**CHAPTER #22 SHORT ANSWER/ESSAY**

1. Pure monopoly is a market structure where a single firm is the sole producer of a product where there are no close substitutes. In addition, monopolists are price makers, and entry to the market contains barriers.
2. One example of a monopoly might be a public utility company like DTE. A professional sports team like the Tigers could be considered a monopoly because they are the only producer of MLB in the area. Even though there are other teams in the nation, it wouldn’t be practical for someone in say Chicago, to drive and attend games in Detroit on a regular basis. The Tigers have a monopoly in the immediate vicinity.
3. Economies of scale are a barrier to entry because only one company may be able to produce large quantities of output at low atc. Small competitors would be producing such small output as to produce higher on their LRATC, therefore they could not compete. Also the cost of needed technologies to produce large amounts of output at low atc, achieving economies of scale is high.
4. Most natural monopolies are public utilities because the large cost and economies of scale associated with production at the lower end of LRATC requires very large amounts of output. Government regulates natural monopolies to ensure consumer prices closer to minimum ATC.
5. Patents and licenses create barriers to entry as they give legal monopolies or near monopolies to the producers of goods and services. For example a patent might give a drug maker a 20 year monopoly on the sale of a medication they developed, while a license would allow a cabby the right to drive a cab. By controlling the number of licenses the government ensures profits of licensed cabbies, while acting as a barrier to entry.
6. A monopolist could temporarily lower prices dramatically to drive out potential competitors; or increase its advertising, in an attempt to ensure failure of the competitor.
7. Monopolist versus pure competitor; a) demand schedule is perfectly elastic for the pure competitor while inversely related for the monopolist. B) marginal revenue is equal to price for the pure competitor, but less than price for the monopolist. c) Marginal revenue and average revenue are equal and constant for the pure competitor, but decreasing for the monopolist d) The pure competitor’s price is where MR=MC=P, while the monopolists is where a vertical line running through MR=MC intersects the demand curve. E) The pure competitor is a price taker while the monopolist is a price maker
8. Marginal revenue is always less than average revenue (price) when demand is less than perfectly elastic because when a monopolist lowers their price to sell an additional unit, they must also give the price break to all previous units that would have been sold at a higher price.
9. If a monopolist were producing in its inelastic region; decreasing its price to increase sales would actually decrease total revenue since marginal revenue becomes negative. Reducing output would cause marginal/total revenue to increase as one moves up their respective curves. Basically when marginal revenue is positive, total revenue is increasing, but when marginal revenue is negative (inelastic region) total revenue is negative.
10. A profit maximizing monopolist will produce output where MR=MC, and at a price equal where the vertical line running through MR=MC intersects the demand curve.
11. There is no supply curve for a monopoly as there is not a unique relation between price and quantity supplied. Changes in demand conditions yield price and supply, and in some instances different demand conditions could bring about different prices for the same level of output!
12. The monopolist does not simply charge the highest possible price as demand and therefore total revenue would drop, even if profits were generated. The goal is largest profit, not largest per unit profit!
13. If the monopolist set its price associated with its highest average profit, its total profit would not be greatest. This is because the highest average profit would be at lower levels of output, on the upward sloping portion of the total revenue curve. The monopolist want to maximize total profits, by generates greatest revenues.
14. Some monopolists are unprofitable because their profit maximizing output is such that price lies below ATC, which could be caused by shifts in cost curves or changes in tastes and therefore demand. In the short run, the monopolist will suffer losses. In the long run however, the monopolist will not continue to suffer losses and will shift resources to alternative production.
15. Pure competition is more efficient than monopoly from a production and allocation standpoint because pure competition production where P =MB=MC (allocative) but the monopolist produces where P>MC. From a productive standpoint pure competitors produce at P=Min ATC, while a monopolist P>Min Atc.
16. Monopolies affect distribution of income by charging consumers price greater than minimum ATC. In doing so income is transferred from higher paying consumers to the shareholders of the monopoly.
17. Costs might differ from a monopoly and a pure competitor producing in the same industry because of the four following reasons. A) economies of scale b) X-inefficiency c) Rent seeking behavior d) Technological advances. Be sure to read about these in detail (p.433-435)
18. In some instances only massive levels of output might support production equated with economies of scale. These high levels of output lend themselves to technological advances which lower costs. This can offset some of the inherent inefficiency associated with monopoly.
19. X-Inefficiency refers to a firm producing above its lowest atc due to bad management, poor technology, etc… This increases the cost of production for the monopolist.
20. Rent seeking is a behavior designed to transfer wealth to a particular firm at someone else’s (society’s) expense. This behavior often times means spending money to lobby government to maintain the monopolist’s status. This therefore raises the costs of the monopolist.
21. Since a monopolists position isn’t dependent upon producing at lowest possible cost because of their position as a monopolist, the statement doesn’t necessarily apply. On the other hand if a monopolist doesn’t stay on top of technology, it may be possible for a firm to use new technology to compete against a monopolist. The position of a monopolist creates its very threat to tech advances, as it may be complacent.
22. Price discrimination refers to the ability of a monopolist to charge different customers different prices, even when there is no justification from a cost standpoint. The conditions which must be met for a monopolist to do this are; a) have monopoly power b) be able to segregate buyers c) product must not be able to be resold
23. If a monopolist can segregate its buyers based on elasticity it can then price discriminate. It will charge the inelastic buyers a higher price than the elastic buyers. For example business travelers versus pleasure travelers.
24. Price discrimination increases the profits of a monopolist and increases output to a level greater than if it didn’t discriminate. Consumers still pay higher prices, though elastic buyers get a little better price.
25. Public Utility regulators attempt get monopolist to produce socially optimum output since monopolists under allocate resources. The problem in doing so is that this level of output would be associated with a price ensuring losses to the monopolist. Therefore a fair return price is often times the goal; getting the monopolist to produce where P=ATC=Demand. Not productively, or allocatively effiecient, but better than where the monopolist normally produces from an efficiency standpoint.

**CHAPTER #23 SHORT ANSWER ESSAY**

1. The three characteristics of monopolistic competition are; a) relatively large number of sellers, b) differentiated products, c) Easy entry and exit
2. Product differentiation refers to the variations in a particular product (basketball shoes) that different competitors produce. Methods of variation can include; a) product attributes such as styling and quality, b) service, c) brand names & packaging, d) control over price, and e)location.
3. Product differentiation affects the kind of competition and degree of monopoly in M.C. in that it allows for more competition due to the variety of differentiation; thus lowering the degree of monopoly power in the structure as compared to pure monopoly. However, if a M.C. competitor can convince its customers through advertising that its differentiation is best; this loyalty can lead to some control over prices. That is the M.C. can charge a higher price, and customers will be willing to pay it based on their loyalty to the differentiation.
4. The demand curve faced by a monopolistically competitive firm in the short run is more elastic as compared to a monopolists, but not completely elastic like the P.C. This elasticity is due to the substitutability of competitors products.
5. The two factors that determine the elasticity of a M.C. demand curve will be based on the success of their product differentiation and the advertising which will communicate that differentiation to potential consumers.
6. As in other market structures, the oligopolist in the short run will produce where the vertical from the x-axis, running through MR = MC intersects the demand curve. In the short run, the Monopolistic competitor will be earning either profits or losses. Refer to graphs a or b on p. 447.
7. Whether a monopolistic competitor earns profits or losses is dependent upon where its price is relative to atc. Above equals losses, and below will yield profits.
8. In the long run monopolistic competitors will tend to earn normal (zero) economic profits. This is due to the entry of firms reducing profits (causing a leftward shift of existing forms demand curves), or the exit of firms reducing losses (causing a rightward shift of existing firms demand curves). This is a tendency as some firms may still earn economic profits in the long run because of effective product differentiation and customer loyalty, which allows them to charge slightly higher prices!
9. The two complications that explain why some firms can earn economic and not just normal products in the long run are product differentiation that can’t be duplicated by others, which can lead to higher costs of entry; thus yielding slight monopoly like power regarding pricing.
10. Since monopolistically competitive firms produce where P(MB)>MC, allocative efficiency is not achieved as resources are under allocated. Productive efficiency is not achieved either as price is above minimum atc. The gap between the output produced and what would be produced if price were at minium atc (yielding productive, and allocative efficiency) is known as excess capacity.
11. A monopolistic competitor will use further product differentiation and advertising (to emphasize this differentiation) in an attempt to protect and increase economic profits in the long run.
12. Product variety and improvement may offset the economic inefficiencies associated with monopolistic competition in that customers get a wide variety of products meeting various consumer tastes. This encourages other firms to do the same, increasing furthermore consumer benefit.
13. The essential characteristics of oligopoly are few producers, homogeneous/of differentiated product, mutual interdependence, and high entry barriers similar to monopoly. Oligopoly differs from pure competition in that there are many fewer firms, and a downward sloping demand curve as well as productive and allocative inefficiency. Different from monopolistic competition in that there are fewer competitors, a more inelastic demand curve, and has greater inefficiencies. Different from monopoly in that there is competition , and its demand curves are more elastic because there are competitors, and it is less ineffecient than monopoly.
14. The concentration ratio in an industry simply refers to the % of output controlled by a particular number of the largest firms. For example, a four firm concentration ratio of 60% would mean that the four largest firms in that particular industry produce 60% of its output. These ratios can be misleading (shortcomings) because they don’t recognize localized markets, inter industry competition, and the impact of import competition.
15. The Herfindahl Index is another way to measure the market influence of competitors in a oligopoly which avoids the shortcomings of concentration ratios. It squares the % of market shares of oligopolists and adds them; with the largest being 10,000 for a monopoly (100 squared). As the resultant index dimninishes the market share and the influence of the oligopolist diminishes as well.
16. Since oligopolists make their price/output decisions based on what their competition may or may not do (strategy) studying game theory (strategy of gaming against an opponent) can be very useful to understand our opponent in order to maximize profits. Mutual interdependence refers to the idea that oligopolists make decisions based on what they think their competitors may do in order to maximize profits, while collusion means that they may come together to discuss and decide price/output decisions to achieve the same goals. Collusion is also mutual interdependence.
17. One model is not effective in terms of describing oligopoly market structure. This is due to the fact that oligopolies are diverse; some tight (few competitors having large market share) some loose ( a few competitors having say 50% of market, with lots of fringe or smaller firms having the other 50%). Also its difficult to determine demand and marginal revenue as you don’t always know what your competition will do even though you try and predict it. This causes prices to tend to “stick” and these complexities lead to different models or theories of the structure of oligopoly.
18. The kinked demand theory helps to explain oligopoly in that the elastic portion of the demand curve represents a scenario where one firm raises prices and the other maintains, and the inelastic portion represents the scenario where one lowers and the other follows. Prices tend to stick at the kink as why would you raise prices to lose output to your competition who stays at the kink, or lower prices, getting into a price war, and potentially lowering profits or even generating losses due to the price war. Stay put at the kink!
19. If a few firms produce a homogeneous product with identical cost curves they will all produce at MR=MC, and divide up market output and thus profits. In essence this creates the effect of monopoly. The only difference is that the pure monopolists demand curve would be more inelastic compared to the more elastic curves of the individual demand curves of the oligopoly competitors who are colluding in the cartel
20. Collusion by oligopolists can guarantee market share and profits, where if they don’t competition and possible price wars could cause instability and losses. Obstacles to collusion can be differences in cost curves; the incentive to cheat to gain market share, more firms entering, a recession, as well as anti trust (anti monopoly) laws.
21. Price leadership is a situation where the industry leader (usually largest & most efficient firm) sets the price in the industry and the others follow its lead. The tactics of this leader are infrequent price changes, communicating pending price changes to others in order to seek approval, and limit pricing which is the lowering of price, even to the point of loss, to keep other firms from entering the oligopoly.
22. Oligopolists engage in little price changing because its dangerous. Lowering your price to gain market share can cause a price war and eventual losses, while raising price might cause your competition to maintain, and thus you lose market share. Through the use of product development (develop new/further differentiate old) and advertising to communicate this development, the oligopoly hopes to gain market share from competitors without resorting to price changes, that is by using non price competition.
23. Advertising may yield lower prices for a product to consumers because the add conveys the attributes of the product(s) of oligopolists and saves consumers time and money driving around comparison shopping which in essence drives up the product price once they start to buy. Also if advertising leads to greater purchasing (output), economies of scale benefits may increase and this lower costs.
24. The down side of advertising which could lead to higher consumer costs is that if successful, advertising leads to increased market share, and the potential of monopoly, leading to higher consumer costs with the loss of competitive markets.. Advertising can be misleading, or inaccurate or tell us nothing about the product and consumers may thus purchase an inferior product at a higher price. High advertising costs can act as a barrier to entry keeping out firms who may have better products to offer, thus diminishing consumer choice, limiting it to higher cost, inferior products.
25. Oligopoly is both productively, and allocatively inefficient, as P>MC, and P≠min atc. With that said foreign competition can improve this by making markets more efficient, limit pricing can bring price and output levels closer to the social optimum, and product development (new and different) can lead to technological advances that lower cost and increase output, again increasing efficiency.