

## Module 12.2 Quiz - Answers

### Question 1

The demand for products from monopolistic competitors is relatively elastic due to:

- A) high barriers to entry.
- B) the availability of many close substitutes. ✓**
- C) the availability of many complementary goods.

#### Explanation

The demand for products from firms competing in monopolistic competition is relatively 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 at lower prices.

(Module 12.2, LOS 12.c)

### Question 2

Compared to a perfectly competitive industry, in an industry characterized by monopolistic competition:

- A) both price and quantity are likely to be lower.
- B) price is likely to be higher, and quantity is likely to be lower. ✓**
- C) quantity is likely to be higher, and price is likely to be lower.

#### Explanation

Monopolistic competition is likely to result in a higher price and lower quantity of output compared to perfect competition.

(Module 12.2, LOS 12.c)

### Question 3

A firm will *most likely* maximize profits at the quantity of output for which:

- A) price equals marginal cost.
- B) price equals marginal revenue.
- C) **marginal cost equals marginal revenue.** ✓

#### Explanation

The profit-maximizing output is the quantity at which marginal revenue equals marginal cost. In a price-searcher industry structure (i.e., any structure that is not perfect competition), price is greater than marginal revenue.

(Module 12.2, LOS 12.c)

### Question 4

An oligopolistic industry has:

- A) few barriers to entry.
- B) few economies of scale.
- C) **a great deal of interdependence among firms.** ✓

#### 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.

(Module 12.2, LOS 12.d)

### Question 5

Consider a firm in an oligopoly market that believes the demand curve for its product is more elastic above a certain price than below this price. This belief fits *most appropriately* to which of the following models?

- A) Cournot model.
- B) Dominant firm 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 for a price increase than for a price decrease.

(Module 12.2, LOS 12.d)

### Question 6

Consider an agreement between France and Germany that will restrict wine production so that maximum economic profit can be realized. The possible outcomes of the agreement are presented in the following table.

	Germany complies	Germany defaults
France complies	France gets €8 billion Germany gets €8 billion	France gets €2 billion Germany gets €10 billion
France defaults	France gets €10 billion Germany gets €2 billion	France gets €4 billion Germany gets €4 billion

Based on the concept of a Nash equilibrium, the *most likely* strategy followed by the two countries with respect to whether they comply with or default on the agreement will be:

- A) **both countries will default.** ✓
- B) both countries will comply.
- C) one country will default and the other will comply.

#### Explanation

The Nash equilibrium results when each nation pursues the strategy that is best, given the strategy that is pursued by the other nation.

- Given that Germany complies with the agreement: France will get €8 billion if it complies, but €10 billion if it defaults. Therefore, France should default.
- Given that Germany defaults: France will get €2 billion if it complies, but €4 billion if it defaults. Therefore, France should default.

Because France is better off in either case by defaulting, France will default. Germany will follow the same logic and reach the same conclusion.

(Module 12.2, LOS 12.d)