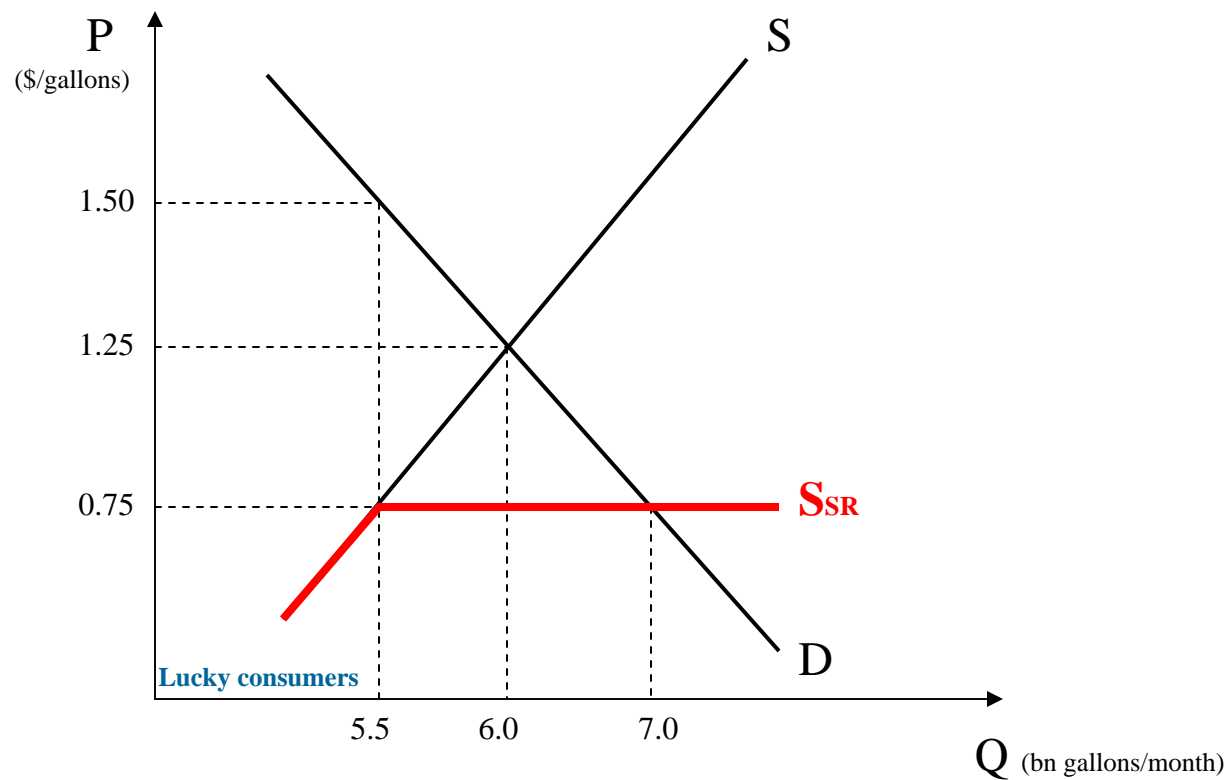
- No intervention.
- b.i.- Short run: Domestic production = 5.5; Imports = 0; Price = 1.50.
- Long run: Domestic production = 6.0; Imports = 0; Price = 1.25.



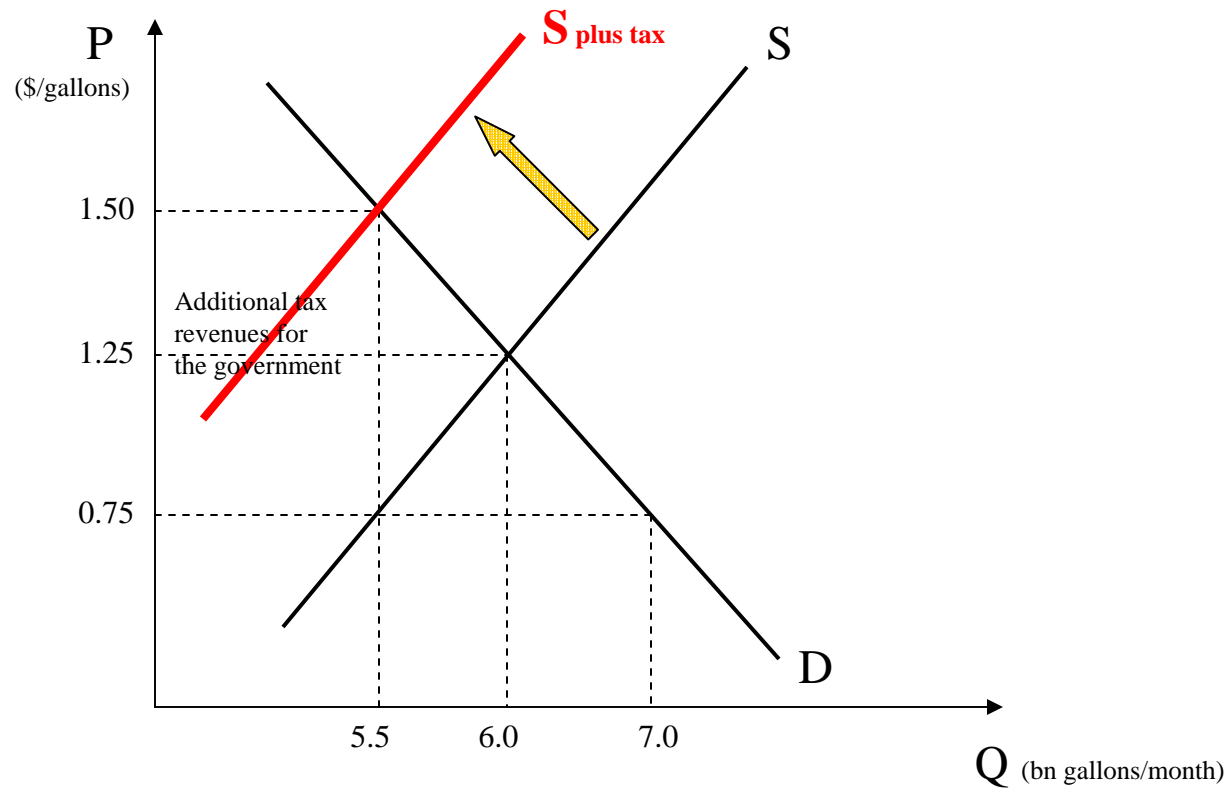
- Rationing with coupons.
- b.ii.- Coupons = Domestic production = 5.5; Imports = 0;  
Price = 1.50 (0.75 to producers and 0.75 to coupon holders).



- Soviet economy: price ceiling.
- b.iii.- Domestic production = 5.5; Imports = 0; Price = 0.75;  
Excess of demand = 1.5 bn gallons/month.

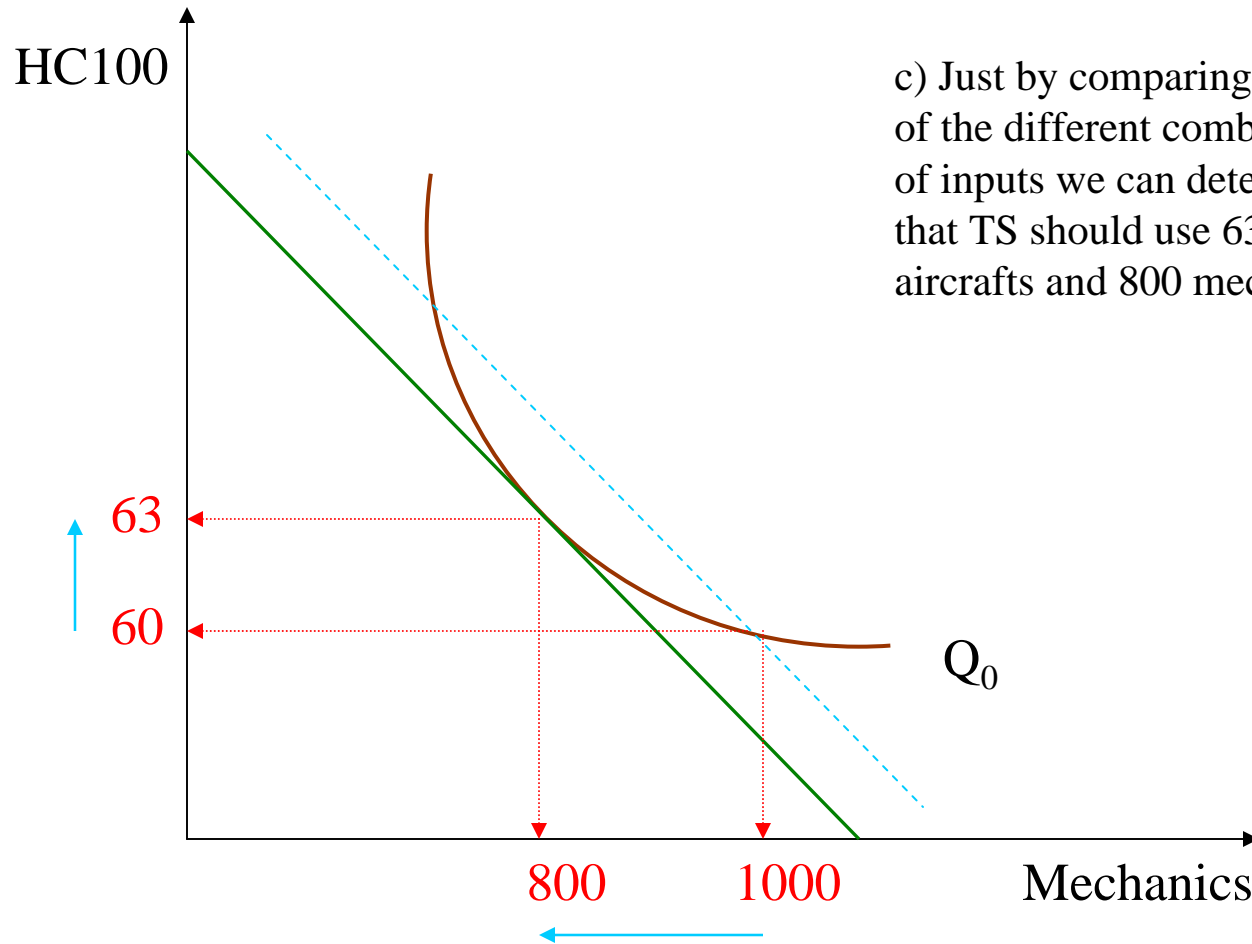


- Government taxation.
- b.ii.- Domestic production = 5.5; Imports = 0;  
Price = 1.50 (0.75 to producers and 0.75 to government).



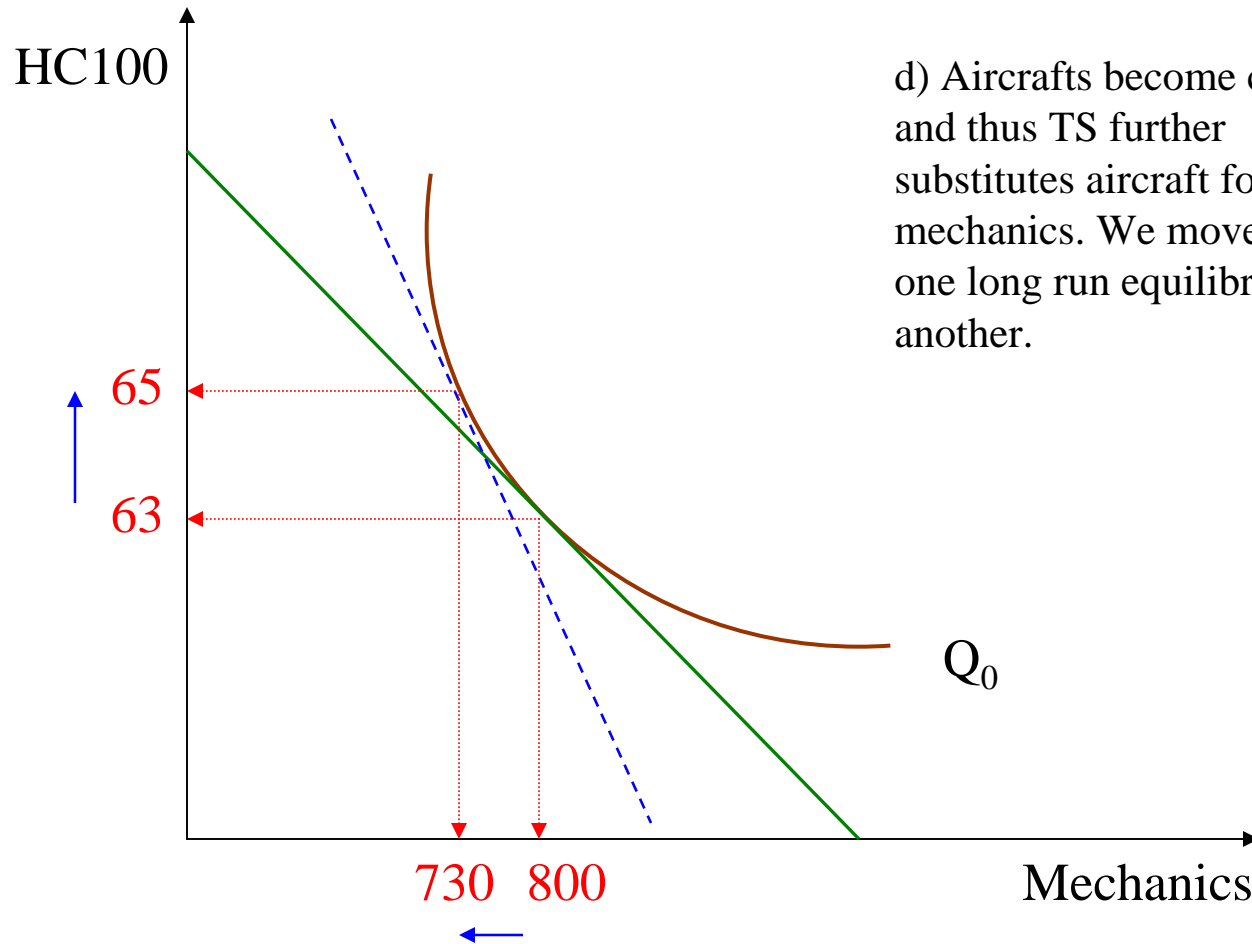
- Oil embargo: Summary.
- In all examples in the short-run the quantity of gasoline available is the same. The difference is who gains and who loses:
  - Free market: high price; rent goes to oil companies.
  - Ration coupons: high price; rent goes to those with coupons.
  - Price ceiling: low price; benefits go to those willing to wait for gas.
  - Sales tax: high price; rent goes to government.
- Only the free market is efficient in terms of inducing a supply response to the embargo.

# Transport Service – 1



c) Just by comparing the costs of the different combination of inputs we can determine that TS should use 63 HC100 aircrafts and 800 mechanics.

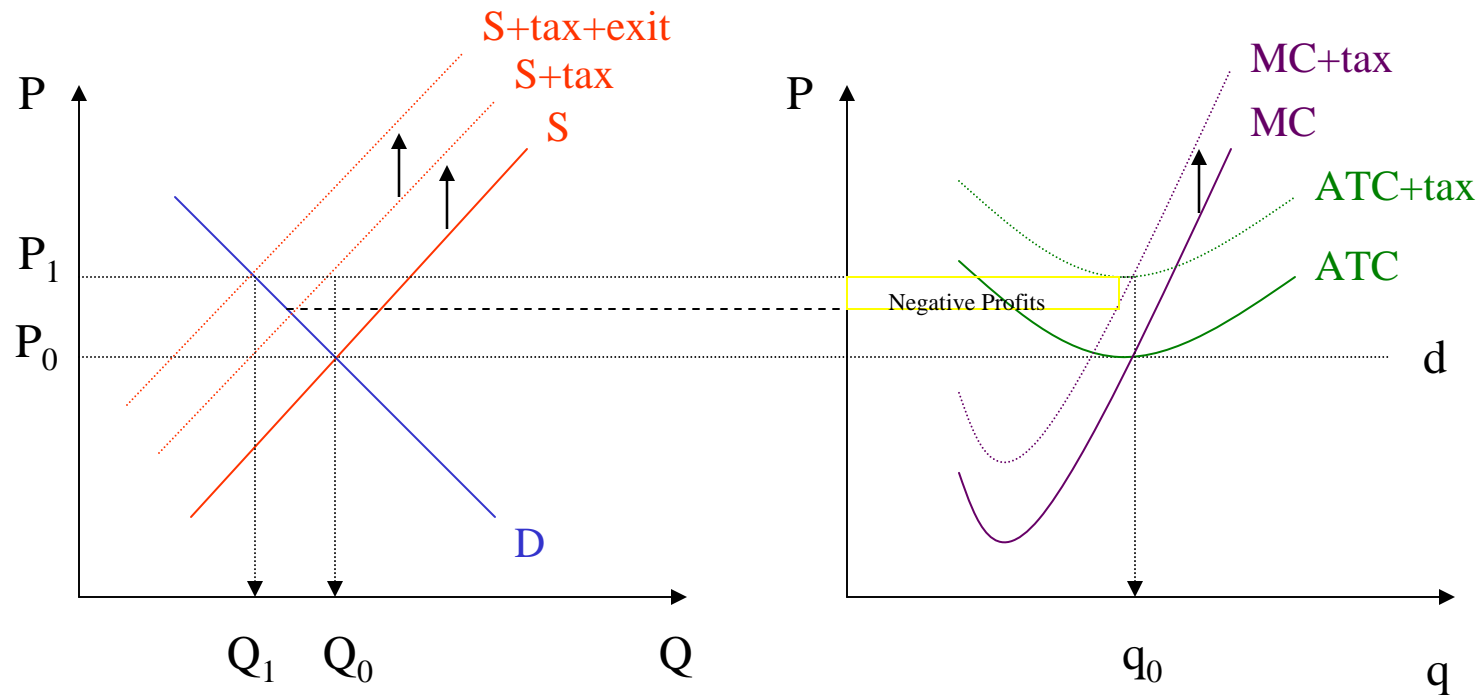
## Transport Service – 2



d) Aircrafts become cheaper and thus TS further substitutes aircraft for mechanics. We move from one long run equilibrium to another.

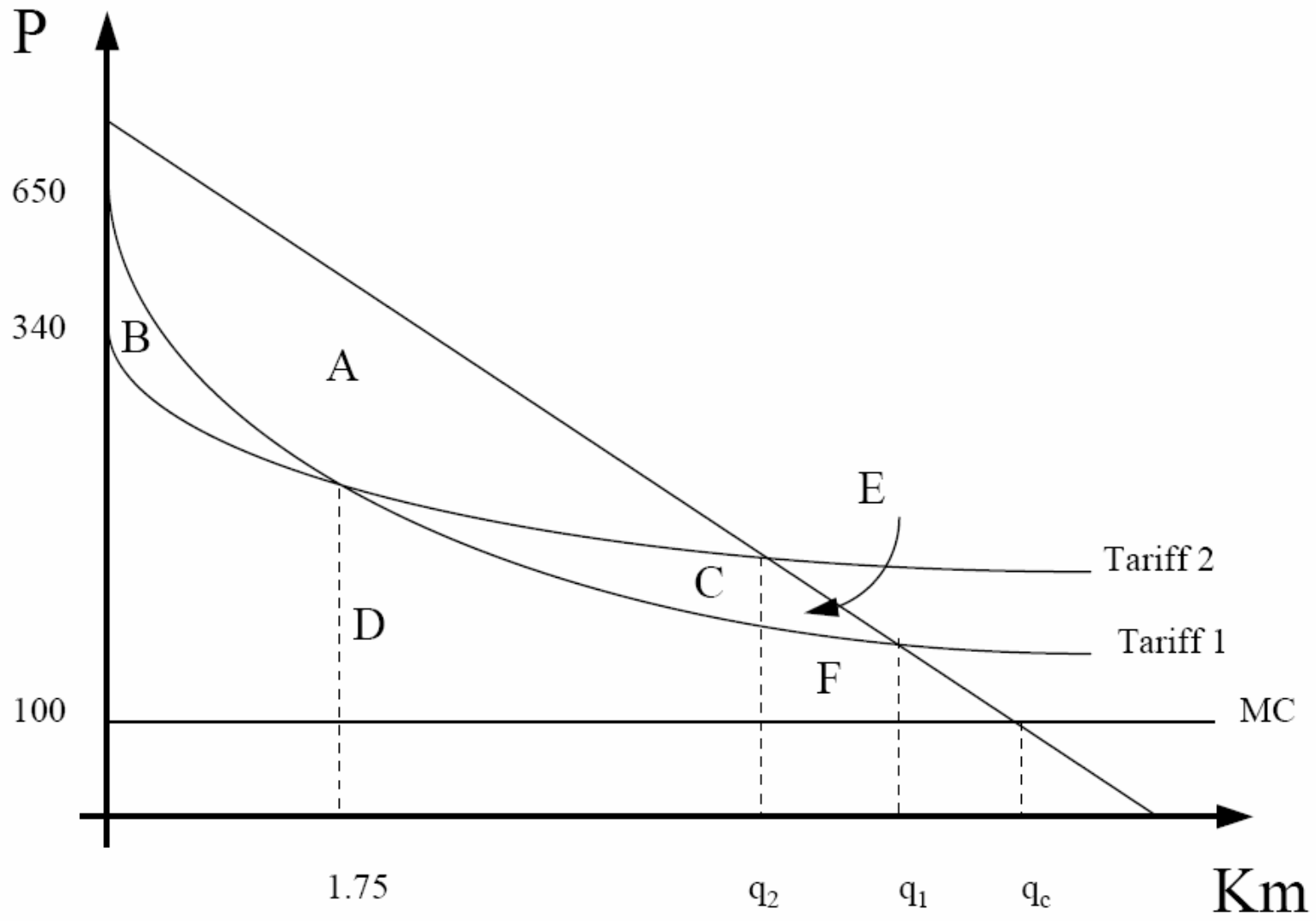
# Wine Taxation

- Consider the supply of EC white wine and demand by US importers.



Tax burden is shared in the short run only. In the long run importers will pay it all.

# Taxicabs in Tokyo



## Prisoner's Dilemma: Advertising (Tobacco)

|     | Ad.          | No             |
|-----|--------------|----------------|
| Ad. | <u>8 , 8</u> | 20 , 2         |
| No  | 2 , 20       | <u>14 , 14</u> |

- Assume that advertising only influences market shares, not the size of the market.
- What is the consequence of a ban on advertising put forward by the government?

## Prisoner's Dilemma: Advertising (Tobacco)

|     | Ad.   | No     |
|-----|-------|--------|
| Ad. | 8, 8  | 20, 2  |
| No  | 2, 20 | 14, 14 |


# Signaling: General Electric & Westinghouse

|    |    |           |                |
|----|----|-----------|----------------|
|    |    | W         |                |
|    |    | Hi        | Lo             |
| GE | Hi | 100 , 100 | 20 , 140       |
|    | Lo | 140 , 20  | <u>70 , 70</u> |

# Signaling: Guaranteed Prices

W

|    |    | W         |   |
|----|----|-----------|---|
|    |    | Hi        | Lo                                      |
| GE | Hi | 100 , 100 | 20 , 140                                |
|    | Lo | 40 , 20   | -30 , 70<br><u>                    </u> |



# Signaling: Price Leadership

W

---

|    |    | Hi               | Lo        |   |
|----|----|------------------|-----------|---|
| GE | Hi | <u>100 , 100</u> | 20 , 40   | ← |
|    | Lo | 40 , 20          | -30 , -30 |   |

↑