Chapter 17—Monopolistic Competition

MULTIPLE CHOICE

1. In a monopolistically competitive industry, price is
   a. equal to marginal cost since each firm is a price taker.
   b. below marginal cost since each firm is a price taker.
   c. above marginal cost since each firm is a price setter.
   d. always a fraction of marginal cost since each firm is a price setter.

   ANS: C DIF: Average REF: 382

2. Monopolistic competition differs from perfect competition because in monopolistically competitive markets
   a. there are barriers to entry.
   b. all firms can eventually earn economic profits.
   c. each of the sellers offers a somewhat different product.
   d. strategic interactions between firms is vitally important.

   ANS: C DIF: Average REF: 382

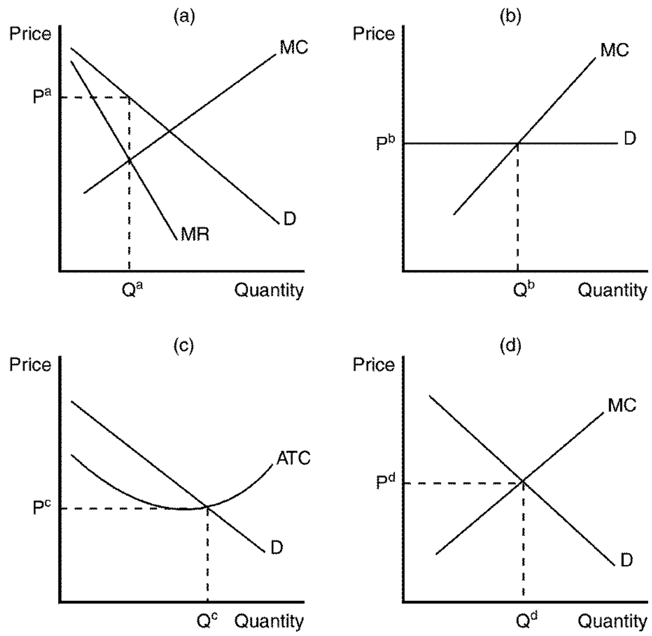
3. A profit-maximizing firm in a monopolistically competitive market differs from a firm in a perfectly competitive market because the firm in the monopolistically competitive market
   a. is characterized by market share maximization.
   b. has no barriers to entry.
   c. faces a downward-sloping demand curve for its product.
   d. faces a horizontal demand curve at the market clearing price.

   ANS: C DIF: Average REF: 382

4. A profit-maximizing firm in a monopolistically competitive market is characterized by which of the following?
   a. Average revenue exceeds marginal revenue.
   b. Marginal revenue exceeds average revenue.
   c. Average revenue is equal to marginal revenue.
   d. Revenue is always maximized along with profit.

   ANS: A DIF: Average REF: 382

   Figure 17-1



5. **Refer to Figure 17-1**. Which of the graphs would most likely represent a profit-maximizing firm in a monopolistically competitive market?
   a. panel a
   b. panel b
   c. panel c
   d. panel d

   ANS: A DIF: Average REF: 382

6. **Refer to Figure 17-1**. If a firm in a monopolistically competitive market was producing the level of output depicted as Q_d in panel d, it would
   a. not be maximizing its profit.
   b. be minimizing its losses.
   c. be losing market share to other firms in the market.
   d. be operating at excess capacity.

   ANS: A DIF: Average REF: 382

7. **Refer to Figure 17-1**. The firm depicted in panel b faces a horizontal demand curve. If panel b depicts a profit-maximizing firm,
   a. it could be operating in either a perfectly competitive market or in a monopolistically competitive market.
   b. it would not have excess capacity in its production as long as it is earning zero economic profit.
   c. it is able to choose the price at which it sells its product.
   d. All of the above are correct.

   ANS: B DIF: Average REF: 382

8. As some incumbent firms exit a monopolistically competitive market, profits of existing firms
   a. decline and product diversity in the market decreases.
   b. decline and product diversity in the market increases.
   c. rise and product diversity in the market decreases.
   d. rise and product diversity in the market increases.

ANS: C DIF: Average REF: 382

9. The free entry and exit of firms in a monopolistically competitive market guarantees that
   a. both economic profits and economic losses can persist into the long run.
   b. both economic profits and economic losses disappear in the long run.
   c. economic profits can persist into the long run, but not economic losses.
   d. economic losses can persist into the long run, but not economic profits.

   ANS: B DIF: Average REF: 382

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

    ANS: D DIF: Average REF: 382

11. When a firm's demand (average revenue) curve is tangent to its average-total-cost curve, the
    a. firm's economic profit is zero.
    b. firm must be earning economic profits.
    c. firm must be incurring economic losses.
    d. firm must be operating in a monopolistically competitive market.

    ANS: A DIF: Average REF: 382

12. When a profit-maximizing firm in a monopolistically competitive market is in long-run equilibrium,
    a. the demand curve will be perfectly elastic.
    b. price exceeds marginal cost.
    c. marginal cost is falling.
    d. marginal revenue exceeds marginal cost.

    ANS: B DIF: Average REF: 384

13. A profit-maximizing firm in a monopolistically competitive market always operates at the point of
    a. minimum average total cost.
    b. unitary elasticity of demand.
    c. efficient scale.
    d. None of the above are correct.

    ANS: D DIF: Average REF: 384

14. Since a firm in a monopolistically competitive market faces a
    a. downward-sloping demand curve, it will always operate with excess capacity.
    b. downward-sloping demand curve, it will always operate at efficient scale.
    c. perfectly elastic demand curve, it will always operate with excess capacity.
    d. perfectly inelastic demand curve, it will always operate at efficient scale.

    ANS: A DIF: Average REF: 385

15. A monopolistically competitive market could be considered inefficient because
    a. marginal revenue exceeds average revenue.
    b. price exceeds marginal cost.
    c. efficient scale is realized in the long run, but not in the short run.
    d. markup pricing does not occur in any other market structure.

ANS: B DIF: Average REF: 386

16. The deadweight loss that is associated with a monopolistically competitive market is a result of
   a. price falling short of marginal cost in order to increase market share.
   b. price exceeding marginal cost.
   c. operating in a regulated industry.
   d. excessive advertising costs.

   ANS: B DIF: Average REF: 386

17. Before a new firm enters a monopolistically competitive market with a new product, it considers
   a. the profit opportunities.
   b. the business-stealing externality.
   c. the product-variety externality.
   d. All of the above are correct.

   ANS: A DIF: Average REF: 387

18. The product-variety externality is associated with
   a. the producer surplus that accrues to incumbent firms in a monopolistically competitive industry.
   b. loss of consumer surplus from exposure to additional advertising.
   c. the consumer surplus that is generated from the introduction of a new product.
   d. the opportunity cost of firms exiting a monopolistically competitive industry.

   ANS: C DIF: Average REF: 387

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

   ANS: B DIF: Average REF: 387

Scenario 17-1
Vacation Inns of Canada (VIC) has recently announced intentions of building a new hotel/resort complex in Victoria, B.C. Assume that the hotel/resort market in Victoria is characterized by monopolistic competition.

20. **Refer to Scenario 17-1**. As a result of the new VIC hotel/resort, tourists who stay in Myrtle Beach are likely to experience a
   a. product-variety externality, which harms consumers.
   b. product-variety externality, which benefits consumers.
   c. business-stealing externality, which harms consumers.
   d. business-stealing externality, which benefits consumers.

   ANS: B DIF: Average REF: 387

21. **Refer to Scenario 17-1**. Existing hotels, motels, and lodging facilities in Victoria are likely to experience what kind of externality as a result of the new VIC hotel/resort?
   a. product-variety
   b. business-stealing
   c. competitive
   d. advertising

ANS: B DIF: Average REF: 387

22. Long-run profit earned by a monopolistically competitive firm is driven to the competitive level due to a
    a. change in the technology that the firm utilizes.
    b. shift of its demand curve.
    c. shift of its supply curve.
    d. None of the above are correct.

ANS: B DIF: Average REF: 383

23. When a market is monopolistically competitive, the typical firm in the market is likely to experience a
    a. positive profit in the short run and in the long run.
    b. positive or negative profit in the short run and a zero profit in the long run.
    c. zero profit in the short run and a positive or negative profit in the long run.
    d. zero profit in the short run and in the long run.

ANS: B DIF: Average REF: 382

24. Among the following situations, the one that is least likely to apply to a monopolistically competitive firm is that in which
    a. profit is positive in the short run.
    b. total cost exceeds total revenue in the short run.
    c. profit is positive in the long run.
    d. total revenue equals total cost in the long run.

ANS: C DIF: Average REF: 382

25. For a monopolistically competitive firm, at the profit-maximizing quantity of output,
    a. price exceeds marginal revenue.
    b. marginal revenue exceeds marginal cost.
    c. marginal cost exceeds average revenue.
    d. All of the above are correct.

ANS: A DIF: Average REF: 382

26. An important difference between the situation faced by a profit-maximizing monopolistically competitive firm in the short run and the situation faced by that same firm in the long run is that in the short run,
    a. price may exceed marginal revenue; in the long run, price equals marginal revenue.
    b. price may exceed marginal cost; in the long run, price equals marginal cost.
    c. price may exceed average total cost; in the long run, price equals average total cost.
    d. there are many firms in the market; in the long run, there are only a few firms in the market.

ANS: C DIF: Average REF: 382

27. In a situation of long-run equilibrium, the term
    a. "excess capacity" applies to monopolistically competitive firms, but not to competitive firms.
    b. "zero economic profit" applies to competitive firms, but not to monopolistically competitive firms.
    c. "markup over marginal cost" applies to both monopolistically competitive and competitive firms.
    d. All of the above are correct.

ANS: A DIF: Average REF: 384

28. Firm A is a perfectly competitive firm. Firm B is a monopolistically competitive firm. Both firms are currently maximizing their respective profits. Which of the following statements is correct?
    a. Both Firm A and Firm B would be eager to make an additional sale.
    b. Firm A would be eager to make an additional sale, but Firm B would not care whether it made an additional sale or not.
    c. Firm B would be eager to make an additional sale, but Firm A would not care whether it made an additional sale or not.
    d. Neither Firm A nor Firm B would care whether they made an additional sale or not.

ANS: C DIF: Average REF: 384

A monopolistically competitive firm has the following cost structure:

Output	1	2	3	4	5	6	7
Total Cost($)	30	32	36	42	50	63	77

The firm faces the following demand curve:

Price ($)	20	18	15	12	9	7	4
Quantity	1	2	3	4	5	6	7

29. To maximize profit (or minimize losses), the firm will produce
    a. 2 units.
    b. 3 units.
    c. 4 units.
    d. 5 units.

ANS: B DIF: Challenging REF: 384

30. Critics claim that when advertising decreases the elasticity of demand, firms are able to
    a. become more competitive.
    b. increase their advertising budget.
    c. lower their advertising budget.
    d. charge a larger mark-up over marginal cost.

ANS: D DIF: Average REF: 388

31. 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.

ANS: D DIF: Average REF: 388

32. Critics of advertising argue that in some markets advertising may
    a. attract products of lower quality into the market.
    b. attract less informed buyers into the market.
    c. decrease elasticity of demand.
    d. enhance competition in markets to an unnecessary degree.

ANS: C DIF: Average REF: 388

33. One theory of advertising suggests that
    a. information on price is always a necessary ingredient of effective advertising.
    b. the content of advertising may be irrelevant to product success in the market.
    c. celebrity advertising is not effective in retail food markets.
    d. Post and Kellogg should not advertise new cereals.

ANS: B DIF: Average REF: 388

34. If advertising reduces a consumer's price sensitivity between identical goods, it is likely to
    a. increase the elasticity of demand for differentiated products.
    b. enhance competition, and encourage more product diversity.
    c. impede competition and reduce social well-being.
    d. encourage the consumption of all homogenous goods.

ANS: C DIF: Average REF: 392

35. If a firm in a monopolistically competitive market successfully uses advertising to decrease elasticity of demand for its product,
    a. the firm will be able to increase its markup over marginal cost.
    b. the firm will eventually have to lower price to remain competitive.
    c. it will increase the well-being of society.
    d. it will reduce average total cost.

ANS: A DIF: Average REF: 392

36. It is a well-publicized fact that television advertisements aired during major sporting events are very expensive. A theory asserting that people buy a product simply because it is advertised would suggest that information on the cost of advertising
    a. enhances the effectiveness of the advertisement.
    b. reduces people's willingness to purchase advertised products.
    c. is leaked to discredit the firms that spend so much on advertising.
    d. reduces the effective staying power of a product.

ANS: A DIF: Average REF: 388

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

ANS: D DIF: Average REF: 388

38. According to the "signaling theory" of advertising, consumers
    a. pay little or no attention to which firms advertise and which firms do not advertise.
    b. are often more impressed by a firm's willingness to spend money on advertising than they are by the content of the advertisement.
    c. are often more impressed by low-cost advertisements than they are by high-cost advertisements.
    d. gain little or no information about product quality from advertisements.

ANS: B DIF: Average REF: 391

39. ABC Company knows that it produces and sells a very good mouse trap. XYZ Company knows that it produces and sells a lousy mouse trap. According to the "signaling theory" of advertising, the quality difference likely produces the result that
    a. both ABC and XYZ have incentives to spend large amounts of money on advertising their mouse traps.
    b. ABC has an incentive to spend a large amount of money on advertising its mouse trap, but XYZ does not.
    c. XYZ has an incentive to spend a large amount of money on advertising its mouse trap, but ABC does not.
    d. neither ABC nor XYZ has an incentive to spend a large amount of money on advertising their mouse traps.

    ANS: C DIF: Average REF: 391

40. Two soft drinks sit side-by-side in a grocery store: A six-pack of Coca-Cola (a brand name) sells for $3.00, while a six-pack of Uncle Don's cola (not a brand name) sells for $1.50. Even defenders of brand names would have to admit that
    a. no rational consumer would spend twice as much for Coca-Cola as he would for Uncle Don's cola.
    b. the side-by-side presence of these two colas conveys no useful information to consumers.
    c. Coca-Cola has no incentive to maintain the quality of its product just because of the Coca-Cola brand name.
    d. None of the above are correct.

    ANS: D DIF: Average REF: 391

41. Which of the following statements is false?
    a. The typical monopolistically competitive firm could reduce its average total cost if it produced more output.
    b. Monopolistically competitive firms advertise in order to increase the elasticity of the demand curve they face.
    c. Expensive advertising might help consumers if it is a signal that the product is good.
    d. Brand names acquired at great cost might help consumers by assuring quality.

    ANS: B DIF: Average REF: 391