ECN 221 Practice Problems for Chapter 13 ~ Answers

1. A
2. A
3. F
4. B
5. A
6. B
7. D
8. C
9. C
10. C
11. A
12. C
13. F
14. F
15. T
16. T
17. T
18. F

Long answer/Essay

19. Explain the different types of barriers to entry that allow monopolists to maintain their market power. Give an example of each.

Types of Barriers to Entry:

1. **Economic Barriers to Entry**
   - ownership of the entire supply of a given resource (eg: DeBeers)
   - large scale cost advantages
   → in an industry where the region of increasing returns to scale is large, and those RTS result in low operating costs - a firm that gets into the market first and grows (moves down the LRATC curve) will keep other firms out of the market because they cannot compete with the existing firm. Eg: AT&T = "NATURAL MONOPOLY" = when economies of scale are so great that the good or service can be provided at the lowest cost if only one firm provides it. Most local public utilities are "local natural monopolies" by gov't regulation. - its more efficient to have only one phone company and one cable company and one water company in a given area.

2. **Legal barriers to entry**
   - Gov't licenses (eg: liquor sales in NC)
   - Patents = exclusive rights to produce and market their product for 17 years. this protect the inventor who did all the work and encourages R&D/innovation (eg: Xerox corp. Patent on photocopying)

3. **Technological Barriers to entry**
   → a single firm may have technological superiority over other firms or use technology to create a monopoly (eg: Microsoft with software IBM (20 years ago) with hardware)
20. Compare the long-run outcomes in perfectly competitive markets and monopolistic markets with regard to (a) price (b) market quantity supplied (c) profitability (d) efficiency.

**MONOPOLY VS. PERFECT COMP**

1. $P_{MON} > P_{PC}$
2. $Q_{MON} < Q_{PC}$
3. $\text{PROFIT}_{MON} > \text{PROFIT}_{PC}$

* Monopolists are going to charge a higher price and produce lower output and earn positive economic profits.

In a PC market $\Rightarrow P = MC = \text{minimum ATC}$ $\Rightarrow$ what consumers are WTP is exactly equal to what suppliers are WTA $\Rightarrow$ The PC market solution is *efficient* $\Rightarrow$ firms sell the good at the lowest possible price that allows them to stay in the market $= \text{min ATC}$

In a monopoly, profits are $> 0$ $\Rightarrow$ price is $> MC$ and $P > \text{min ATC}$, $\Rightarrow$ What consumers are willing to pay is $> \text{what the firm is WTA}$. $= \text{Inefficient because the value to consumers is } > \text{the value to producers AND because the firm is not operating at the point of minimum ATC.}$

* monopoly markets are inefficient while PC markets are efficient

21. Given that monopoly power allows firms to profit at the expense of consumers and creates market inefficiencies, why does the government grant monopoly power to firms in the case of (a) local utility companies and (b) patents?

(a) to encourage innovation. If the ability to earn profits were not protected, then there would be little incentive to engage in research and development… firms would spend money on R&D (incur large costs) only to have their ideas and inventions stolen by another firm.

(b) To minimize costs of providing the good or service to consumers. With utilities and other natural monopolies, it is more efficient to have a single firm providing the entire market supply.