

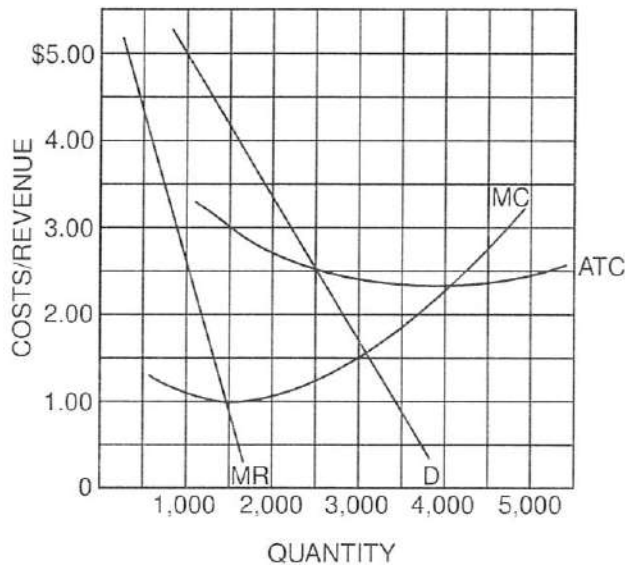
## Regulating Monopoly

Suppose you are an analyst for a board that regulates local monopolies. Your supervisor has given you the three questions below. Using the information in Figure 37.1, answer your supervisor's questions.



Figure 37.1

### Regulating a Monopoly



- If this monopolist is not regulated, what will be the level of
  - output? \_\_\_\_\_
  - price? \_\_\_\_\_
  - total revenue? \_\_\_\_\_
  - total costs? \_\_\_\_\_
  - profit or loss? \_\_\_\_\_
- If this monopolist is regulated by marginal cost pricing (i.e., the socially optimal price), what will be the level of
  - output? \_\_\_\_\_
  - price? \_\_\_\_\_
  - total revenue? \_\_\_\_\_

Adapted from Robert W. Pulsinelli and Roger LeRoy Miller, *Student Learning Guide to Accompany Economics Today*, 8th ed. (New York: HarperCollins College Publishers, 1994), p. 411.

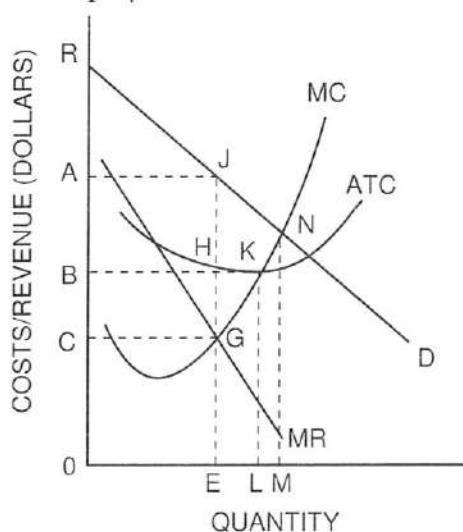
- (D) total costs? \_\_\_\_\_
  - (E) profit or loss? \_\_\_\_\_
  - (F) Will the monopoly need a subsidy? \_\_\_\_\_
  - (G) If so, how much? \_\_\_\_\_
3. If cost-of-service regulation (fair-return price or average cost pricing) is imposed on this monopolist, what will be the level of
- (A) output? \_\_\_\_\_
  - (B) price? \_\_\_\_\_
  - (C) total revenue? \_\_\_\_\_
  - (D) total costs? \_\_\_\_\_
  - (E) profit or loss? \_\_\_\_\_
4. What are the advantages and disadvantages of marginal cost pricing?
5. What are the advantages and disadvantages of cost-of-service regulation?

## A Quick Review of Perfect Competition and Monopoly

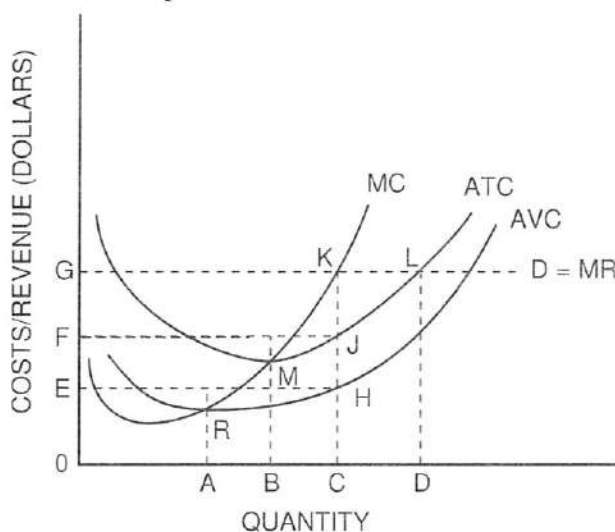


Figure 39.1  
Graphs of Monopoly and Perfect Competition

### Monopoly



### Perfect Competition



These questions are based on Figure 39.1. Underline the correct answer. Assume that the monopoly can set only one price. Both the monopoly and the perfect competitor seek to maximize profits.

- A monopoly firm will maximize profits at what price?  
(A) 0A (B) 0B (C) 0C (D) 0R
- Economic profits for the monopoly firm are represented by the area of which rectangle?  
(A) 0CGE (B) 0AJE (C) AJHB (D) BAJN
- Total costs for the monopoly firm are represented by the area of which rectangle?  
(A) BKL0 (B) CGE0 (C) AJE0 (D) BHE0
- The total revenue for the monopoly firm is represented by the area of which rectangle?  
(A) 0CGE (B) 0AJE (C) AJHB (D) BAJH
- The perfect competitor will maximize profits at what output level?  
(A) 0A (B) 0B (C) 0C (D) 0D

The graphs for this activity are from *Test Bank 1 to Accompany Campbell McConnell, Economics*, 10th ed. (New York: McGraw-Hill Book Co., 1987). Activity written by John Morton, National Council on Economic Education, New York, N.Y.

6. The perfect competitor will shut down below which price-output relationship?  
(A) K                      (B) M                      (C) L                      (D) R
7. At price OG, the area of which rectangle represents total revenue for the profit-maximizing perfect competitor?  
(A) OGKC                      (B) OFJC                      (C) FGKJ                      (D) EFJH
- ~~8. At output OG, total variable cost is represented by the area of which rectangle?~~  
(A) OGKC                      (B) FGKJ                      (C) OEHK                      (D) OFJC
9. At price OG, profits for the perfect competitor are represented by the area of which rectangle?  
(A) OGKC                      (B) OFJC                      (C) FGKJ                      (D) OEHK
10. At what price-output relationship will a perfect competitor operate in the long run?  
(A) K                      (B) L                      (C) M                      (D) R
11. For the monopolist, what is the area of consumer surplus?  
(A) ABHJ                      (B) AJGC                      (C) ARJ                      (D) ARJE