

ANSWERS

Question #1: Monopolistic Competition

Question 1: 15 points (6 + 2 + 3 + 4)

(a) 6 points (1 point for each graph showing the appropriate cost curves, 1 point each for identifying profit maximizing quantity at $MC=MR$, and 1 point each for showing price for each firm—read off the correct demand curve)

- 1 point each: two graphs with appropriate cost curves
- 1 point each: Q indicated for each firm where $MR=MC$
- 1 point each: P for each firm read off the correct D curve at correct Q

(b) 2 points (1 point for the price comparison and 1 point for quantity comparison)

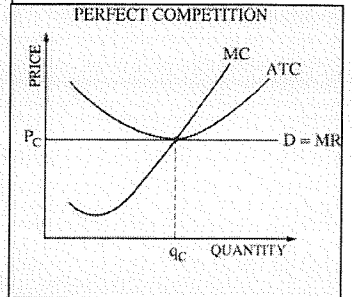
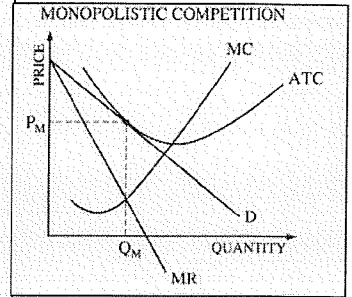
- 1 point: P in perfect competition is lower than P in monopolistic competition.
- 1 point: Quantity in perfect competition is greater than in monopolistic competition

(c) 3 points (1 point each for indicating zero economic profit for each firm and 1 point for explanation)

- 1 point: firm in perfect competition earns zero economic profit
- 1 point: firm in monopolistic competition earns zero economic profit
- 1 point: entry of new firms increases industry output, individual firm's output decreases, prices will fall to level of ATC (Correct explanation consistent with the exit of firms is also accepted)

(d) 4 points (1 point each for correctly identifying elasticity for each firm, 1 point each for correct explanation)

- 1 point: for the perfectly competitive firm, demand is perfectly elastic
- 1 point: because P is constant, the percentage change in P is zero
- 1 point: for the monopolistically competitive firm demand is elastic
- 1 point: MR is positive in the elastic portion of the demand curve



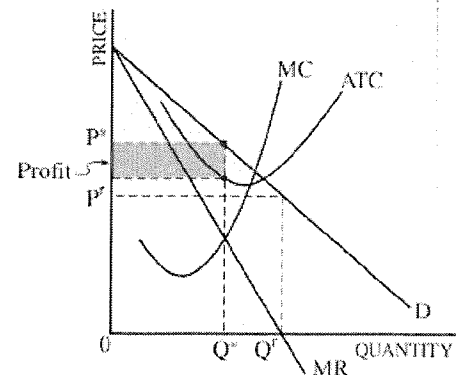
Question #2: Monopoly

9 points (1+4+2+1+1)

(a) 1 point: Brunelle must lower its price on all units to sell additional units. Thus, the additional revenue from the last unit sold is the price *minus* the loss on units that would otherwise sell at a higher price.

(b) 4 points:

- 1 - Correctly labeled graph with downward-sloping demand and marginal revenue below demand
- 1 - For Q^* at $MC=MR$
- 1 - For P^* at the height of the demand curve above $MC=MR$
- 1 - For shading the correct area of profit $(P^*-ATC)Q^*$



(c) 2 points:

- 1 - For Identifying Q^f at $MR = 0$
- 1 - For identifying P^f at the height of the demand curve above Q^f

(d) 1 point: Brunelle is not producing the allocatively efficient level of output because $P > MC$ ($MSB > MSC$)

(e) 1 point: Brunelle's demand curve will shift inward to the left