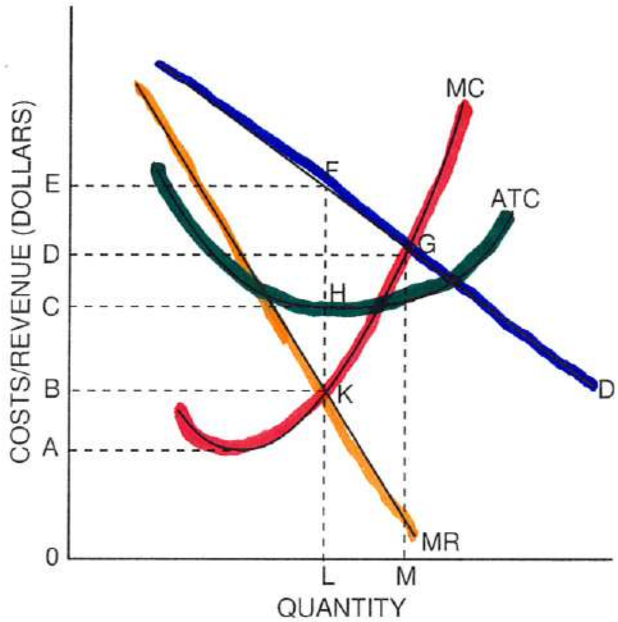
UNIT 3

Monopolistic Competition

Figure 40.1
Monopolistically Competitive Firm in the Short Run



1. Use Figure 40.1 to answer these questions.

   (A) At what level of output will this firm operate? ____________

   [redacted]

   (C) What price will this firm charge for its product? ____________

   (D) The area of which rectangle is equal to total revenue? ____________

   (E) What is the firm's average total cost? ____________

   (F) The area of which rectangle is equal to the firm's total cost? ____________

   (G) Is the firm making profits or incurring losses? ____________

   (H) The area of which rectangle is equal to profits or losses? ____________

Adapted from Otis Gilley, *Student Learning Guide to Accompany Miller: Economics* (New York: HarperCollins Publishers Inc., 1985). Activity written by John Morton, National Council on Economic Education, New York, N.Y.

2. Would the demand curve for a monopolistic competitor be more or less elastic than the demand curve for a monopolist? Justify your answer.

3. What are the characteristics of a monopolistically competitive market? In what sense is there competition and in what sense is there monopoly in this type of market structure?

4. What are three examples of monopolistically competitive markets?

5. True, false or uncertain, and why? "Monopolistic competition is just another form of pure monopoly."

6. True, false or uncertain, and why? "Monopolistic competition is even better than perfect competition."

7. True, false or uncertain, and why? "In the long run, monopolistic competitors produce at their most efficient point."

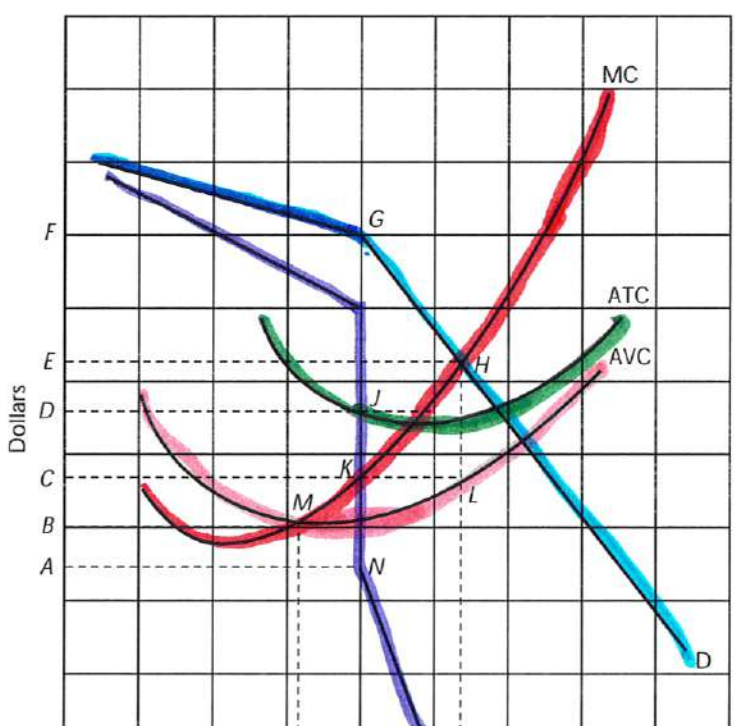
ACTIVITY 46
The Kinked Demand Curve of an Oligopolist

The kinked demand curve is a method of analysis designed to explain why oligopolists prefer to compete on quality rather than price. A kinked demand curve illustrates the price rigidity of an oligopolist. The oligopolist, like any other firm, maximizes profits where marginal revenue equals marginal cost. The kinked demand curve shows that if an oligopolistic firm raises its price above the existing price, it will lose market share and have lower profits. This is because the other firms in the industry will not follow the price increase.

If the oligopolistic firm lowers its price, the other firms in the industry will have to follow to avoid losing market share. Therefore, the firm does not gain market share but does receive less revenue. Again, the firm finds that its profits have decreased. For these reasons, oligopolistic firms tend either to have rigid prices or to find a way to collude with each other before raising prices.

Use the *Kinked Demand Curve of an Oligopolist* to answer the questions that follow.

Kinked Demand Curve of an Oligopolist



1. At what level of output will this firm operate? _________

2. What is the marginal cost at this level of output? _________

3. What price will the firm charge for its product? _________

Adapted from Robert W. Pulsinelli and Roger LeRoy Miller, *Student Learning Guide to Accompany Economics Today*, 8th edition, (New York: HarperCollins College Publishers, 1994) p. 396.

ACTIVITY 46 continued

4. The area of which rectangle equals total revenue? _________

5. What is the firm's average cost? _________

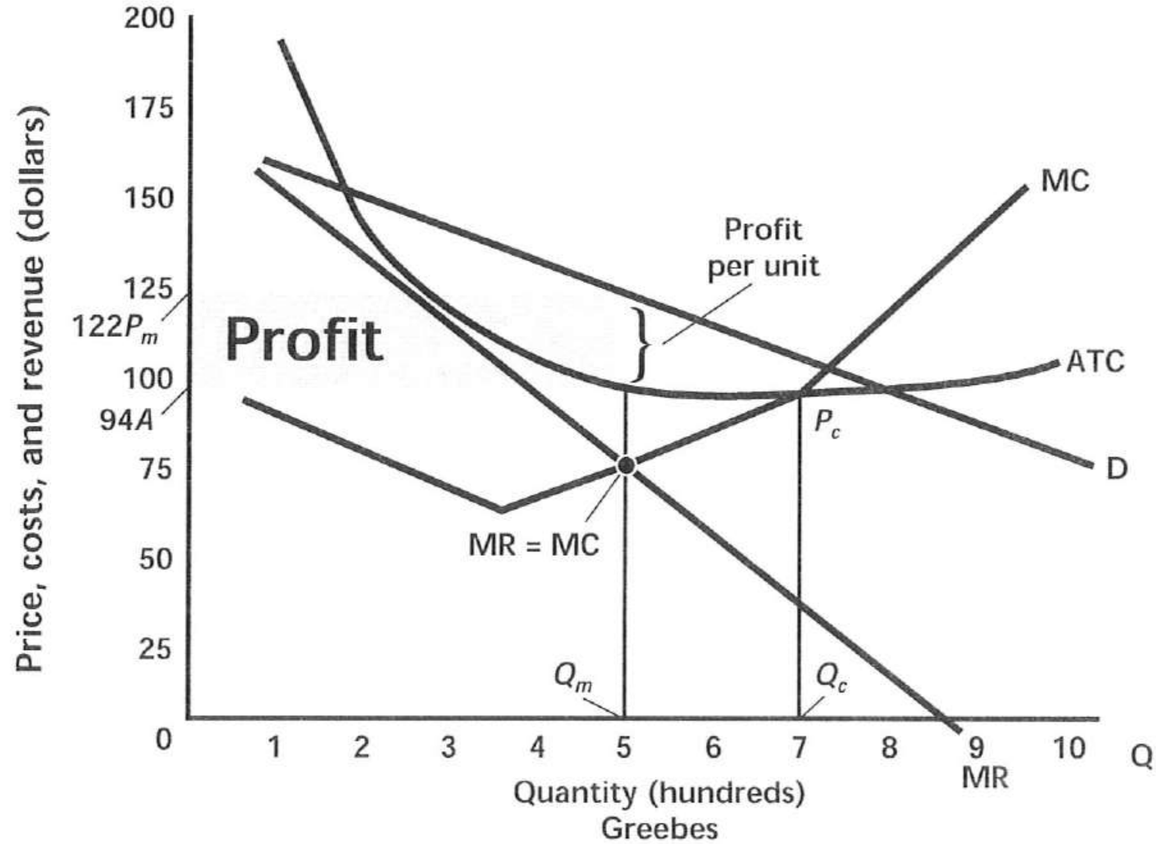
6. The area of which rectangle is equal to the firm's total cost? _________

7. The area of which rectangle is equal to the firm's profit? _________

8. Suppose the firm is operating at an output level of Y units. How low would marginal costs at Y units of output have to drop before the firm would lower its price? _________

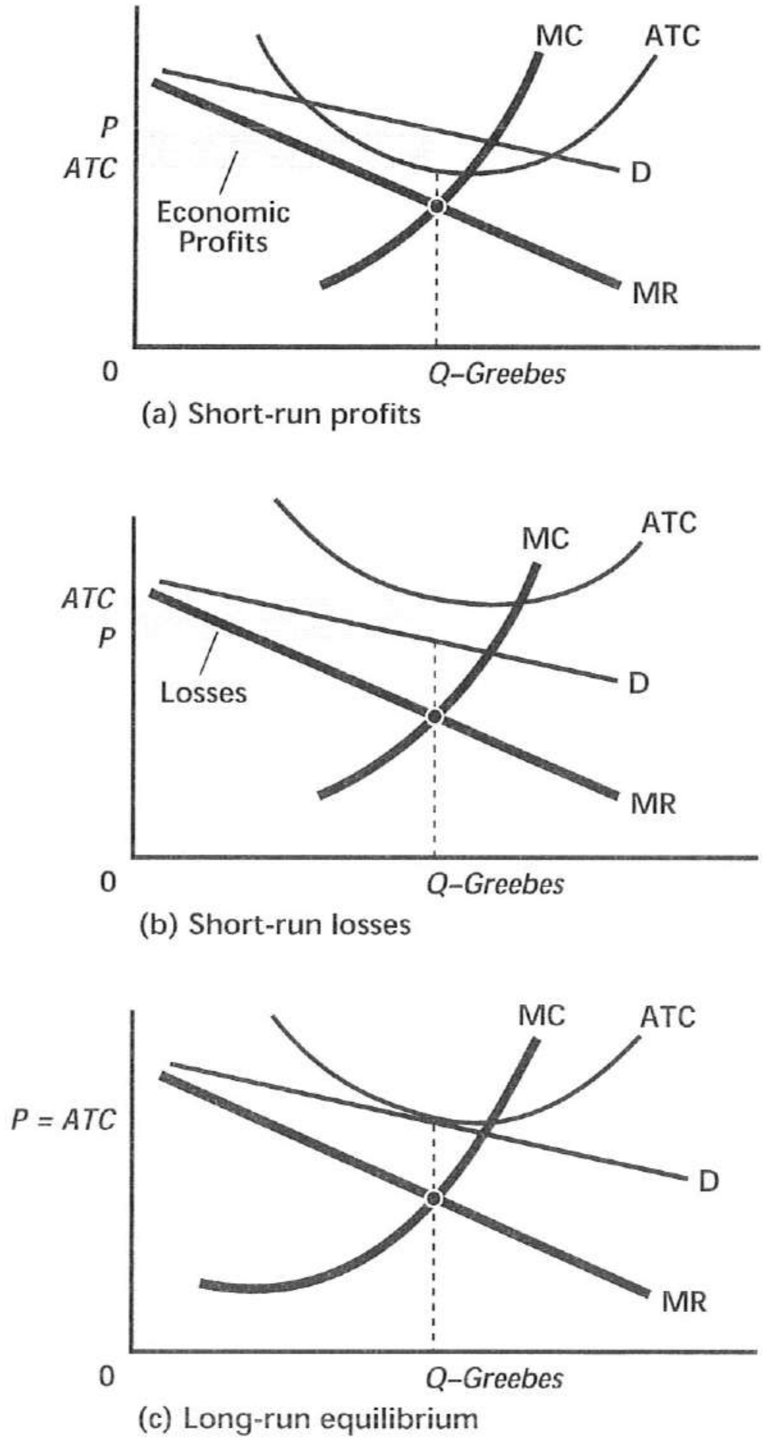
Visual 3.11

The Profit-Maximizing Position of a Monopoly



Visual 3.12

Short-Run and Long-Run Equilibrium for a Monopolistic Competitor



Visual 3.13

The Kinked Demand Curve of an Oligopolist