Answers to End-of-Chapter Review Questions

1. The three idealized market structures with market power are pure monopoly (only one seller), monopolistic competition (many sellers, but they sell slightly different things), and oligopoly (so few sellers that they each need to watch what the others are doing).

2. Pure monopoly is characterized by there being only one seller, the good being sold has no close substitutes, and barriers of entry.

3. Three types of barriers to entry are economic barriers (high fixed costs, network externalities, economies of scale), legal barriers (copyrights, franchises, patents, trademarks), and deliberate barriers (exclusionary practices, predatory pricing, dumping).

4. A pure monopolist is imagined to maximize profits by producing where marginal revenue equals marginal cost but charging as high a price as it can on the market demand curve.

5. Monopolists are inefficient because deadweight loss is created (the price level exceeds marginal cost), innovations may be reduced, costs may be spent to maintain barriers to entry, and rent-seeking behavior.

6. Monopoly market power generally leads to inefficiencies in the form of deadweight loss. The monopolist produces at an output level at which price exceeds marginal cost and society could gain from increased output of the product. See Figure 12.2.

7. Four cases in which a monopoly might be efficient are natural monopolies (economies of scale dictate that one firm can produce at the minimum per-unit cost), intellectual property (the potential benefits of patents, trademarks, etc. actually encourage innovations), pressure to appear competitive (firms worry that too-high monopoly profits will attract too much attention so they operate more like a competitive firm), and perfect price discrimination (the monopolist is able to charge every buyer his or her maximum willingness to pay).

8. A price-discriminating seller charges different prices to different buyers, reducing or eliminating consumer surplus. See Figure 12.3.

9. Monopolistic competition is characterized by numerous small buyers and sellers, each seller’s product is somewhat different from that offered by the other sellers, producers of the good or service can freely enter or exit the industry, and buyers and sellers have perfect information.

10. A monopolistically competitive firm is expected to maximize profits by producing where marginal revenue equals marginal cost, charging a price set by the demand curve for its product, and trying to engage in nonprice competition.
11. Monopolistically competitive markets are not efficient because firms, compared to perfectly competitive firms, will produce lower levels of output and charge higher prices.

12. Oligopoly is characterized by a market dominated by only a few sellers and difficult entry.

13. Two theories used to describe the behavior of oligopolists are strategic interaction and game theory (firms plot their moves while considering other firms’ behavior), and collusion, cartels and price leadership (firms cooperate and form a monopoly for pricing purposes).