Monopolistic Competition

1. In a monopolistically competitive industry, profit-maximizing firms are price
   a. takers who produce a quantity where price is equal to marginal cost.
   b. takers who produce a quantity where price is greater than marginal cost.
   c. setters who set price equal to marginal cost.
   d. setters who set price above marginal cost.

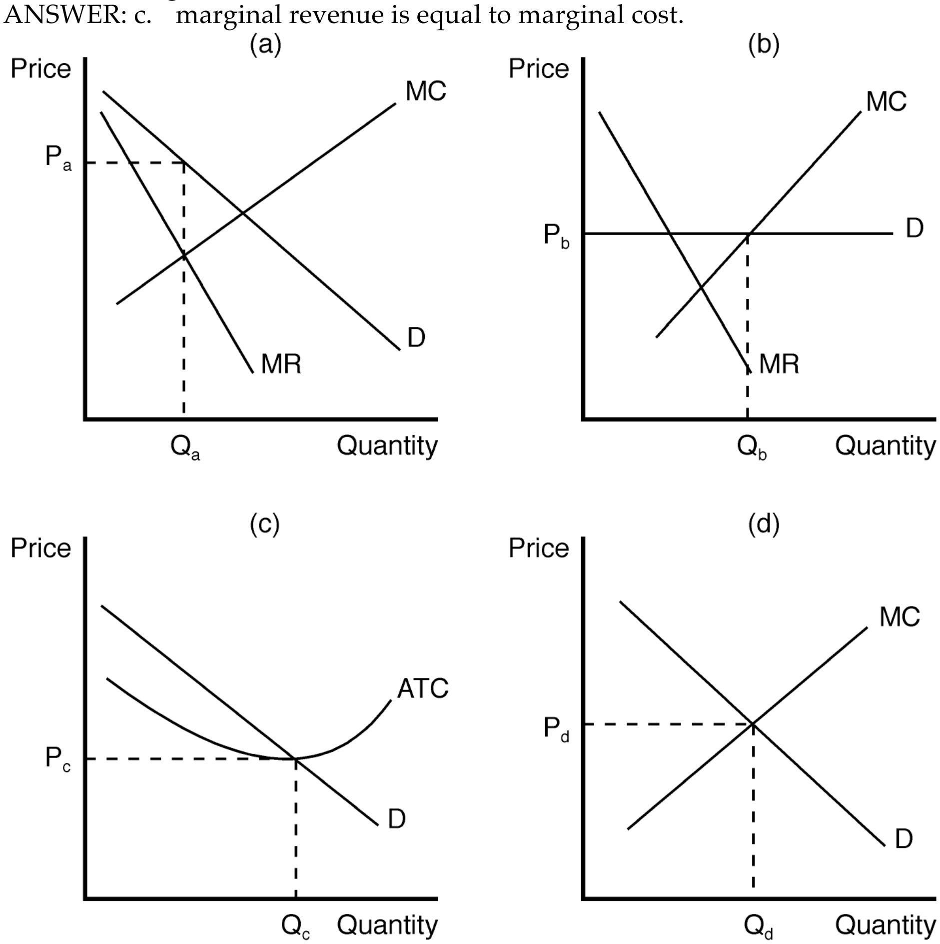
ANSWER: d. setters who set price above marginal cost.

2. When free entry is one of the attributes of a market structure, economic profits in the long run
   a. are equal to implicit cost.
   b. are greater than implicit cost.
   c. are zero.
   d. depend on whether or not firms produce identical products.

ANSWER: c. are zero.

3. The profit-maximizing rule for a firm in a monopolistically competitive market is to produce the quantity at which
   a. average revenue equals average total cost.
   b. average total cost is at its minimum.
   c. marginal revenue is equal to marginal cost.
   d. marginal cost is at its minimum.

ANSWER: c. marginal revenue is equal to marginal cost.



4. According to the graphs, which of the following graphs represent a profit-maximizing firm in a perfectly competitive market and a profit-maximizing firm in a monopolistically competitive market respectively?
   a. panel a and panel b
   b. panel b and panel a
   c. panel c and panel b
   d. panel c and panel d

ANSWER: b. panel b and panel a

5. According to the graphs, if a firm in a monopolistically competitive market was producing the level of output depicted as Q_c in panel c, it would
   a. be minimizing its losses.
   b. be losing market share to other firms in the market.
   c. not be maximizing its profit.
   d. be operating at excess capacity.

ANSWER: c. not be maximizing its profit.

6. Product differentiation causes the seller of a good to face what type of demand curve?
   a. upward sloping
   b. downward sloping
   c. horizontal
   d. vertical

ANSWER: b. downward sloping

7. A monopolistically competitive firm chooses
   a. the quantity of output to produce and the price of its output.
   b. the quantity of output to produce, but the market determines price.
   c. the price, but competition in the market determines the quantity.
   d. only whether to enter or exit the market.

ANSWER: a. the quantity of output to produce and the price of its output.

8. If firms in a monopolistically competitive market are earning negative economic profits, which of the following scenarios would best reflect the change facing incumbent firms as the market adjusts to its new equilibrium?
   a. a downward shift in their marginal cost curve
   b. an upward shift in their marginal cost curve
   c. a decrease in demand
   d. an increase in demand

ANSWER: d. an increase in demand

9. As new firms enter a monopolistically competitive market, profits of existing firms
   a. decline and product diversity in the market increases.
   b. decline and product diversity in the market decreases.
   c. rise and product diversity in the market decreases.
   d. rise and product diversity in the market increases.

ANSWER: a. decline and product diversity in the market increases.

10. When a profit-maximizing firm in a monopolistically competitive market is producing the long-run equilibrium quantity,
    a. its demand curve will be tangent to its average total cost curve.
    b. it will be earning economic profits.
    c. its average revenue will equal marginal cost.
    d. All of the above are correct.

ANSWER: a. its demand curve will be tangent to its average total cost curve.

11. Since a firm in a monopolistically competitive market faces a
    a. downward-sloping demand curve, it will always operate at efficient scale.
    b. perfectly inelastic demand curve, it will always operate at efficient scale.

c. perfectly elastic demand curve, it will always operate at excess capacity.
d. downward-sloping demand curve, it will always operate at excess capacity.

ANSWER: d. downward-sloping demand curve, it will always operate at excess capacity.

12. Monopolistically competitive firms operate at
    a. excess capacity, so that additional production would raise average total cost.
    b. excess capacity, so that additional production would lower average total cost.
    c. efficient scale, so that additional production would raise average total cost.
    d. efficient scale, so that additional production would lower average total cost.

ANSWER: b. excess capacity, so that additional production would lower average total cost.

13. In the long run, a firm in a perfectly competitive market operates at
    a. excess capacity and so do monopolistically competitive firms.
    b. excess capacity while monopolistically competitive firm operate at efficient scale.
    c. efficient scale and so do monopolistically competitive firms.
    d. efficient scale while monopolistically competitive firms operate at excess capacity.

ANSWER: d. efficient scale while monopolistically competitive firms operate at excess capacity.

14. A monopolistically competitive market could be considered inefficient because
    a. price exceeds marginal cost.
    b. marginal cost exceeds average revenue.
    c. firms in monopolistically competitive markets often collude.
    d. mark-up pricing does not occur in any other market structure.

ANSWER: a. price exceeds marginal cost.

15. The deadweight loss that is associated with a monopolistically competitive market is a result of
    a. operating in a constant cost industry.
    b. pricing above marginal cost.
    c. advertising costs.
    d. pricing below marginal cost in order to increase market share.

ANSWER: b. pricing above marginal cost.

16. The administrative burden of regulating price in a monopolistically competitive market is
    a. small because firms produce at under-capacity.
    b. small due to economies of scale.
    c. large because of a large number of firms that produce differentiated products.
    d. large because price is usually below marginal cost.

ANSWER: c. large because of a large number of firms that produce differentiated products.

17. If regulators required firms in monopolistically competitive markets to set price equal to marginal cost,
    a. firms would most likely experience economic losses.
    b. firms would also operate at the efficient scale.
    c. new firms would be likely to enter the market.
    d. the most efficient firms are not likely to be affected.

ANSWER: a. firms would most likely experience economic losses.

18. When the loss from a business-stealing externality exceeds the gain from a product-variety externality,
    a. market efficiency is likely to be enhanced by the entry of new firms.
    b. there are likely to be too many firms in a monopolistically competitive market.
    c. the market structure is likely to be above the efficient scale.
    d. firms are more likely to operate at efficient scale.

ANSWER: b. there are likely to be too many firms in a monopolistically competitive market.

19. If advertising decreases the elasticity of demand for a firm's product, the firm is likely to
    a. lower their advertising budget.
    b. become more competitive.

c. charge a larger mark-up over marginal cost.
d. produce above the efficient scale.
ANSWER: c. charge a larger mark-up over marginal cost.

20. In recent years, the courts have been
a. less lenient of advertising in order to enhance the ability of markets to allocate resources efficiently.
b. less lenient of advertising in order to decrease elasticity of demand for specific products.
c. more lenient of advertising in order to enhance brand loyalty.
d. more lenient of advertising in order to enhance competition in markets.
ANSWER: d. more lenient of advertising in order to enhance competition in markets.

21. When firms in a monopolistically competitive market engage in price-related advertising, defenders of advertising argue that
a. the quality of products sold in the market always increases.
b. customers are less likely to be informed about other characteristics of the product.
c. new firms are discouraged from entering the market.
d. each firm has less market power.
ANSWER: d. each firm has less market power.

22. Results of the study done by Lee Benham on advertising for eyeglasses suggests that
a. optometrists would enthusiastically endorse advertising restrictions.
b. brand loyalty and market power in the eyeglass market was likely to be more pervasive in states that allowed advertising.
c. advertising restrictions were clearly beneficial to societal welfare.
d. eyeglass sales were more profitable in states that allowed advertising.
ANSWER: a. optometrists would enthusiastically endorse advertising restrictions.

23. Defenders of advertising argue that it is not rational for profit-maximizing firms to spend money on advertising for products that have
a. low prices.
b. high prices.
c. superior quality.
d. inferior quality.
ANSWER: d. inferior quality.

24. In some countries, brand name fast-food restaurants are not allowed to operate. Such restrictions are likely to
a. reduce barriers to entry in imperfect markets.
b. reduce the competitive nature of local fast-food markets.
c. enhance the social well-being of society.
d. enhance the choice set of consumers among local restaurants.
ANSWER: b reduce the competitive nature of local fast-food markets.

25. Viola uses only Log Cabin® brand maple syrup on her pancakes. She claims that even though generic maple syrups are cheaper, that they often seem watery. In a blind taste test Viola prefers a generic maple syrup. Her behavior is consistently explained by which of the following?
a. Consumers of brand-name products do not know their true preferences.
b. Consumers may choose brand-names to ensure the general quality of the product.
c. Consumers of brand-name products are likely to be uninformed about the quality of competing generic products.
d. None of the above is consistent.
ANSWER: b. Consumers may choose brand-names to ensure the general quality of the product.

1 ANSWER: d. setters who set price above marginal cost.
TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 1 RANDOM: Y

2 ANSWER: c. are zero.
TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 1 RANDOM: Y

3 ANSWER: c. marginal revenue is equal to marginal cost.
TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 1 RANDOM: Y

4 ANSWER: b. panel b and panel a
TYPE: M KEY1: G SECTION: 1 OBJECTIVE: 2 GRAPH FORMAT: M RANDOM: N GRAPH: 1

5 ANSWER: c. not be maximizing its profit.
TYPE: M KEY1: G SECTION: 1 OBJECTIVE: 1 GRAPH FORMAT: M RANDOM: N GRAPH: 1

6 ANSWER: b. downward sloping
TYPE: M KEY1: G SECTION: 1 OBJECTIVE: 2 GRAPH FORMAT: M RANDOM: N

7 ANSWER: a. the quantity of output to produce and the price of its output.
TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 2 RANDOM: Y

8 ANSWER: d. an increase in demand
TYPE: M KEY1: G SECTION: 1 OBJECTIVE: 2 RANDOM: Y

9 ANSWER: a. decline and product diversity in the market increases.
TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 2 RANDOM: Y

10 ANSWER: a. its demand curve will be tangent to its average total cost curve.
TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 1 RANDOM: Y

11 ANSWER: d. downward-sloping demand curve, it will always operate at excess capacity.
TYPE: M KEY1: C SECTION: 1 OBJECTIVE: 1 RANDOM: Y

12 ANSWER: b. excess capacity, so that additional production would lower average total cost.
TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 2 RANDOM: Y

13 ANSWER: d. efficient scale while monopolistically competitive firms operate at excess capacity.
TYPE: M KEY1: C SECTION: 1 OBJECTIVE: 2 RANDOM: Y

14 ANSWER: a. price exceeds marginal cost.
TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 3 RANDOM: Y

15 ANSWER: b. pricing above marginal cost.
TYPE: M KEY1: C SECTION: 1 OBJECTIVE: 3 RANDOM: Y

16 ANSWER: c. large because of a large number of firms that produce differentiated products.
TYPE: M KEY1: C SECTION: 1 OBJECTIVE: 3 RANDOM: Y

17 ANSWER: a. firms would most likely experience economic losses.
TYPE: M KEY1: C SECTION: 1 OBJECTIVE: 3 RANDOM: Y

18 ANSWER: b. there are likely to be too many firms in a monopolistically competitive market.
TYPE: M KEY1: C SECTION: 1 OBJECTIVE: 3 RANDOM: Y

19 ANSWER: c. charge a larger mark-up over marginal cost.
TYPE: M KEY1: C SECTION: 2 OBJECTIVE: 4 RANDOM: Y

20 ANSWER: d. more lenient of advertising in order to enhance competition in markets.
TYPE: M KEY1: C SECTION: 2 OBJECTIVE: 4 RANDOM: Y

21 ANSWER: d. each firm has less market power.
TYPE: M KEY1: C SECTION: 2 OBJECTIVE: 4 RANDOM: Y

22 ANSWER: a. optometrists would enthusiastically endorse advertising restrictions.
TYPE: M KEY1: C SECTION: 2 OBJECTIVE: 4 RANDOM: Y

23 ANSWER: d. inferior quality.
TYPE: M KEY1: D SECTION: 2 OBJECTIVE: 4 RANDOM: Y

24 ANSWER: b reduce the competitive nature of local fast-food markets.
TYPE: M KEY1: C SECTION: 2 OBJECTIVE: 5 RANDOM: Y

25 ANSWER: b. Consumers may choose brand-names to ensure the general quality of the product.
TYPE: M KEY1: C SECTION: 2 OBJECTIVE: 5 RANDOM: Y