

## Week 11

### Monopolistic Competition

Classroom exercises: Exercises 11.1 to 11.5

Home exercises: Exercises 11.6 to 11.9

### Classroom exercises

**EXERCISE 11.1-** CYU 15-2 (p. 454, 4<sup>th</sup> ed.)

1 - Currently a monopolistically competitive industry, composed of firms with U-shaped average total cost curves, is in long-run equilibrium. Describe how the industry adjusts, in both the **short** and **long** run, in each of the following situations:

- a) A technological change that increases fixed cost for every firm in the industry.
- b) A technological change that decreases marginal cost for every firm in the industry.

2 - Why is it impossible in the **long run** for firms in a monopolistically competitive industry to create a monopoly by joining together to form a single firm?

**EXERCISE 11.2-** CYU 15-4, a) b) e c) - (p. 460, 4<sup>th</sup> ed.)

1.- In which of the following cases is advertising likely to be economically useful? Economically wasteful? Explain your answer.

- a) Advertisements on the benefits of aspirin
- b) Advertisements for Bayer aspirin
- c) Advertisements on the benefits of drinking orange juice

2. - Some industry analysts have stated that a successful brand name is like a barrier to entry. Explain the reasoning behind this statement.

**EXERCISE 11.3.** *Problem 1* a) e b) [p. 462, 4<sup>th</sup> ed.]

Use the three conditions for monopolistic competition discussed in the chapter to decide which of the following firms are likely to be operating as monopolistic competitors.

If they are not monopolistically competitive firms, are they monopolists, oligopolists, or perfectly competitive firms?

- a) A local band that plays for weddings, parties, and so on.
- b) Minute Maid, a producer of individual-serving juice boxes.

**EXERCISE 11.4.** *Problem 2* (p. 462, 4<sup>th</sup> ed.)

You are thinking of setting up a coffee shop. The market structure for coffee shops is monopolistic competition. There are three Starbucks shops and two other coffee shops very much like Starbucks in your town already. In order for you to have some degree of market power, you may want to differentiate your coffee shop. Thinking about the three different ways in which products can be differentiated, explain how you would decide whether you should copy Starbucks or whether you should sell coffee in a completely different way.

**EXERCISE 11.5.** *Problem 6* (p. 463, 4<sup>th</sup> ed.)

“In the long run, there is no difference between monopolistic competition and perfect competition.” Discuss whether this statement is true, false, or ambiguous with respect to the following criteria.

- a) The price charged to consumers
- b) The average total cost of production
- c) The efficiency of the market outcome
- d) The typical firm’s profit in the long run

**Home exercises**

**EXERCISE 11.6-** *CYU 15-3* (p. 457, 4<sup>th</sup> ed.)

**True or false?** Explain your answers.

- a) Like a firm in a perfectly competitive industry, a firm in a monopolistically competitive industry is willing to sell a good at any price that equals or exceeds marginal cost.
- b) Suppose there is a monopolistically competitive industry in long-run equilibrium that possesses excess capacity. All the firms in the industry would be better off if they merged into a single firm and produced a single product, but whether consumers are made better off by this is ambiguous.
- c) Fads and fashions are more likely to arise in monopolistic competition or oligopoly than in monopoly or perfect competition.

**EXERCISE 11.7-** *Problem 1, c) e d)* [p. 462, 4<sup>th</sup> ed.]

Use the three conditions for monopolistic competition discussed in the chapter to decide which of the following firms are likely to be operating as monopolistic competitors. If they are not monopolistically competitive firms, are they monopolists, oligopolists, or perfectly competitive firms? (*see EXERCISE 11-1*)

- c) Your local dry cleaner
- d) A farmer who produces soybeans

**EXERCISE 11.8-** *Problem 4* [p. 462, 4<sup>th</sup> ed.]

The local hairdresser industry has the market structure of monopolistic competition. Your hairdresser boasts that he is making a profit and that if he continues to do so, he will be able to retire in five years. Use a diagram to illustrate your hairdresser’s current situation. Do you expect this to last? In a separate diagram, draw what you expect to happen in the long run. Explain your reasoning.

**EXERCISE 11.9-** *Problem 7* [p. 463, 4<sup>th</sup> ed.]

“In both the short run and in the long run, the typical firm in monopolistic competition and a monopolist each make a profit.” Do you agree with this statement? Explain your reasoning.

**EXERCISE 11.10-** *Problem 9* [p. 463, 4<sup>th</sup> ed.]

For each of the following situations, decide whether advertising is directly informative about the product or simply an indirect signal of its quality. Explain your reasoning.

- a) Football great Peyton Manning drives a Buick in a TV commercial and claims that he prefers it to any other car.
- b) A newspaper ad states, “For sale: 1999 Honda Civic, 160,000 miles, new transmission.”
- c) McDonald’s spends millions of dollars on an advertising campaign that proclaims: “I’m lovin’ it.”
- d) Subway advertises one of its sandwiches by claiming that it contains 6 grams of fat and fewer than 300 calories.