Economics 105

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Pledge: *No Aid; No Violations* November 5, 1997

Sign ____*Mr Key*______________

Quiz #2

Part I: Tricky Statements: [80 points]

1. The *balance sheet* is a snapshot picture reporting a firm's assets and liabilities and net worth at the end of the fiscal year (e.g., Dec 31, 1996).

2. Accountants prefer accelerated depreciation to straight-line depreciation because it is increases current depreciation charges, thereby yielding a lower profit to be reported to the Internal Revenue Service, which reduces the current corporate profit tax. Reported profits and corporate profit taxes may be higher when the asset is fully depreciated, but at least the tax payment will have been postponed, which amounts to an interest free loan from Uncle Sam.

3. TRUE The "write-up of basis at death" provision of the Internal Revenue Code means that if you hold on to the asset until you die, your heirs will only have to pay the capital gains tax on any increase in value that occurs after your death. If instead you sell the asset yourself, you will have to pay capital gains tax on the increase in the value of the asset during the period you owned it, which means that you will have less to pass on to your heirs.

9. The production function $Q = 10L^{3/4} K^{1/5}$ is not homogeneous of degree one; it is homogeneous of degree ¾+ 1/5 = 19/20.

16. .Under monopolistic competition (and imperfect competition), price is greater than marginal cost (because the demand curve is downward sloping), marginal cost is *equal to* marginal revenue (because of profit maximization), and total revenue equals total cost (because of free entry and exit)..

17 .A profit maximizing firm will always shut down its factory rather than produce where price is below average *variable* cost. (p < avc implies pq < q avc, or revenue < variable cost; hence profits < - fixed cost.

20. Under monopolistic competition, all the firms in the industry face downward sloping demand curves. Therefore, price is greater than marginal cost. Also, marginal cost *equals* marginal revenue because the firm's are profit maximizers. Nevertheless, firms make zero economic profit because of free entry and exit.

Part II: (20 points] The graphs show the total cost, average total cost, average variable cost and demand curves for a monopolist:. Note that the marginal cost curve goes through the minimum points of the average total cost and of the average variable cost curves (the break-even point and the shut-down point). Also, maximum revenue of $250 would be realized at output q = 5.

The average score is 85. Minimum = 76; maximum = 100.