ECO201, Fall 1998

Prof. Bill Even

Quiz 3: Chapter 14: Monopolistic Competition, Oligopoly, and Regulation.

DIRECTIONS: Put all your answers on the attached answer sheet. No credit will be given for answers placed elsewhere.

1. Compared to a monopoly, a monopolistically competitive firm is likely to:
   a. have a more elastic demand curve since there are more substitutes available for its product.
   b. have a more inelastic demand curve since there are more substitutes available for its product.
   c. have a more elastic demand curve since there are fewer substitutes available for its product.
   d. have a more inelastic demand curve since there are fewer substitutes available for its product.

To answer the next 8 questions, suppose that a monopolistically competitive firm in the shoe industry is faced with the following demand and cost curves. Assume there are no externalities in the production or purchase of shoes, and notice that quantity is measure in 1000s.

Assuming this firm maximizes profits,

2. what price will the firm charge?
3. what output will the firm produce?

To maximize social well-being and eliminate any possible deadweight loss,

4. what price should this firm charge?
5. what level of output should this firm produce?

6. At the profit maximizing output, what is the deadweight loss?

At the profit maximizing output,

7. what is the benefit to society of the last shoe produced?
8. what is the cost to society of the last shoe?

9. At the long run equilibrium, this shoe firm will be producing:
   a. less than 4,000 shoes per month.
   b. between 4,000 and 5,000 shoes per month.
   c. 5,000 shoes per month.
   d. more than 5,000 shoes per month.
10. In the long run, economic profits for a firm in a monopolistically competitive industry will:
   a. be positive.   b. be zero.   c. could be positive or zero.

To answer the next 6 questions, consider the diagrams below representing the market for milk and the typical firm's cost curves.

BE SURE TO NOTE THAT QUANTITIES ARE MEASURED IN THOUSANDS OR MILLIONS IN THE DIAGRAMS ABOVE WHEN CALCULATING YOUR ANSWERS.

11. If the milk industry is at a competitive long run equilibrium, what is the current price of milk and how much is the typical firm producing?

12. If a cartel agreement is formed among milk producers and their objective is to maximize profits in the milk industry, what level of production should the industry choose?

13. At the competitive outcome, what is the size of the deadweight loss to society?

14. At the cartel agreement, what is the deadweight loss to society?

15. Compared to the competitive outcome, how much worse off are consumers by the formation of the cartel?

16. At the cartel agreement, an individual firm:
   a. could increase its profits by producing more than its quota.
   b. could increase its profits by producing less than its quota.
   c. is maximizing its profits by producing exactly its quota.

To answer the next two questions, suppose that the following firms make up the entire athletic shoe industry and have the market shares indicated:
Nike (30%); Converse (10%); Adidas (10%); Reebok (20%); NewBalance (10%); Brooks (10%); Fila (10%).

17. What is the Herfindahl-Hirschmann Index for the athletic shoe industry?
18. What is the four-firm concentration ratio for the athletic shoe industry?
19. Other things being the same, the Department of Justice is MORE likely to allow a merger between two firms if there are (many, few) few barriers to entry and it is (easy, difficult) for firms to observe their competitor’s price.
   a. many; easy.  b. many; difficult  c. few; easy.  d. few; difficult.

20. In the McTravel Travel Agent lawsuit,
   a. airlines were allowed to enforce resale price maintenance because the courts believed the practice was necessary to insure that “full service” travel agents could survive.
   b. airlines were not allowed to enforce resale price maintenance because the courts believed eliminating the practice was necessary to insure that “full service” travel agents could survive.
   c. airlines were allowed to enforce resale price maintenance because the courts saw the practice was necessary to prevent collusive behavior between travel agents.
   d. airlines were not allowed to enforce resale price maintenance because the courts saw the practice allowed travel agents to collude on price.

21. The first major piece of Anti-Trust legislation in the U.S. was targeted at:

22. Resale price maintenance
   a. occurs when wholesalers dictate the price that retailers must sell their product for.
   b. could allow wholesalers to enforce a cartel agreement among retailers.
   c. might be necessary to insure that “full-service” retailers can compete.
   d. all of the above.

23. After the formation of OPEC and the subsequent increase in oil prices:
   a. member countries eventually cheated on the OPEC quotas by producing more than their quota.
   b. member countries eventually cheated on the OPEC quotas by producing less than their quota.
   c. new firms were attracted into the industry because of the higher oil prices.
   d. a and c.
   e. b and c.

24. The Clayton Act outlawed:
   a. tying contracts and interlocking directorates.
   b. tying contracts and false advertising.
   c. interlocking directorates and false advertising.

Answers.

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