Economics 380: Midterm 2

16 November, 2005

This test is open book. It is marked out of 100. You have 60 minutes. Good luck.

1. [25] Microsoft is currently considering leasing its Windows operating system. Why would it seek to do this? In your answer you should explain precisely how leasing could increase Microsoft’s profits.

2. [25] What is the difference between second-degree and third-degree price discrimination? Name three examples of price discrimination in the airline industry. Include at least one example of second-degree price discrimination and at least one example of third-degree price discrimination.

3. [25] Suppose an airline is using yield management.
   (a) Intuitively, when would the airline increase its price? When would the airline decrease its price? Explain why.
   (b) Instead of yield management, the airline could simply use a fixed price. When will there be little loss from using a fixed price? That is, for what kind of flights will the lost profit be small?

4. [25] You are bidding for a used car at an auction.
   (a) A car is likely to have private-value and common-value components: provide an example of each.
   (b) Explain how the common value components can lead to a winner’s curse.