Question #1 of 121

A competitive firm will tend to expand its output as long as:

A) its marginal revenue is positive.

B) its marginal revenue is greater than the market price.

C) the market price is greater than the marginal cost.

Explanation

A competitive firm faces a flat demand curve. This means the price is constant and the marginal revenue line is flat. A firm will continue to produce as long as MR > MC, so the competitive firm will produce as long as P > MC. It will stop when MC = MR = P.

(Study Session 4, Module 15.1, LOS 15.b)

Question #2 of 121

Which of the following *most* accurately describes the relationship between price (P), marginal cost (MC), and marginal revenue (MR) at the profit maximizing output level for a firm in a perfectly competitive industry?

A) P > MC < MR.

B) P = MC = MR.

C) P > MC = MR.

Explanation

For a perfectly competitive firm, maximum profit occurs at the output level where marginal revenue equals marginal cost. And, since the demand curve faced by each firm in perfect competition is horizontal, marginal revenue is equal to price.

(Study Session 4, Module 15.1, LOS 15.b)

Question #3 of 121

An attempt by that oligopolists to act with another firm in setting a higher price is called:

A) collusion.

B) prisoner's dilemma.

C) high economic profits.

Explanation

Collusion is when firms organize into an association to increase profits by controlling prices and output. Collusion can take place when an industry has a small number of competitors and high barriers to entry.

(Study Session 4, Module 15.3, LOS 15.d)

Question #4 of 121

Which of the following statements is *least* accurate with regard to the efficiency of monopolistic competition?

A) The expense of advertising and promotion may not be justified by their benefit to consumers.

B) Monopolistic competition is at least as efficient as perfect competition.

C) Consumers benefit from brand name promotion and advertising.

Explanation

The efficiency of monopolistic competition is unclear. Consumers may make better purchasing decisions due to the information content of brand name promotion and advertising. However, there are those that argue that the increased cost of advertising and sales is not justified by the benefits of these activities and represent inefficient use of resources.

(Study Session 4, Module 15.2, LOS 15.b)

Question #5 of 121

Which of the following is *least* relevant when explaining why monopoly firms can earn positive economic profits over the long term?

A) Control over production input resources.

B) The existence of economies of scale.

C) The ability to use price discrimination.

Explanation

High entry barriers due to economies of scale, government licensing, resource controls, and patents prevent new firms from entering the market to exploit positive economic profit opportunities.

(Study Session 4, Module 15.4, LOS 15.b)

Question #6 of 121

Compared to a competitive market, a monopoly situation will produce:

A) less output, and the sum of the consumer surplus and the producer surplus will be increased.

B) less output, and the sum of the consumer surplus and the producer surplus will be reduced.

C) more output, and the sum of the consumer surplus and the producer surplus will be reduced.

Explanation

A monopolist, faced with the same demand curve that would exist under perfect competition, will decrease output to the point that marginal revenue equals marginal cost. This will have the effect of reducing the sum of the consumer surplus and the producer surplus, relative to what they would have been under perfect competition. However, the size of the producer surplus increases on an absolute basis at the expense of the consumer surplus.

(Study Session 4, Module 15.4, LOS 15.d)

Question #7 of 121

If the market demand for a product increases in a competitive market, then price:

A) and quantity will increase.

B) will decrease and quantity will increase.

C) will increase and quantity will decrease.

Explanation

If the market demand for a product increases in a competitive market, then the equilibrium price and equilibrium quantity supplied will increase.

(Study Session 4, Module 15.1, LOS 15.e)

Question #8 of 121

Monopolists will maximize profit by producing at an output level where which of the following conditions exists?

A) Marginal revenue = marginal cost < price.

B) Price = marginal revenue = marginal cost.

C) Price = demand = marginal revenue = marginal cost.

Explanation

To maximize profit, monopolists will expand output until marginal revenue equals marginal cost. Price will be greater than marginal revenue because a monopolist faces a downward sloping demand curve.

(Study Session 4, Module 15.4, LOS 15.d)

Question #9 of 121

Which of the following situations is *least likely* to lead to high barriers to entry and monopoly supply?

A) Economies of scale are present.

B) Natural resources are spread among many firms.

C) Governmental licensing and regulations are present.

Explanation

All cases except wide distribution of a natural resource facilitate a monopoly. If natural resource ownership is concentrated in one firm a monopoly would result.

(Study Session 4, Module 15.1, LOS 15.a)

Question #10 of 121

A monopolist will continue expanding output as long as:

A) marginal revenue is positive.

B) marginal revenue is greater than marginal cost.

C) economic profit is greater than zero.

Explanation

The optimum behavior of all firms is to produce until the point where MR = MC. So, the monopolist can increase total profit by increasing production as long as marginal revenue is greater than marginal costs.

(Study Session 4, Module 15.4, LOS 15.b)

Question #11 of 121

Which one of the following structures is characterized by free entry and exit, a differentiated product, and price searcher behavior?

A) Monopolistic competition.

B) Pure competition.

C) Oligopoly.

Explanation

Monopolistic competition is another name for competitive price-searcher markets. There are a large number of independent sellers, each produces a differentiated product, each market has a low barrier to entry, and each producer faces a downward sloping demand curve.

(Study Session 4, Module 15.4, LOS 15.h)

Question #12 of 121

Assume that the market for paper supplies and the market for toothpicks have the following characteristics:

The *Market for Paper Supplies* is comprised of:

- A large number of independent sellers
- Differentiated products
- Low barriers to entry/exit

The *Market for Toothpicks* is comprised of:

- A large number of independent sellers
- Homogeneous products
- No barriers to entry/exit

The Papyrus Company operates in the market for paper supplies and Wudden Floss operates in the toothpick market. The sales managers for both companies want to know how a change in price will affect the quantity sold.

Which of the following choices *best* completes the following sentence? If both firms increase prices, the quantity sold by Papyrus Company will:

A) increase, and the quantity sold by Wudden Floss will decrease.

B) decrease, and Wudden Floss will sell nothing.

C) decrease, and so will the quantity sold by Wudden Floss.

Explanation

Papyrus Company is an example of a price searcher engaged in monopolistic competition (low barriers to entry). Thus, the company faces a downward sloping demand curve and highly elastic demand. An increase in price will result in fewer units sold. Wudden Floss is an example of a price taker operating in a purely competitive market. Thus, the firm faces a horizontal demand curve and perfectly elastic demand. An increase in price will result in *no units sold*. In a purely competitive market, the firm must take the market price.

(Study Session 4, Module 15.2, LOS 15.h)

Question #13 of 121

Firms in perfectly competitive markets and firms operating in a market characterized by monopolistic competition have several things in common. Which of the following is *least likely* one of them? Both:

A) face perfectly elastic demand curves.

B) operate in markets that have low or no barriers to entry.

C) maximize economic profit.

Explanation

The only item listed in the question that monopolistic competition and pure competition do not have in common is a perfectly elastic demand curve. Under pure competition, producers face a perfectly elastic demand curve, whereas price searchers face downward sloping demand curves.

(Study Session 4, Module 15.1, LOS 15.a)

Question #14 of 121

Characteristics of monopolistic competition include all of the following EXCEPT:

A) differentiated products.

B) large numbers of independent sellers.

C) high barriers to entry.

Explanation

Monopolistic competition has *low* barriers to entry.

(Study Session 4, Module 15.1, LOS 15.a)

Question #15 of 121

If a market features differentiated products but has low barriers to entry, in long-run equilibrium the firms in the market will earn:

A) substantial economic losses.

B) zero economic profits.

C) substantial economic profits.

Explanation

Low barriers to entry suggest free entry and exit, which implies zero economic profits in the long run.

(Study Session 4, Module 15.2, LOS 15.b)

Question #16 of 121

In a perfectly competitive market, what determines the price of the product?

A) The producers of the product.

B) Market supply and demand.

C) The members of the supply chain.

Explanation

Individual firms in perfect competition have no influence over market price. They are price takers who must sell at the prevailing market price. If they set their price higher than the market, they will sell nothing.

(Study Session 4, Module 15.1, LOS 15.d)

Question #17 of 121

A firm has the following characteristics:

- relatively small in size.
- marginal revenue is equal to the selling price.
- economic profits will not be earned for any significant period of time.

The firm is *best* described as existing in a(n):

A) price searcher market.

B) purely competitive market.

C) monopolistic market structure.

Explanation

The firm being described is a price taker firm in a purely competitive market. These firms must sell their product at the going market price, there are no barriers to entry, and there are a large number of firms that produce a homogeneous product.

(Study Session 4, Module 15.4, LOS 15.h)

Question #18 of 121

Which of the following is *most likely* to be considered a characteristic of monopolistic competition?

A) Inelastic demand curves.

B) High barriers to entry and exit.

C) Differentiated products.

Explanation

Differentiated products are a key characteristic of monopolistic competition. Although producers have downward sloping demand curves, they are typically elastic.

(Study Session 4, Module 15.1, LOS 15.a)

Question #19 of 121

A monopolist will expand production until:

A) MR = MC and the price of the product will be determined by the MR curve.

B) MR = MC and the price of the product will be determined by the demand curve.

C) P = MC and the price of the product will be determined by the MC curve.

Explanation

A monopolist will expand production until MR = MC. The demand curve lies above the intersection of the MR and MC curve and the price charged is the price on the demand curve for the output where MR = MC.

(Study Session 4, Module 15.4, LOS 15.d)

Question #20 of 121

In the dominant firm model of oligopoly, it is *least likely* that one firm:

A) effectively sets the price in the market.

B) has a significant cost advantage over its competitors.

C) is the innovation leader in product development.

Explanation

The dominant firm model of oligopoly is based on the assumption that one firm has a significant cost advantage which allows it to set the price in the market and control a relatively large share of the industry's production and sales. It does not assume that the firm will be the innovation leader in product development. In fact, being more innovative is one of the factors that allow smaller competitors that work at a cost disadvantage to survive.

(Study Session 4, Module 15.3, LOS 15.d)

Question #21 of 121

Characteristics of an oligopoly *least likely* include:

A) interdependence among competitors.

B) significant barriers to entry.

C) identical products.

Explanation

In an oligopoly, a small number of producers sell products that can be similar or differentiated. An oligopoly typically features significant barriers to entry including economies of scale. Pricing and output decisions by each firm directly influence the decisions of competing firms.

(Study Session 4, Module 15.1, LOS 15.a)

Question #22 of 121

Which of the following is *least likely* to be considered a necessary condition for a monopolist to realize profits from price discrimination?

A) A product for which the demand curve is downward sloping.

B) The ability to prevent trading between customers in different price groups.

C) Two different costs of production.

Explanation

Price discrimination works when the seller (discriminator) faces a downward-sloping demand curve and has at least two customer groups each having different price elasticities for the product. It is also necessary that trading does not occur between customer groups so that the customers paying a lower price cannot resell the product to the customers paying a higher price.

(Study Session 4, Module 15.4, LOS 15.d)

Question #23 of 121

Which of the following is *least likely* a barrier to entry?

A) Patents.

B) Allocative Efficiency.

C) Economies of Scale.

Explanation

The other barriers to entry are government licensing and legal barriers such as utilities are given the exclusive right to supply electricity in certain areas.

(Study Session 4, Module 15.1, LOS 15.a)

Question #24 of 121

Consider a price fixing agreement between Spain and Italy that restricts cheese production such that maximum economic profit will be realized by both countries. The possible outcomes of the agreement are presented in the table below. Based on the Prisoners' Dilemma framework, the *most likely* strategy followed by the two countries will be:

	Italy Complies	**Italy Defaults**
Spain Complies	Spain gets €7 billion Italy gets €7 billion	Spain gets €3 billion Italy gets €9 billion
Spain Defaults	Spain gets €9 billion Italy gets €3 billion	Spain gets €5 billion Italy gets €5 billion

A) neither country will increase output.

B) both countries will increase output.

C) Italy will increase output; Spain will produce at the agreed level.

Explanation

The solution for the Prisoners' Dilemma for each nation is arrived at as follows:

- Given that Italy complies with the agreement: Spain will get €7 billion if it complies, but €9 billion if it defaults. Therefore Spain should default.
- Given that Italy defaults: Spain will get €3 billion if it complies, but €5 billion if it defaults. Therefore Spain should default.
- Because Spain is better off in either case by defaulting, Spain will default.
- Italy will follow the same logic and reach the same conclusion.

(Study Session 4, Module 15.3, LOS 15.d)

Question #25 of 121

Which of the following is *most likely* the long-term adjustment in a perfectly competitive industry that is characterized by firms incurring economic losses?

A) Some existing firms will exit the market.

B) Equilibrium price will decrease.

C) The industry supply curve will shift downward and to the right.

Explanation

Some of the existing firms will exit the market, leading to a decrease in industry supply and an increase in equilibrium price. Eventually, the remaining firms in the industry will increase output at the higher market price until economic profit equals zero.

(Study Session 4, Module 15.1, LOS 15.e)

Question #26 of 121

Under perfect competition, a firm will be inclined to increase output as long as which of the following conditions exists?

A) Marginal revenue is greater than the average cost.

B) Marginal revenue is greater than marginal cost.

C) Marginal cost is less than average cost.

Explanation

A firm will continue to expand output as long as it is possible to earn an economic profit. In other words, a firm will expand output as long as marginal revenue is greater than marginal cost.

(Study Session 4, Module 15.1, LOS 15.b)

Question #27 of 121

If the market demand for a product increases in a competitive market, then in the short run the quantity supplied by an individual firm will:

A) increase and the firm will generate economic profits.

B) increase and the firm will generate economic losses.

C) decrease and the firm will generate economic profits.

Explanation

If the market demand for a product increases in a competitive market, then both price and quantity supplied by an individual firm will increase and the firm will generate economic profits in the short run because price will be greater than average total costs.

(Study Session 4, Module 15.1, LOS 15.e)

Question #28 of 121

Statement 1: "The kinked demand curve model of oligopoly assumes that a decrease in price will not be followed by other firms in the industry, but a price increase will."

Statement 2: "Firms in monopolistic competition have high advertising expenses because they want to create the perception that their product is different from their competitors' products when the competing products are actually quite similar."

With respect to these statements:

A) both are incorrect.

B) both are correct.

C) only one is correct.

Explanation

Statement 1 is incorrect because the kinked demand curve model contends that each firm in oligopoly competition believes that an increase (not decrease) in its price will not be followed by the competition, but a decrease (not increase) in price will. Each firm believes that it faces a demand curve that is more elastic (flatter) above a given price, i.e., the kink, than it is below the given price.

(Study Session 4, Module 15.3, LOS 15.d)

Question #29 of 121

Which of the following is *least* accurate regarding the relationship between price (P), marginal revenue (MR), average total cost (ATC), and marginal cost (MC) at the profit maximizing output under monopoly?

A) P = MR.

B) MR = MC.

C) MR < ATC.

Explanation

To maximize profit, all firms expand output until marginal revenue equals marginal cost. Price is determined from the demand curve, which is above the marginal revenue curve since a monopoly faces a downward sloping demand curve.

(Study Session 4, Module 15.4, LOS 15.b)

Question #30 of 121

Consider the following statements:

Statement 1: "When oligopoly firms cheat on price fixing agreements, the result increases economic efficiency."

Statement 2: "Monopolistic competition is inefficient because a large deadweight loss from advertising and marketing costs is a characteristic of this form of competition."

With respect to these statements:

A) only one is correct.

B) both are incorrect.

C) both are correct.

Explanation

With a price-fixing agreement, producers in an oligopoly market restrict output to increase price and joint profits just as a monopoly producer does. Such agreements decrease economic efficiency. When these agreements are violated, quantity produced increases, increasing economic efficiency. Therefore Statement 1 is accurate.

The efficiency of monopolistic competition is not clear. While increased opportunity cost is associated with the intensive marketing and advertising activities that are characteristic of monopolistic competition, consumers definitely benefit from these selling activities because they receive information that often enables them to make better purchasing decisions. Hence the advertising and marketing costs may be more than the efficient amount, but do not represent a deadweight loss. Therefore Statement 2 is inaccurate.

(Study Session 4, Module 15.3, LOS 15.d)

Question #31 of 121

In order for effective price discrimination to occur the seller must:

A) have more than one identifiable group of customers with the same price elasticities of demand for the product.

B) face a demand curve with a negative slope.

C) maximize revenue by selling at the highest price possible.

Explanation

In order for effective price discrimination to occur, the seller must have a downward sloping demand curve. The seller must also have at least two identifiable groups of customers with price elasticities of demand for the product, and the seller must be able to prevent customers from reselling the product.

(Study Session 4, Module 15.4, LOS 15.d)

Question #32 of 121

Which of the following is *least* accurate with regard to advertising for firms operating under monopolistic competition?

A) The increase to average total costs associated with advertising increases as output increases.

B) Advertising expenses are high relative to perfect competition and monopoly.

C) Advertising may decrease average total cost.

Explanation

Advertising expenses are high for firms in monopolistic competition. Not only because firms need to inform consumers about the unique features of a firm's products, but also to create or increase a perception of differences between products that are actually quite similar. Advertising costs increase average total costs, but the increase to average total cost attributable to advertising decreases as output increases because more fixed advertising dollars are being averaged over a larger quantity. If advertising increases output (sales) significantly, it can actually decrease a firm's average total cost if there are economies of scale.

(Study Session 4, Module 15.2, LOS 15.b)

Question #33 of 121

Which of the following *most* accurately describes why firms under monopolistic competition face elastic demand for their products?

A) Allocative efficiency.

B) The availability of many close substitutes.

C) High barriers to entry.

Explanation

The demand for products from firms competing in monopolistic competition is relatively elastic due to the availability of close substitutes. If a firm increases its product price, it will lose customers to firms selling slightly differentiated products at lower prices.

(Study Session 4, Module 15.2, LOS 15.b)

Question #34 of 121

Which of the following statements regarding a monopolist is *most* accurate?

A) A monopolist will charge the highest price for which he can sell his product.

B) A monopolist will maximize the average profit per unit sold.

C) A monopolist, like any other profit-maximizing firm, will sell at the output level where marginal revenue equals marginal cost.

Explanation

The demand curve for monopolists slopes downward to the right reflecting the fact that a higher price results in lower demand. Monopolists maximize profits by expanding output until marginal revenue equals marginal cost.

(Study Session 4, Module 15.4, LOS 15.d)

Question #35 of 121

Consider the following statements:

Statement 1: "A natural monopoly exists when economies of scale are so pronounced that all of an industry's demand should be supplied by one firm."

Statement 2: "Monopoly is characterized by a single seller of a distinct product for which no good substitutes exist."

Statement 3: "Average cost pricing is a form of regulation that is intended to force monopolists to reduce output to the point where the monopolist's average total cost curve intersects its marginal cost curve."

Which of the following *best* describes the accuracy of these statements?

	Statement 1	Statement 2	Statement 3
A)	Incorrect	Correct	Incorrect
B)	Correct	Incorrect	Correct
C)	Correct	Correct	Incorrect

Explanation

Statement 3 is incorrect because average cost pricing attempts to force the monopolist to produce where the average total cost curve intersects the demand curve and to charge a price equal to ATC.

(Study Session 4, Module 15.4, LOS 15.b)

Question #36 of 121

Which of the following is *least likely* a barrier to entry?

A) Price controls.

B) Economies of scale.

C) Resource controls.

Explanation

Often barriers to entry are government licensing and legal barriers.

(Study Session 4, Module 15.1, LOS 15.a)

Question #37 of 121

Assume that a perfectly competitive firm produces 10 units of a good and sells them each for a price (P) equal to $15. If the marginal cost (MC) of the 10th unit is $15 and the average total cost (ATC) is $13, economic profit for the firm is *closest* to:

A) $120.00

B) $0.00

C) $20.00

Explanation

When MR = MC = P, economic profit equals TR – TC. In this case, TR = $150 = 10 × $15 and TC = $130 = 10 × ATC = 10 × $13. So, economic profit is $20 = $150 – $130.

(Study Session 4, Module 15.1, LOS 15.b)

Question #38 of 121

When a regulatory agency requires a monopolist to use average cost pricing, the intent is to produce the quantity where the:

A) the market demand curve intersects the average total cost curve.

B) marginal revenue curve intersects the marginal cost curve.

C) average total cost curve intersects the marginal revenue curve.

Explanation

When a regulatory agency requires a monopolist to use average cost pricing, the intent is to price the product where the average total cost curve intersects the market demand curve. There are problems in using this method, e.g., determining exactly what the average total cost really is.

(Study Session 4, Module 15.4, LOS 15.b)

Question #39 of 121

Monopolistic competition differs from pure monopoly in that:

A) monopolistic competitors are price takers, monopolists are not.

B) monopolists maximize profit; monopolistic competitors do not.

C) barriers to entry are high under monopoly, but low under monopolistic competition.

Explanation

Monopolistic competition is characterized by the low barriers to enter its competitive markets. In contrast, a monopoly exists only where there are high barriers to market entry.

(Study Session 4, Module 15.1, LOS 15.a)

Question #40 of 121

A competitive firm will tend to expand its output as long as marginal:

A) revenue is greater than the average cost. ✗

B) revenue is greater than marginal cost. ✓

C) cost is less than average cost. ✗

Explanation

All firms will continue to expand production until marginal revenue = marginal cost.

(Study Session 4, Module 15.1, LOS 15.b)

Question #41 of 121

The *most likely* limitation of the N-firm and Herfindahl-Hirshman concentration measures in assessing market power is that they:

A) do not explicitly include the effects of potential competition. ✓

B) are insensitive to mergers within the industry. ✗

C) are both backward looking. ✗

Explanation

Because potential competition from new entrants is not considered in the calculation of industry concentration measures, market power (pricing power) may be low even though the market shares of the top firms in the industry are quite large.

(Study Session 4, Module 15.3, LOS 15.g)

Question #42 of 121

The kinked demand model assumes that below the current price, the demand curve becomes:

A) less elastic because competitors will decrease their prices. ✓

B) less elastic because competitors will not decrease their prices. ✗

C) more elastic because competitors will decrease their prices. ✗

Explanation

The kinked demand model of oligopoly behavior assumes that a firm's competitors will not match a price increase, but will match the price of a competitor that offers a lower price. The result is a demand curve that is more elastic above the current price, but less elastic below it.

(Study Session 4, Module 15.3, LOS 15.d)

Question #43 of 121

Which of the following is *least likely* a necessary condition for a monopolist to realize increased profits from price discrimination?

A) A product for which the demand curve is downward sloping.

B) Two different costs of production.

C) The ability to prevent trading between customers in different price groups.

Explanation

Price discrimination works when the seller (discriminator) faces a downward-sloping demand curve and has at least two customer groups each having different price elasticities of demand for the product. It is also necessary that trading does not occur between customer groups so that the customers paying a lower price cannot resell the product to the customers paying a higher price.

(Study Session 4, Module 15.4, LOS 15.f)

Question #44 of 121

Which of the following is *most* accurate for a price-taker firm in long-run equilibrium when there are no barriers to entry?

A) TC = TR = MC.

B) P = MC = ATC = MR.

C) P = AVC = MR.

Explanation

For a price-taker firm, long-run equilibrium is where P = MC = ATC. For price taking firms, P = MC. Competition eliminates economic profits in the long run so that P = ATC.

(Study Session 4, Module 15.1, LOS 15.b)

Question #45 of 121

Firms in a perfectly competitive industry will increase their output until which of the following conditions is met?

A) Total revenue equals price.

B) Marginal revenue equals average total cost.

C) Marginal cost equals price.

Explanation

When a firm operates under conditions of perfect competition, marginal revenue always equals price. Under perfect competition, price is constant (a horizontal line) so marginal revenue is constant. Therefore a firm will increase output until marginal cost equals price.

(Study Session 4, Module 15.1, LOS 15.d)

Question #46 of 121

The demand curve for a firm in a perfectly competitive market is:

A) downward sloping.

B) upward sloping.

C) horizontal.

Explanation

In a market of perfect competition an individual firm's demand schedule is perfectly elastic (horizontal).

(Study Session 4, Module 15.1, LOS 15.a)

Question #47 of 121

A monopolist will maximize profits by:

A) producing at the output level where marginal revenue equals marginal cost and charging a price on the demand curve that corresponds to the output rate.

B) producing at the output level where marginal revenue equals average variable cost and charging a price along the demand curve that corresponds to the output rate.

C) producing at the point where price is equal to MR.

Explanation

A monopolist will maximize profits by producing at the output level where marginal revenue equals marginal cost and charging a price on the demand curve that corresponds to the output rate.

(Study Session 4, Module 15.4, LOS 15.d)

Question #48 of 121

A perfectly competitive firm will continue to increase output so long as which of the following conditions exists?

A) Marginal revenue is positive.

B) Market price is greater than marginal cost.

C) Marginal revenue is greater than price.

Explanation

A perfectly competitive firm will tend to expand its output so long as the market price is greater than marginal cost since price and marginal revenue are equal. In the short term and long term, profit is maximized when marginal cost and marginal revenue are equal (i.e., MC = MR).

(Study Session 4, Module 15.1, LOS 15.b)

Question #49 of 121

Assume that a firm in an oligopoly market believes the demand curve for its product is more elastic above a specific price than below this price. This belief is *most closely* associated with which of the following models?

A) Dominant firm model.

B) Kinked demand model.

C) Nash equilibrium model.

Explanation

The kinked demand model assumes that each firm in a market believes that at some price, demand is more elastic in respect to price increases than it is to price decreases.

(Study Session 4, Module 15.3, LOS 15.f)

Question #50 of 121

The kinked demand model assumes that at prices above the current price, the demand curve becomes:

A) less elastic because competitors will not increase their prices.

B) more elastic because competitors will not increase their prices.

C) more elastic because competitors will increase their prices.

Explanation

The kinked demand model of oligopoly behavior assumes that a firm's competitors will not match a price increase, but will match the price of a competitor that offers a lower price. The result is a demand curve that is more elastic above the current price, but less elastic below it.

(Study Session 4, Module 15.3, LOS 15.d)

Question #51 of 121

In a study seminar, the following comments were made:

Comment 1: "In the short run, an increase in demand in a perfectly competitive industry will result in negative economic profit for some firms in the industry."

Comment 2: "In the long run, a permanent increase in demand in a perfectly competitive industry will result in zero economic profit for the firms in the industry."

With respect to these comments:

A) both are correct.

B) both are incorrect.

C) only one is correct.

Explanation

Comment 1 is incorrect because an increase in industry demand will increase equilibrium price and output. At the higher price, firms will earn positive economic profits in the short run because the higher price will exceed average total cost. Over the long run, however, new firms will enter the market to exploit the positive economic profits, causing prices to decline until all firms are again earning zero economic profit.

(Study Session 4, Module 15.1, LOS 15.e)

Question #52 of 121

When a firm is earning positive economic profits in a monopolistic competitive market, what will *most likely* occur?

A) New firms will enter driving down the economic profits to zero.

B) Losses will occur in the short run.

C) Price takers will be over run by price searchers.

Explanation

New firms will enter a monopolistic competitive market with economic profits above zero and will absorb some market demand. This will shift the demand curve down to the point where price equals average total cost and there are zero economic profits.

(Study Session 4, Module 15.2, LOS 15.b)

Question #53 of 121

Monopolistic competition differs from pure monopoly in that:

A) monopolistic competitors have low barriers to entry and monopolists do not.

B) monopolistic competitors are price takers and monopolists are not.

C) monopolists maximize profits and monopolistic competitors do not.

Explanation

Another name for monopolistic competition is a competitive price searcher market. Monopolistic competition refers to a large number of independent sellers, each produces a differentiated product, each market has a low barrier to entry, and each producer faces a downward sloping demand curve.

(Study Session 4, Module 15.1, LOS 15.a)

Question #54 of 121

Under perfect competition, a firm will experience zero long term economic profit when:

A) MC is less than ATC.

B) MC = ATC = MR = price.

C) price is less than average total cost.

Explanation

Under perfect competition, a firm will experience zero long term profits when P = MC = MR = ATC. It recovers all costs including opportunity costs and earns zero economic profit.

(Study Session 4, Module 15.1, LOS 15.b)

Question #55 of 121

Which of the following regarding monopolistic competition is *most* accurate?

A) There are very few independent sellers.

B) Each firm produces a differentiated product.

C) Zero barriers to entry and exit exist.

Explanation

Other characteristics of monopolistic competition (also known as competitive price searcher markets) are: a large number of independent sellers, low barriers to entry, and an elastic downward sloping demand curve.

(Study Session 4, Module 15.1, LOS 15.a)

Question #56 of 121

What is the relationship between price and marginal revenue for a price searcher?

A) Marginal revenue = price.

B) Marginal revenue < price.

C) Marginal revenue > price.

Explanation

For a price searcher, demand is downward sloping, marginal revenue is less than price since price must be reduced to sell additional units of output.

(Study Session 4, Module 15.2, LOS 15.b)

Question #57 of 121

Under which type of market structure are the production and pricing alternatives of a firm *most* affected by the decisions of its competitors?

A) Oligopoly.

B) Monopolistic competition.

C) Perfect competition.

Explanation

An oligopoly market structure is characterized by a small number of firms producing similar or differentiated products, with a high degree of interdependence among competitors. Each firm's optimal price and output are strongly affected by the pricing and output decisions of its competitors.

(Study Session 4, Module 15.1, LOS 15.a)

Question #58 of 121

An economic market characterized by a large number of independent firms all producing identical products is *best* described as:

A) monopolistic competition.

B) perfect competition.

C) monopoly.

Explanation

In a perfectly competitive economic market, there are many independent firms, each seller is small relative to the total market, and there are no barriers to entry or exit.

(Study Session 4, Module 15.4, LOS 15.h)

Question #59 of 121

Which of the following is *least likely* a characteristic of perfect competition?

A) The demand curve for an individual firm is a vertical line.

B) The size of each firm is small relative to the size of the overall market.

C) The products produced within a given market are homogenous.

Explanation

Under perfect competition individual firms have no control over price resulting in a demand schedule that is perfectly elastic or horizontal.

(Study Session 4, Module 15.1, LOS 15.a)

Question #60 of 121

A practice whereby a seller charges different prices to different consumers of the same product or service is called:

A) price competition.

B) discriminatory pricing.

C) price discrimination.

Explanation

Price discrimination is the practice of charging different consumers different prices for the same product or service.

(Study Session 4, Module 15.4, LOS 15.d)

Question #61 of 121

Consider the following statements:

Statement 1: "The sum of consumer and producer surpluses is maximized under both monopoly and perfect competition."

Statement 2: "All else being equal, a monopolist that practices price discrimination will be more allocatively efficient than a single-price monopolist."

With respect to these statements:

A) neither of these statements is accurate.

B) only one of these statements is accurate.

C) both of these statements are accurate.

Explanation

Statement 1 is incorrect because the sum of consumer and producer surpluses is maximized under perfect competition when marginal benefit and marginal cost are equal, or equivalently, where the marginal cost curve intersects the demand curve. Monopolies, however, produce a quantity that is less than the quantity where marginal cost equals marginal benefit, so the sum of producer and consumer surpluses is not maximized.

(Study Session 4, Module 15.1, LOS 15.a)

Question #62 of 121

Which of the following is a characteristic of perfect competition?

A) There are a few sellers.

B) There are no barriers to entry into the market.

C) The products of different firms are sold at different prices.

Explanation

The only true statement listed in the question is that, under perfect competition there are no barriers to entry into the market. Each of the other possible answers is not a characteristic of perfect competition. While the competitors can earn positive economic profits in the short-run, they cannot earn long term economic profits due to ease of entry and exit.

(Study Session 4, Module 15.1, LOS 15.a)

Question #63 of 121

Which of the following is *least likely* to be considered a reason why regulation of monopolies is not effective?

A) Regulation shifts industry demand and increases prices.

B) Regulation reduces the incentive for firms to reduce costs.

C) Regulators do not know the firm's cost structure.

Explanation

Regulation is not associated with a shift in industry demand.

(Study Session 4, Module 15.4, LOS 15.b)

Question #64 of 121

Which of the following statements about monopolies is *most* accurate?

A) Monopolists charge the highest possible price.

B) A monopoly structure is characterized by a well-defined product for which there are no good complements.

C) A monopolist's optimal production quantity is at the point where marginal revenue equals marginal cost.

Explanation

All firms maximize profits where MR = MC. Because of a downward-sloping demand curve and high barriers to entry, monopolists can charge a price higher than MC. Like other price searchers, monopolists take price from the demand curve (at the quantity where MR = MC).

Both remaining statements are false. A monopoly structure is characterized by a well-defined product for which there are no good *substitutes*. Monopolists want to maximize profits, not price.

(Study Session 4, Module 15.4, LOS 15.b)

Question #65 of 121

Which of the following is *least likely* a barrier to entry?

A) Economies of scale.

B) Few sellers.

C) Government licensing and legal barriers.

Explanation

Few sellers are a *characteristic*, not a barrier, of a price-searcher market where there are high barriers to entry. Other barriers are patents or exclusive rights of production.

(Study Session 4, Module 15.1, LOS 15.a)

Question #66 of 121

In a perfectly competitive industry, the short-run supply curve for the market is the:

A) marginal cost curve above the average variable cost curve.

B) marginal cost curve above the average total cost curve.

C) sum of the individual supply curves for all firms in the industry.

Explanation

The short-run supply curve for a *firm* is its marginal cost curve above the average variable cost curve. The short-run supply curve of the *market* is the sum of the supply curves for all firms in the industry.

(Study Session 4, Module 15.1, LOS 15.c)

Question #67 of 121

A firm operating as a price taker will:

A) be a revenue maximizer.

B) face an inelastic demand curve.

C) produce quantity where P = MR = MC.

Explanation

A firm operating as a price taker will produce quantity where MC = MR. It will maximize profit and not revenue. In the long run, it will make zero economic profits after taking into account fair return on capital.

(Study Session 4, Module 15.1, LOS 15.a)

Question #68 of 121

In the long-run, a firm operating under perfect competition will:

A) generate zero economic profit.

B) produce a quantity where marginal revenue is less than marginal cost.

C) face a vertical demand curve.

Explanation

A firm operating under conditions of perfect competition will generate zero economic profit in the long run. Firms may generate economic profits in the short run, but due to the lack of entry barriers, new competitors will enter the market and prices will adjust downward until economic profits become zero.

(Study Session 4, Module 15.1, LOS 15.b)

Question #69 of 121

Price discrimination is *most* accurately defined by which of the following? Price discrimination is the practice of charging different consumers different prices for:

A) similar products that have different price elasticities of demand.

B) similar products that have identical per-unit production costs.

C) the same product or service.

Explanation

Price discrimination is the practice of charging different consumers different prices for the same product or service. Examples include different prices for airline tickets based on whether a Saturday-night stay is involved and different prices for movie tickets based on age.

(Study Session 4, Module 15.4, LOS 15.d)

Question #70 of 121

An oligopolistic industry *least likely* has:

A) many sellers.

B) high barriers to entry.

C) large economies of scale.

Explanation

An oligopolistic industry has a few sellers with large economies of scale, a great deal of interdependence among firms, and high barriers to entry.

(Study Session 4, Module 15.1, LOS 15.a)

Question #71 of 121

Assume that a firm in an oligopoly market believes the demand curve for its product is more elastic above a specific price than below this price. This belief is *most closely* associated with which of the following models?

A) Dominant firm model.

B) Nash equilibrium model.

C) Kinked demand model.

Explanation

The kinked demand model assumes that each firm in a market believes that at some price, demand is more elastic in respect to price increases than it is to price decreases.

(Study Session 4, Module 15.3, LOS 15.d)

Question #72 of 121

For a perfectly competitive firm in the short-run, what will be the effect of an increase in market demand on equilibrium price and quantity, respectively?

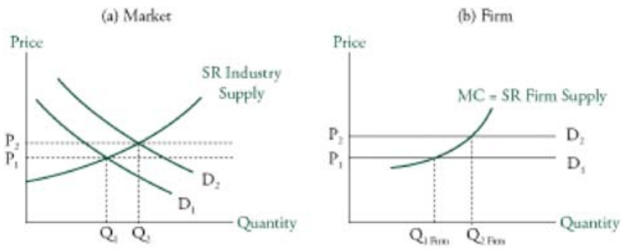
A) Increase; increase.

B) Decrease; increase.

C) Increase; decrease.

Explanation

In the short run, an increase in market demand (a shift to the right) will increase both equilibrium price and quantity.



(Study Session 4, Module 15.1, LOS 15.e)

Question #73 of 121

For price discrimination to work, the seller must face a market with all of the following characteristics EXCEPT:

A) high barriers to entry.

B) a downward sloping demand curve.

C) a way of preventing customers from purchasing the product at a lower price and reselling it at a higher price.

Explanation

Price discrimination is the practice of charging different consumers different prices for the same product or service. For price discrimination to work the seller must: 1) have a downward sloping demand curve, 2) have at least two identifiable groups of customers with different price elasticities of demand, 3) must be able to prevent customers in the lower-price group from reselling the product to customers in the higher-price group.

(Study Session 4, Module 15.4, LOS 15.d)

Question #74 of 121

Which one of the following is *least likely* a characteristic of monopolistic competition?

A) A single seller.

B) Low barriers to entry and exit.

C) Differentiated products.

Explanation

There are many sellers or producers who sell differentiated products that permit firms to attract customers without reducing price; and there are low barriers to entry.

(Study Session 4, Module 15.1, LOS 15.a)

Question #75 of 121

Which of the following statements about a monopolist is *least* accurate?

A) A profit-maximizing monopolist will supply less of his product than the amount consistent with the conditions of ideal static efficiency for an economy.

B) A monopolist will always be able to earn economic profit.

C) A profit-maximizing monopolist will expand output until marginal revenue equals marginal cost.

Explanation

Monopolists maximize profit when MR = MC. If the ATC curve lies above the demand curve, monopolists will lose money.

(Study Session 4, Module 15.4, LOS 15.b)

Question #76 of 121

Which of the following is *least* accurate regarding the allocative efficiency associated with price discrimination? Price discrimination:

A) leads to production where the sum of consumer surplus and producer surplus is greater than it would be otherwise.

B) leads to a decrease in allocative efficiency.

C) results in gains to the discriminating firm by selling to consumers with relatively inelastic demand.

Explanation

Allocative efficiency occurs when the quantity produced maximizes the sum of consumer and producer surplus. That is, where marginal benefit equals marginal cost. Price discrimination reduces the allocative inefficiency that exists when prices are greater than marginal cost by increasing output toward the quantity where price equals marginal cost. Firms gain by selling to customers with inelastic demand while still providing goods to customers with more elastic demand. This may even cause production to take place at a level where it would not take place otherwise.

(Study Session 4, Module 15.4, LOS 15.d)

Question #77 of 121

The type of economic market that features a large number of competitors offering differentiated products is *best* characterized as:

A) oligopoly.

B) perfect competition.

C) monopolistic competition.

Explanation

Monopolistic competition is used to describe markets where there are a large number of competitors producing differentiated products.

In perfect competition all firms produce identical products. In an oligopoly there is a small number of firms.

(Study Session 4, Module 15.4, LOS 15.h)

Question #78 of 121

The short-run supply curve for a firm in a perfectly competitive market is equal to the firm's:

A) ATC curve.

B) MC curve.

C) AVC curve.

Explanation

The short-run supply curve for a firm in a perfectly competitive market is equal to the firm's MC curve. A price taker will maximize profits when it produces the output level where P = MC. As price rises, its point of intersection with the MC curve indicates optimal production.

(Study Session 4, Module 15.1, LOS 15.c)

Question #79 of 121

The short-run supply curve to a firm operating under perfect competition is *most* accurately described as the segment of the:

A) average total cost (ATC) curve above the average variable cost (AVC) curve.

B) marginal cost (MC) curve above the average variable cost (AVC) curve.

C) marginal cost (MC) curve below the average total cost (ATC) curve.

Explanation

The short-run supply curve for a firm under perfect competition is the segment of its MC curve above the AVC curve.

(Study Session 4, Module 15.1, LOS 15.c)

Question #80 of 121

Which of the following describes the regulatory practice of setting prices at a level where the monopoly firm's average total cost curve intersects the demand curve?

A) Cost-of-service pricing.

B) Marginal cost pricing.

C) Average cost pricing.

Explanation

Under average cost pricing, regulators attempt to force monopolies to reduce prices to where a firm's average total cost curve intersects the market demand curve. This will increase output and decrease price, increase allocative efficiency, and ensure zero economic profit.

(Study Session 4, Module 15.4, LOS 15.b)

Question #81 of 121

Natural monopolies exist because they can produce at lower costs with greater output, which means there are economies of scale. Which of the following industries is typically a natural monopoly?

A) Oil.

B) Technology.

C) Utilities.

Explanation

With a natural monopoly average costs of production will be lowest when a single large firm produces the entire output demanded such as a utility.

(Study Session 4, Module 15.1, LOS 15.a)

Question #82 of 121

Which of the following is *least likely* a characteristic of an oligopoly?

A) There are few sellers.

B) Products can either be similar or differentiated.

C) Relatively small economies of scale.

Explanation

Oligopolies have large economies of scale and interdependence among competitors.

(Study Session 4, Module 15.1, LOS 15.a)

Question #83 of 121

Which of the following is *least likely* to be considered a feature that is common to both monopolistic competition and perfect competition?

A) Zero economic profits in the long run.

B) Low or no barriers to entry.

C) Extensive advertising to differentiate products.

Explanation

The only item listed in the question that monopolistic competition and perfect competition do not have in common is the use of advertising to differentiate their products. Extensive advertising is a key feature of monopolistic competition.

(Study Session 4, Module 15.1, LOS 15.a)

Question #84 of 121

In a market characterized by monopolistic competition, which of the following statements about advertising costs is *least* accurate?

A) Many firms spend a significant portion of their advertising budget on brand name promotion.

B) Firms' advertising costs tend to be greater than those for firms in perfect competition.

C) The average total cost attributable to advertising will increase as output increases.

Explanation

The increase in average total cost attributable to advertising decreases as output increases because a fixed cost is being averaged over a larger quantity. Advertising expenses are relatively high for firms in monopolistic competition. This is not only because firms need to inform consumers about the unique features of their products, but also to create or increase a perception of differences between products that are actually quite similar. Many firms spend a significant portion of their advertising budget on brand name promotion.

(Study Session 4, Module 15.2, LOS 15.b)

Question #85 of 121

The demand curves faced by monopolistic competitors is:

A) not sensitive to price due to absence of close substitutes.

B) inelastic due to the availability of many complementary goods.

C) elastic due to the availability of many close substitutes.

Explanation

The demand for products from monopolistic competitors is elastic due to the availability of many close substitutes. If a firm increases its product price, it will lose customers to firms selling substitute products.

(Study Session 4, Module 15.1, LOS 15.a)

Question #86 of 121

Under monopolistic competition, companies can earn positive economic profits in:

A) neither the short run nor the long run.

B) the short run but not in the long run.

C) the short run and in the long run.

Explanation

In a market characterized by monopolistic competition, companies can earn positive economic profits in the short run if the price of their product is greater than the average total cost of producing it. In the long run, because barriers to entry are low, economic profits will attract new entrants. Additional producers will drive the price lower until price equals average total cost, economic profit is zero, and new competitors no longer have an incentive to enter the market.

(Study Session 4, Module 15.2, LOS 15.b)

Question #87 of 121

Concentration measures are *most likely* to be used to:

A) measure elasticity of demand facing an industry.

B) identify the market structure of an industry.

C) analyze barriers to entry into an industry.

Explanation

Concentration measures are used to identify the market structure of an industry (perfect competition, monopolistic competition, oligopoly, or monopoly). Concentration measures do not directly indicate an industry's barriers to entry or elasticity of demand.

(Study Session 4, Module 15.3, LOS 15.g)

Question #88 of 121

A perfectly competitive firm will not expand its output beyond the quantity where:

A) the marginal cost is greater than marginal revenue.

B) the market price is equal to its marginal cost.

C) its marginal revenue is positive.

Explanation

A perfectly competitive firm will tend to expand its output so long as the market price is greater than marginal cost. In the short term and long term, profit is maximized when P = MC.

(Study Session 4, Module 15.1, LOS 15.b)

Question #89 of 121

Even though the producer surplus increases under a monopoly scenario, relative to one of perfect competition, the consumer surplus decreases by:

A) an equal amount.

B) a greater amount.

C) a lesser amount.

Explanation

The consumer surplus decreases by a greater amount than the producer surplus increases, with the difference representing a deadweight loss.

(Study Session 4, Module 15.4, LOS 15.d)

Question #90 of 121

Which of the following *most* accurately describes the competitive structure that is characterized by a firm that operates with the lowest average total cost and has the capacity to produce all of an industry's output?

A) Competitive monopoly.

B) Natural monopoly.

C) Oligopoly.

Explanation

A natural monopoly is characterized by a single firm within the industry that has sufficient capacity to meet the entire demand of an industry because at that scale the lowest average total cost is achieved.

(Study Session 4, Module 15.4, LOS 15.h)

Question #91 of 121

Which of the following is *most likely* to be considered a characteristic of an oligopolistic industry?

A) Many sellers.

B) A great deal of interdependence among firms.

C) Few barriers to entry.

Explanation

An oligopolistic industry has a great deal of interdependence among firms. One firm's pricing decisions or advertising activities will affect the other firms' demand curves.

(Study Session 4, Module 15.1, LOS 15.a)

Question #92 of 121

The practice of charging different consumers different prices for the same product or service is called:

A) variable pricing.

B) price discrimination.

C) price searching.

Explanation

The practice of charging different consumers different prices for the same product or service is called price discrimination.

(Study Session 4, Module 15.4, LOS 15.d)

Question #93 of 121

Which of the following statements about price takers and price searchers is *most* accurate?

A) In the long run, both price takers and price searchers will have zero economic profits.

B) In the long run, both price takers and price searchers maximize profits at the quantity corresponding to the minimum point on the average total cost curve.

C) Price takers maximize profits at the point price = marginal revenue = marginal cost.

Explanation

Because price takers face a horizontal demand curve, they must take price as given and thus maximize profits when P = MR = MC.

The other statements are false. Although firms engaged in pure competition (price takers) maximize profits at the quantity corresponding to the minimum point on the average total cost curve (ATC) (in the long run), this is not necessarily true for price searchers. Price searchers face a downward-sloping demand curve. They produce at the quantity MR = MC and take price from the demand curve. The demand curve may be above the ATC curve. The potential allocative inefficiency of a price searcher engaged in monopolistic competition includes the social cost of *not* producing where P = MC. This potential allocative inefficiency may be outweighed by the benefits of product diversity. Some price searchers, (monopolists, for example), can earn positive economic profits in the long run.

(Study Session 4, Module 15.2, LOS 15.d)

Question #94 of 121

The market structure in which a firm's optimal pricing strategy depends on the responses of other firms is:

A) Monopolistic competition.

B) Oligopoly.

C) Perfect competition.

Explanation

Interdependence of firms is a characteristic of an oligopoly market. Optimal pricing for a firm in an oligopoly market depends on expectations of how its competitors will respond.

(Study Session 4, Module 15.4, LOS 15.f)

Question #95 of 121

The short-run supply curve for a purely competitive market:

A) slopes downward to the right.

B) is a horizontal line.

C) slopes upward to the right.

Explanation

The short-run supply curve for a purely competitive market slopes upward to the right. This reflects the fact that firms in the industry will produce more when the price rises.

(Study Session 4, Module 15.1, LOS 15.c)

Question #96 of 121

In the long-run, after all firms in a perfectly competitive industry have adopted new technology, the:

A) individual firm supply will increase as demand decreases.

B) price will equal minimum average total cost.

C) price will be set where average variable cost is equal to marginal revenue.

Explanation

After some firms in an industry adopt a technological change, the existing firms that use the old technology will experience losses and either adopt the technology or exit the industry. Long-run equilibrium with price equal to minimum average total cost for the new technology will be established.

(Study Session 4, Module 15.1, LOS 15.e)

Question #97 of 121

Which of the following is the *most likely* result of a technological improvement in a perfectly competitive industry?

A) The costs for individual firms increase.

B) The industry supply curve shifts to the right.

C) Individual firms' supply curves shift to the left.

Explanation

When individual firms implement technological change, their costs decline and their supply (cost) curve shifts to the right. At the lower costs, firms are willing to supply a given quantity at a reduced price. The lower cost structure for the individual firms shifts the industry supply curve to the right.

(Study Session 4, Module 15.1, LOS 15.e)

Question #98 of 121

Under perfect competition, the short-run market supply curve is *most accurately* described by which of the following statements? The market short-run supply curve is the:

A) average of the quantities at each price along the marginal cost curve for all firms in a given industry.

B) sum of the quantities at each price along the average total cost curve for all firms in a given industry.

C) sum of the quantities at each price along the marginal cost curves for all firms in a given industry.

Explanation

The short-run market supply curve is the horizontal sum of the marginal cost curves for all firms in a given industry. It is the sum of all quantities from all firms at each price along each firm's marginal cost curve.

(Study Session 4, Module 15.1, LOS 15.c)

Question #99 of 121

In the short run, price searchers maximize profits by producing output where marginal revenue (MR):

A) is greater than marginal costs (MC) and charging a price based on the demand curve.

B) equals marginal costs (MC) and charging a price based on the demand curve.

C) equals marginal costs (MC) and charging a price based on the average total cost (ATC) curve.

Explanation

Price searchers maximize profits by producing an amount of output where MR equals MC and charging a price based on the demand curve. In the short run, profits or losses occur depending upon where the individual firm's ATC curve is in relationship to the demand curve. In the long run, economic profits are zero due to the low barriers to entry. Important note for the test: regardless of whether a firm is a price taker, price searcher, monopoly, or oligopoly, all firms will seek to maximize profits and want to produce the ouput where marginal revenue equals marginal cost.

(Study Session 4, Module 15.2, LOS 15.b)

Question #100 of 121

A firm operating under perfect competition will experience economic losses when which of the following conditions exists?

A) Marginal revenue is greater than average total cost.

B) Market price is less than average total cost.

C) Marginal cost is less than average total cost.

Explanation

Under perfect competition, a firm will experience economic losses when its selling price is less than average total cost.

(Study Session 4, Module 15.1, LOS 15.b)

Question #101 of 121

If a profit maximizing firm finds that its marginal revenue exceeds its marginal cost, it should increase output:

A) if it is a price taker, but not if it is a price searcher.

B) if it is a price searcher, but not if it is a price taker.

C) regardless of whether it is a price taker or a price searcher.

Explanation

Any firm will maximize profits by producing the output where MR = MC.

(Study Session 4, Module 15.2, LOS 15.d)

Question #102 of 121

In which of the following market structures is price *least likely* to be greater than marginal cost?

A) Perfect competition.

B) Monopolistic competition.

C) Monopoly.

Explanation

In a perfect competition price is equal to marginal cost and marginal revenue when a firm is producing at its profit maximizing quantity. In monopolies and markets characterized by monopolistic competition, price is greater than marginal cost and marginal revenue when producing at the profit maximizing quantity.

(Study Session 4, Module 15.4, LOS 15.f)

Question #103 of 121

Which one of the following is *most likely* to contribute to the presence of monopoly in an industry?

A) Inefficiency attributable to bureaucratic decision-making procedures in the industry.

B) Legal barriers to entry into the industry.

C) Diseconomies of scale.

Explanation

An example of an industry with legal barriers is utility firms, which are granted exclusive rights to supply electricity in certain areas.

(Study Session 4, Module 15.1, LOS 15.a)

Question #104 of 121

In which of the following industry structures is a firm *least likely* able to increase its total revenue by decreasing the price of its output?

A) Monopolistic competition.

B) Oligopoly.

C) Perfect competition.

Explanation

Under perfect competition each firm is selling all of its output at the market price. Therefore any firm that sells its output at less than the market price will decrease its total revenue. Under monopolistic competition or oligopoly, firms are price searchers. Decreasing the price will increase the quantity a firm sells and may increase or decrease total revenue.

(Study Session 4, Module 15.4, LOS 15.f)

Question #105 of 121

An oligopolistic firm:

A) is likely to be formed when the minimum-cost output is only a small portion of the market output.

B) will consider the potential response of its rivals when making business decisions.

C) will seldom use product quality as a competitive weapon.

Explanation

Oligopolists are highly dependent upon the actions of their rivals when making business decisions. Price determination in the auto industry is a good example. Automakers tend to play "follow the leader" and announce price increases in close synchronization. They are not working explicitly together, but the actions of one producer have a large impact on the others when products are differentiated, quality may be a competitive strategy.

(Study Session 4, Module 15.1, LOS 15.a)

Question #106 of 121

A perfect competition has all of the following characteristics *EXCEPT*:

A) barriers to entry don't exist.

B) a large number of independent firms.

C) a differentiated product.

Explanation

In a perfectly competitive market all the firms produce a homogeneous product.

(Study Session 4, Module 15.1, LOS 15.a)

Question #107 of 121

A market that is characterized by monopolistic competition is *least likely* to feature:

A) a small number of independent sellers.

B) low barriers to entry.

C) sellers that produce a differentiated product.

Explanation

In monopolistic competition, there is a large, not small, number of independent sellers.

(Study Session 4, Module 15.1, LOS 15.a)

Question #108 of 121

One way in which monopolistic competition can be distinguished from perfect competition is that in monopolistic competition:

A) each firm faces a perfectly elastic demand curve. ✗

B) marginal revenue is greater than marginal cost at the quantity produced. ✗

C) price is greater than marginal cost. ✓

Explanation

In monopolistic competition, price is greater than marginal cost (i.e., firms can realize a markup). In perfect competition, P = MC. Firms in monopolistic competition are price searchers, i.e., each firm faces a downward sloping demand curve. Regardless of the market structure, all firms produce the quantity at which marginal revenue equals marginal cost.

(Study Session 4, Module 15.1, LOS 15.a)

Question #109 of 121

Which of the following is *least likely* a condition of a perfectly competitive market?

A) Sellers make economic profits. ✓

B) Firms face elastic demand curves. ✗

C) Indistinguishable products. ✗

Explanation

The only item listed that is NOT a condition of a perfectly competitive market is that sellers make economic profits. In fact, sellers do not make economic profit after taking into account their opportunity costs.

(Study Session 4, Module 15.1, LOS 15.a)

Question #110 of 121

A profit maximizing firm will expand output as long as marginal revenue is:

A) less than marginal cost. ✗

B) greater than marginal cost. ✓

C) greater than average fixed cost. ✗

Explanation

A purely competitive firm will tend to expand its output so long as the market price (marginal revenue) is greater than marginal cost. In the short term and long term, profit is maximized when P = MC.

(Study Session 4, Module 15.1, LOS 15.b)

Question #111 of 121

Which of the following is *least* accurate regarding product development and marketing for firms under monopolistic competition?

A) Relative to other types of competition, product innovation is critical to the pursuit of economic profits.

B) Brand names can provide consumers with information regarding the quality of firm's products.

C) Firms that bring new and innovative products to the market face relatively more elastic demand curves than their competitors.

Explanation

Firms under monopolistic competition face less elastic demand curves when they introduce new and innovative products. This enables them to increase price and earn economic profits. However, close substitutes and imitations will eventually erode the economic profit from a new product. So, firms must constantly seek innovative product features that make their products relatively more desirable than their competitors.

(Study Session 4, Module 15.1, LOS 15.a)

Question #112 of 121

A technology that all of the firms in a perfectly competitive industry are using in their production process has been banned by new legislation. What will *most likely* be the effect if these firms stop using this technology?

A) Profit will no longer be maximized at the level of output where marginal cost is equal to the market price.

B) The quantity that the industry will supply at a given price will be reduced.

C) Firms will adopt a different technology that reduces their costs of production.

Explanation

If all the firms in a competitive industry have adopted a technology for production, it is presumably the technology that minimizes their production costs. If that technology is outlawed, firms will have to revert to the second-best technology, which will increase their costs of production. This is represented by a shift to the left in the industry supply curve. At each price level, the quantity supplied will be less than before.

Just as a technological improvement will cause firms that adopt it early to earn economic profits that attract new entrants to the industry, prohibition of the cost-minimizing technology will cause economic losses and typically force some firms to exit the industry. Under perfect competition, profit is always maximized at the level of output where marginal cost equals the market price. The state of technology is one factor that determines the level of output at which this occurs.

(Study Session 4, Module 15.1, LOS 15.e)

Question #113 of 121

An oligopoly is characterized by all of the following *EXCEPT*:

A) significant barriers to entry.

B) a large number of sellers.

C) large economies of scale.

Explanation

Oligopolies consist of a small number of sellers. Their products may be either similar or differentiated.

(Study Session 4, Module 15.1, LOS 15.a)

Question #114 of 121

In a natural monopoly:

A) the average total cost of production continually declines with increased output.

B) the price charged by a monopolist is determined by the intersection of the demand curve with the marginal cost curve.

C) one firm controls all natural resources.

Explanation

A monopoly situation in which the average total cost of production continually declines with increased output is called a natural monopoly.

(Study Session 4, Module 15.4, LOS 15.b)

Question #115 of 121

The *most* effective way to assess the impact of a potential merger on the market structure of an industry is to:

A) calculate the Hirfindahl-Hirschman Index.

B) calculate the n-firm concentration ratio.

C) analyze barriers to entry.

Explanation

The Hirfindahl-Hirschman Index is more sensitive to mergers than the n-firm concentration ratio. Although barriers to entry for an industry are important in assessing market structure, they are not necessarily related to the impact of a merger.

(Study Session 4, Module 15.3, LOS 15.g)

Question #116 of 121

In the long run, a perfectly competitive firm will earn:

A) large economic profits.

B) zero economic profits.

C) small economic profits.

Explanation

Zero economic profits means the firm is earning a normal rate of return and a positive accounting profit. Since perfectly competitive firms have no barriers to entry, economic profits cannot be positive in the long run because new competitors will enter the market place driving down economic profits to zero.

(Study Session 4, Module 15.1, LOS 15.b)

Question #117 of 121

If the market demand for a product decreases in a competitive market, then the quantity supplied by an individual firm will:

A) decrease and firms will exit the market in the long run.

B) decrease and firms will enter the market in the long run.

C) increase and firms will enter the market in the long run.

Explanation

If the market demand for a product decreases in a competitive market, then the quantity supplied by an individual firm will decrease and firms will exit the market in the long run because the price will be less than average total costs.

(Study Session 4, Module 15.1, LOS 15.e)

Question #118 of 121

Which of the following statements regarding monopolies is *least* accurate?

A) If a monopolist produces the quantity of output for which marginal cost equals marginal revenue, it will earn an economic profit.

B) Monopolists are price searchers and must experiment with different prices to find the one that maximizes profit.

C) For price discrimination to increase economic profit, the seller must identify at least two groups of customers, each with a different price elasticity of demand.

Explanation

Monopolists expand output until marginal revenue equals marginal cost. However, to realize an economic profit, the demand curve must lie above the firm's average total cost curve at that quantity.

(Study Session 4, Module 15.4, LOS 15.d)

Question #119 of 121

The short-run supply curve for a price taker firm is the portion of the marginal cost (MC) curve:

A) above the average total cost (ATC) curve.

B) below the average variable cost (AVC) curve.

C) above the average variable cost (AVC) curve.

Explanation

The short-run supply curve for a firm is its MC curve above the AVC curve. Price takers will produce where price (P) equals MC. At prices below the AVC curve the firm will not be able to remain in operation. Above the ATC curve the firm is making economic profits and will continue to expand production along the MC curve.

(Study Session 4, Module 15.1, LOS 15.c)

Question #120 of 121

When a firm operates under conditions of perfect competition, marginal revenue always equals:

A) total cost.

B) average variable cost.

C) price.

Explanation

When a firm operates under conditions of perfect competition, marginal revenue always equals price. This is because, in perfect competition, price is constant (a horizontal line) so that marginal revenue is constant.

(Study Session 4, Module 15.1, LOS 15.b)

Question #121 of 121

Which of the following *most* accurately describes a market structure that has one seller of a specific, well-defined product that has no good substitutes?

A) Monopoly.

B) Oligopoly.

C) Perfect competition.

Explanation

A monopoly is characterized by one seller, a specific and well-defined product for which there is no good substitutes, and high barriers to entry.

(Study Session 4, Module 15.4, LOS 15.h)