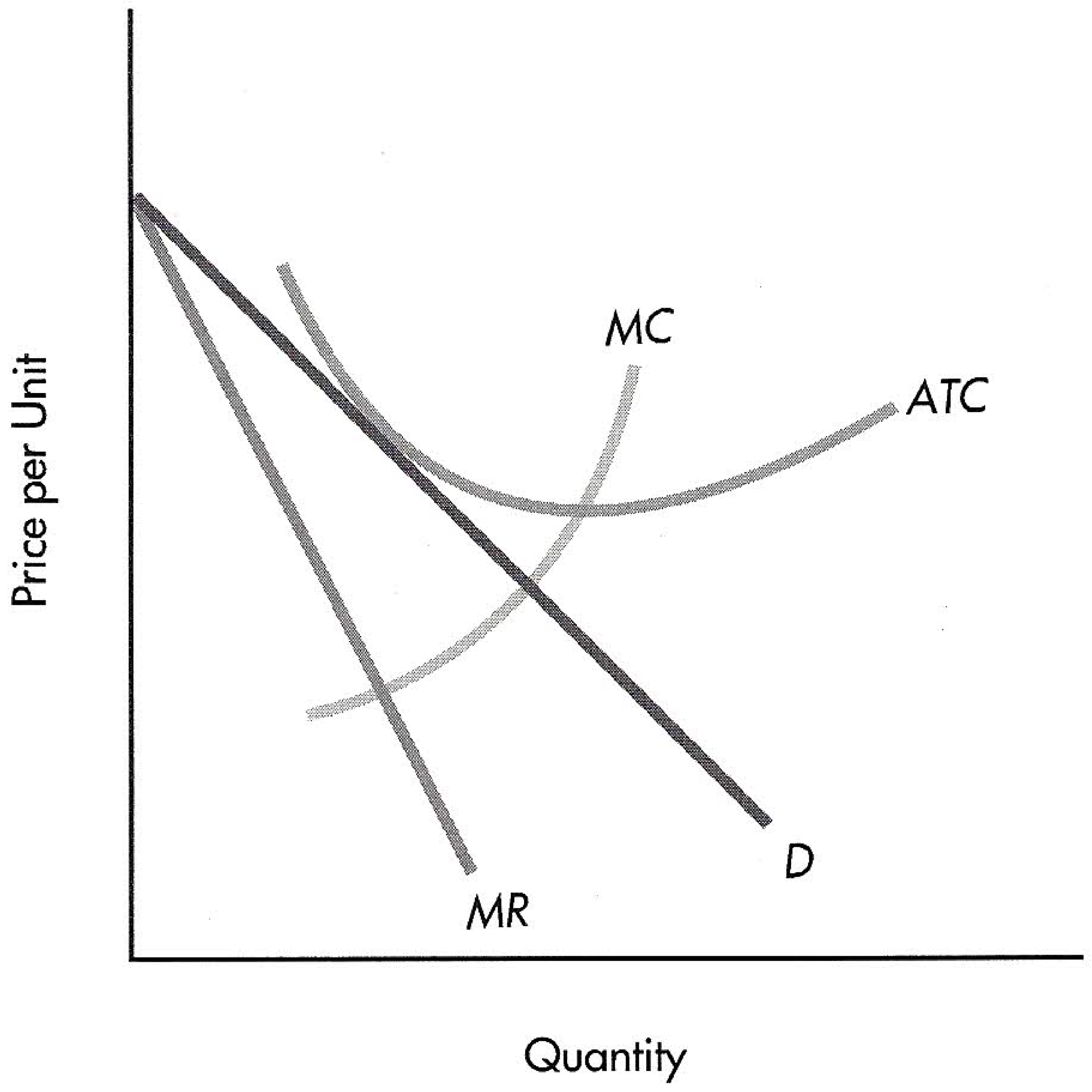
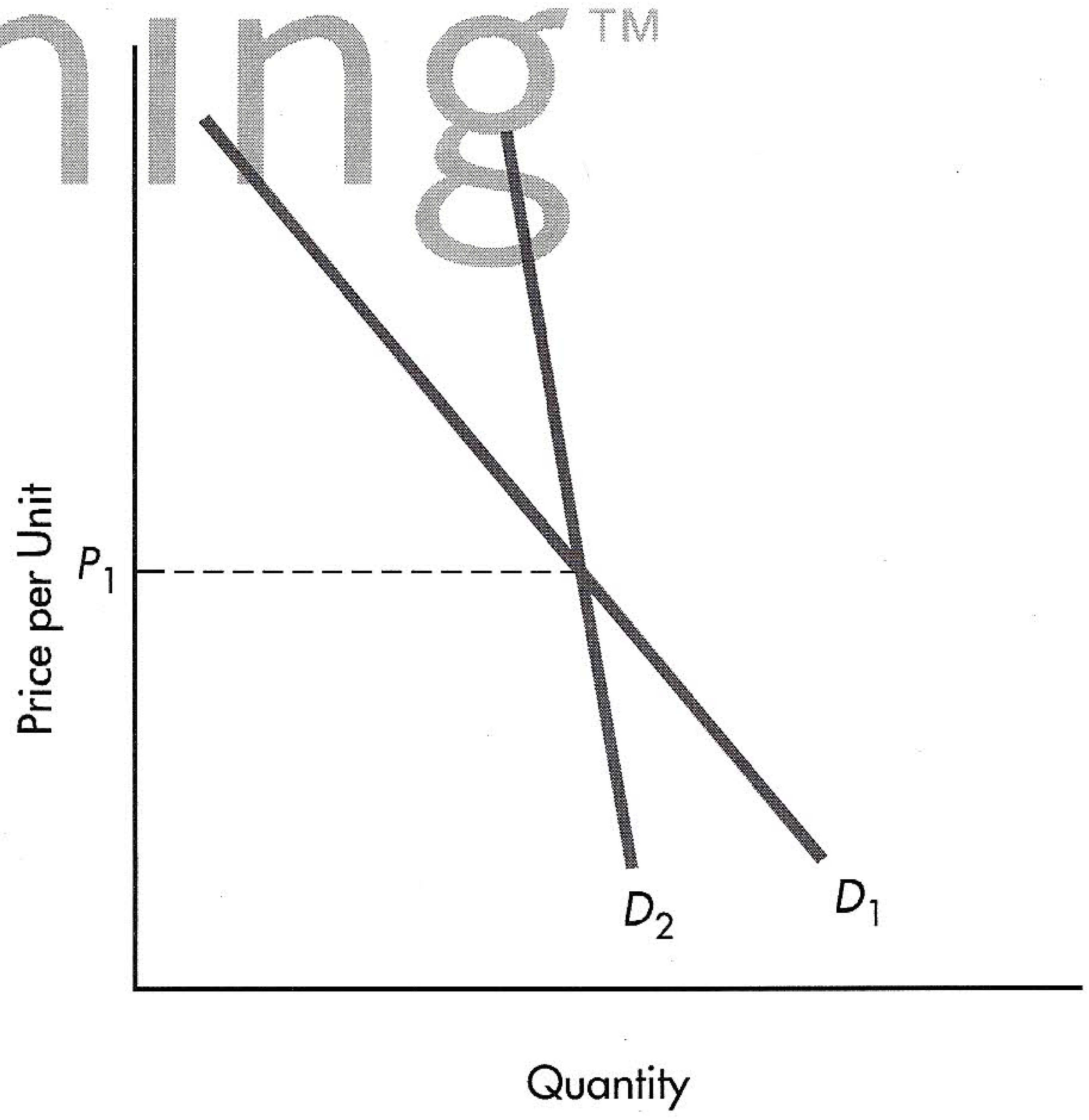
Exercises

1. Disney, Universal, and MGM, among others, have movie studios in Hollywood. Each of these major studios also has one or several subsidiary studios. Disney, for example, has Touchstone. What market structure best describes these movie production companies? Why would each studio have subsidiary studios? Consider the movies that have come out under the Disney name and those that have come out under Touchstone. Are they different?
2. Suppose that Disney was experiencing above-normal profits. If Disney is a member of a monopolistically competitive industry, what would you predict would happen to its demand curve (the demand curve for Disney movies) over time? Suppose that Disney is a member of an oligopoly. How would this change your answer?
3. Why is monopolistic competition said to be inefficient? Suppose that you counted the higher price the consumer pays for the monopolistically competitive firm's product as part of consumer surplus. Would that change the conclusion regarding the efficiency of monopolistic competition?
4. Why might some people claim that the breakfast cereal industry is monopolistically competitive but that the automobile industry is an oligopoly? In both cases, about eight to ten firms dominate the industry.
5. The graph that follows shows an individual firm in long-run equilibrium. In which market structure is this firm operating? Explain. Compare the long-run quantity and price to those of a perfectly competitive firm. What accounts for the difference? Is the equilibrium price greater than, equal to, or less than marginal cost? Why or why not?



6. Explain what is meant by strategic behavior. How does the kinked demand curve describe strategic behavior?
7. The NCAA is described as a cartel. In what way is it a cartel? What is the product being produced? How does the cartel stay together?
8. Almost every town has at least one funeral home, even if the number of deaths could not possibly keep the funeral home busy. What market structure does the funeral home industry best exemplify? Use the firm's demand and cost curves and long-run equilibrium position to explain the fact that the funeral home can handle more business than it has. (*Hint:* Is the firm operating at the bottom of the average-total-cost curve?)
9. What is the cost to a firm in an oligopoly that fails to take rivals' actions into account? Suppose the firm operates along demand curve D_1, shown below, as if no firms will follow its lead in price cuts or price rises. In fact, however, other firms do follow the price cuts, and the true demand curve below price P_1 lies below D_1. If the firm sets a price lower than P_1, what will happen?



10. Suppose a firm in monopolistic competition has the following demand schedule. Suppose the marginal cost is a constant $70. How much will the firm produce? Is this a long- or short-run situation? If the firm is earning above-normal profit, what will happen to this demand schedule?