

***DUE 2/10/09***

**PLEASE TYPE YOUR ANSWERS ON A SEPARATE SHEET ON PAPER!**

1. Suppose the common facilities used for local and long distance calls cost \$20 / month and that interstate usage was 10% of the total.

- A. If the costs were allocated according to usage, how much of the costs would be recovered from long distance?
- B. How much would be recovered from local?
- C. If the Ozark Plan were used, how much of the costs would be recovered from long distance?
- D. If the Ozark Plan were used, how much would be recovered from local?
- E. Should long distance pay more than its usage-allocated costs? Why or why not?

2. In 1975, suppose a call from Chicago to St. Louis cost AT&T \$.03/min and there were 100 million total minutes and calls from Normal to Cincinnati cost AT&T \$.09/min and there were 50 million minutes. Assume the distance between the cities is the same and that the FCC regulates AT&T perfectly.

- A. If the rates are geographically averaged, what price will be charged per minute for the first city pair? For the second city pair?
- B. How much economic profit does AT&T make?
- C. Suppose a competitor can supply calls from Chicago to St. Louis for \$.03/min (their cost to provide service) and it charges customers \$.04/min. If it gets half of the market from Chicago to St. Louis, how much profit will the competitor make?
- D. After the competitor enters, how much profit/loss will AT&T make?
- E. What new rate must AT&T charge to make zero economic profit?