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CONCEPT: CHARACTERISTICS OF MONOPOLISTIC COMPETITION

● A market is in ***monopolistic competition*** when:

□ Nature of Good: The goods for sale are ____________, but not identical

- Products are said to be ***differentiated***

□ Setting Price: The sellers are ________________ to an extent

- Only _______ producer of the _____________ good

- There are _____________ producers of ____________ goods

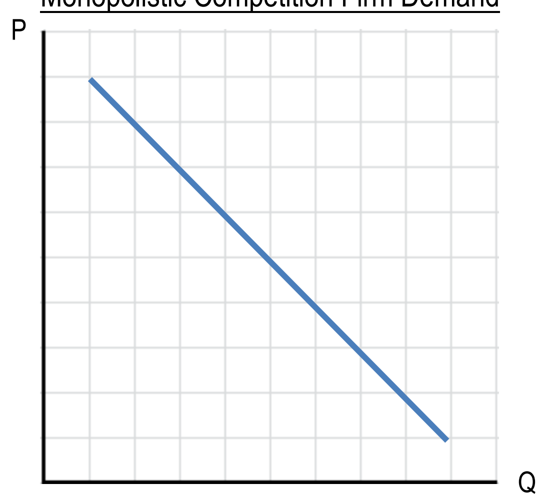
- ***Market power*** – the ability of one person (or group) to have substantial influence on ____________

□ Entry and Exit: Firms can ______________ enter and exit the market.

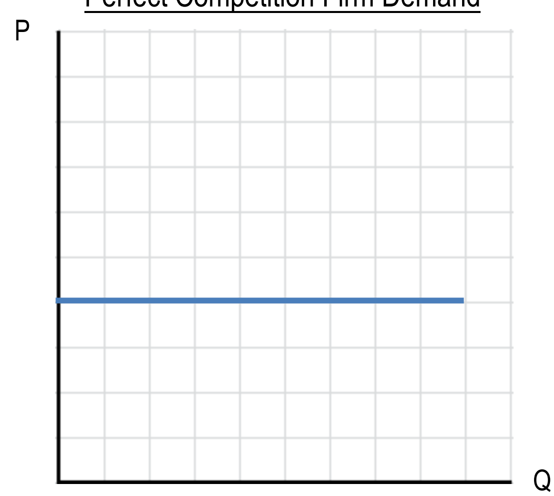
□ Example Product:

● In monopolistic competition, the demand curve facing the individual firm is downward sloping.

Monopolistic Competition Firm Demand



Perfect Competition Firm Demand

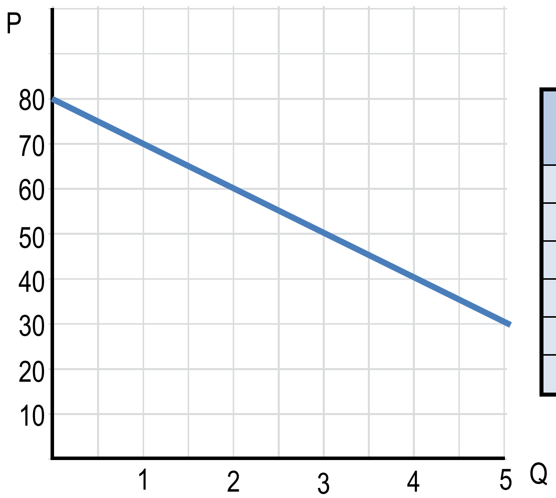


Monopolistic Competition Firm	**Perfect Competition Firm**
Demand Curve → ____________________	Demand Curve → ____________________
Increase Output → ____________________	Increase Output → ____________________
P = AR	P = AR = MR

CONCEPT: MONOPOLISTIC COMPETITION REVENUE

- Firms in monopolistic competition face a ______________________ demand curve. A price decrease has two effects:
  - □ ***Price effect*** – The firm earns _________ revenue per unit sold because of the price decrease
  - □ ***Output effect*** – The firm earns _________ revenue because it sells more quantity at the lower price
- A monopolistically competitive firm's marginal revenue is always ___________ than the price of the good

EXAMPLE: A market for cable subscriptions



Subscribers (Q)	Price (P)	Total Revenue (TR = P x Q)	Average Revenue (AR = TR/Q = P)	Marginal Revenue (MR = ∆TR/∆Q)
0	80			
1	70			
2	60			
3	50			
4	40			
5	30			

PRACTICE: Which of the following statements is true?

a) A monopolistically competitive firm's demand curve is equal to the market demand curve.
b) For a monopolistically competitive firm, an increase in the quantity sold will always increase total revenue.
c) The barriers to market entry in perfect competition are more stringent than those for monopolistic competition.
d) A monopolistically competitive firm's marginal revenue is less than its average revenue.

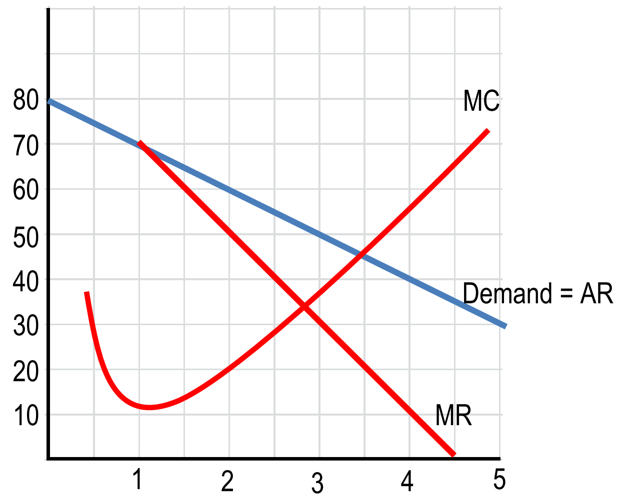
PRACTICE: In monopolistic competition, firms have _______ power to set the price of its produce because _______

a) No; there are no barriers to entry
b) Some; of product differentiation
c) No; of product differentiation
d) Some; there are barriers to entry

CONCEPT: PROFIT ON THE GRAPH

● The ***profit-maximizing quantity*** will always occur where ____________________

□ Profit-maximizing could also mean ______________________

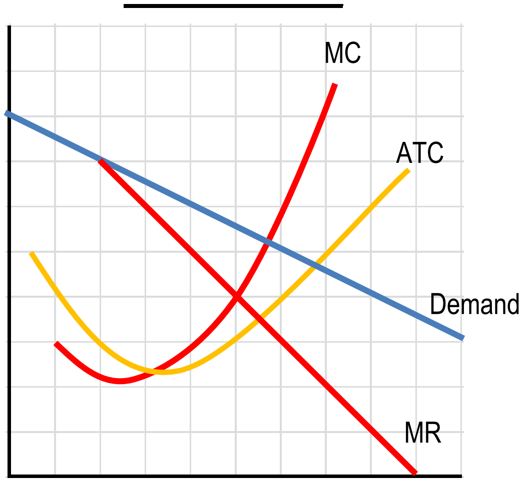


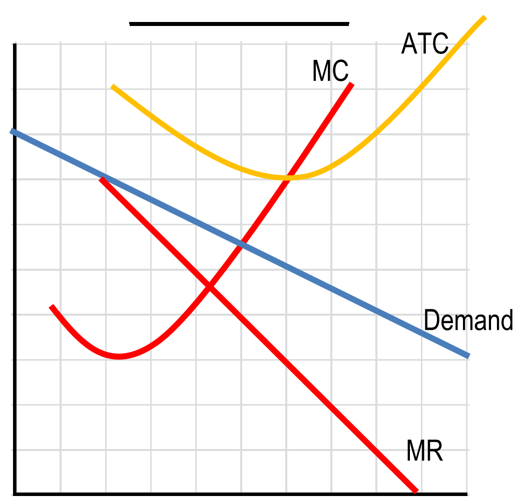
● The ***profit or loss*** is defined by the following formula:

$$Profit = (Price - ATC) * Quantity$$

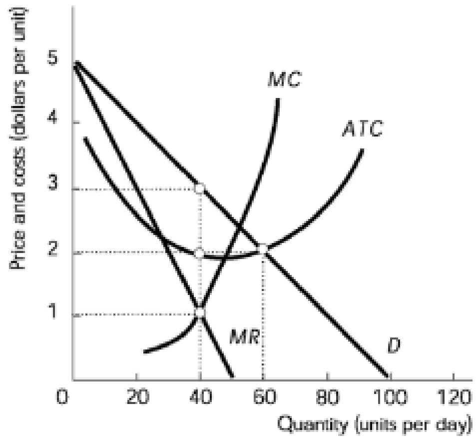
Step 1: Find profit-maximizing quantity where MR = MC

Step 2: Find Price (on Demand Curve) and ATC at that quantity





PRACTICE: Use this graph to answer the following questions:



The firm's profit-maximizing output in monopolistic competition is:

a) 100 units
b) 40 units
c) 60 units
d) 80 units

The price that the firm will charge at its profit-maximizing output is:

a) $1
b) $2
c) $3
d) $4

In the above figure, the monopolistically competitive firm earns an economic profit of:

a) $0
b) Between $0 and $50 per day
c) Between $50 and $100 per day
d) More than $100 per day

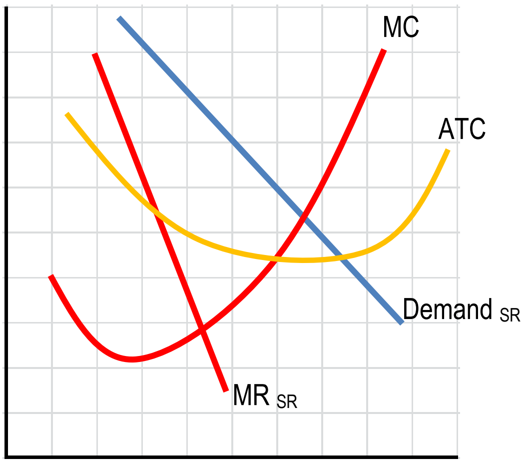
PRACTICE: In the short run, a monopolistically competitive firm chooses

a) Its quantity but not its price
b) Its price but not its quantity
c) Neither its price nor its quantity
d) Both its price and its quantity

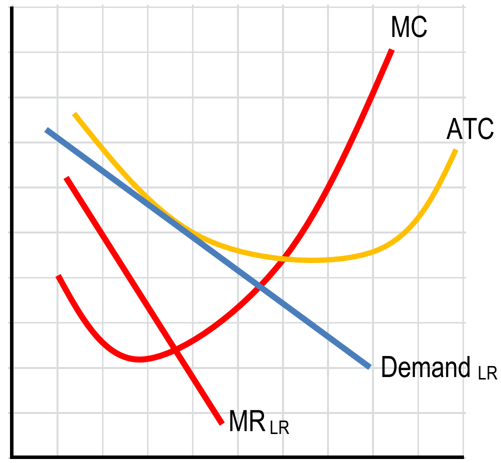
CONCEPT: MONOPOLISTIC COMPETITION IN THE LONG RUN

● As with perfect competition, the entry and exit of competitors leads to _________ economic profit in the long run.

Short-Run Profits



Market Entry Until Profits Are Eliminated



● The entry of firms causes an increase in the availability of ________________

□ Some of the firm's customers go to the new firm → Demand shifts ____________

□ Customers become more sensitive to your price changes → Demand becomes _________ elastic

● In long-run equilibrium, the firm _______________ produce at the minimum cost.

□ Only a firm facing a horizontal demand curve (i.e. ________________) can achieve minimum-ATC in long-run

□ Excess capacity

PRACTICE: New firms will enter a monopolistically competitive market if

a) Marginal revenue is greater than marginal cost
b) Marginal revenue is greater than average total cost
c) Price is greater than marginal cost
d) Price is greater than average total cost

PRACTICE: What is true of a monopolistically competitive market in long-run equilibrium?

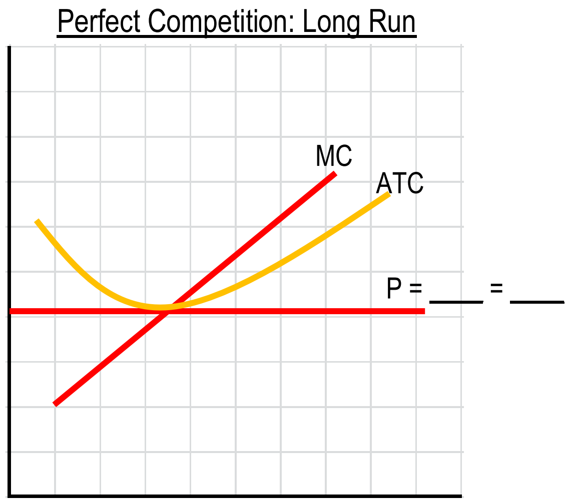
a) Price is greater than marginal cost
b) Price is equal to marginal revenue
c) Firms make positive economic profits
d) Firms produce at the minimum of average total cost

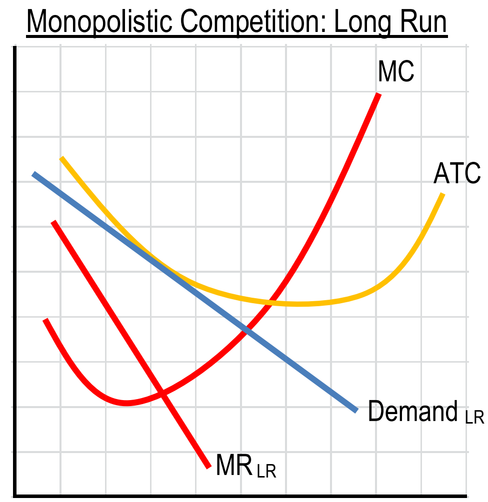
CONCEPT: EFFICIENCY IN MONOPOLISTIC COMPETITION

● Monopolistically competitive markets ____________ achieve productive and allocative efficiency.

□ ***Productive Efficiency*** – producing at the ______________________

- The lowest possible cost is ____________________________





- In the long run, perfect competition forces firms to produce at ____________________

- In the long run, monopolistically competitive firms produce a quantity _________ the minimum-ATC

□ ***Allocative Efficiency*** – production represents ___________________________

- Producing up to the point that the ______ = ______

No Allocative Efficiency in Monopolistic Competition

1. The marginal benefit is represented by the _____________________
2. The marginal cost is represented by the _______________________
3. Firms produce where MR=MC, which is _________ where the MC and demand curve intersect.

PRACTICE: The loss of efficiency that occurs in monopolistic competition has to be weighed against the gain of

a) An increase in employment
b) Higher wages for employees
c) Greater product variety
d) Reduced environmental damage

CONCEPT: ADVERTISING

● Monopolistically competitive firms use advertising to ______________ their product and create _____________

□ Advertising allows firms to:

- Convey prices
- Inform consumers of new products
- Tell consumers where you are located

□ Critics of advertising argue that advertisements are generally ________________ rather than informational

- Example: Corona Beer and the Beach

● ***Brand names*** help firms differentiate their product. They also help consumers ensure the ____________ of the product

□ Firms have an incentive to maintain the quality of their product

● Advertising also acts as a ***signal*** of ______________

□ Consumers rationally think, "if they are willing to spend this much on advertising, the product must be good!"

□ Advertising causes consumers to ___________ the product

- If it is good, they will keep buying
- If it is bad, they will not buy again

PRACTICE: If advertising makes consumers more loyal to particular brands, it could ________ the elasticity of demand and __________ the markup of price over marginal cost.

a) Increase, increase
b) Increase, decrease
c) Decrease, increase
d) Decrease, decrease

CONCEPT: FOUR MARKET MODEL SUMMARY

	Monopolistic Competition
Number of Firms	
Examples	
Barriers to Entry	
Profit-Maximizing Quantity	
Long-Run Profitability	
Relation of Price (P=AR) and MR	
Relation of Price and MC	