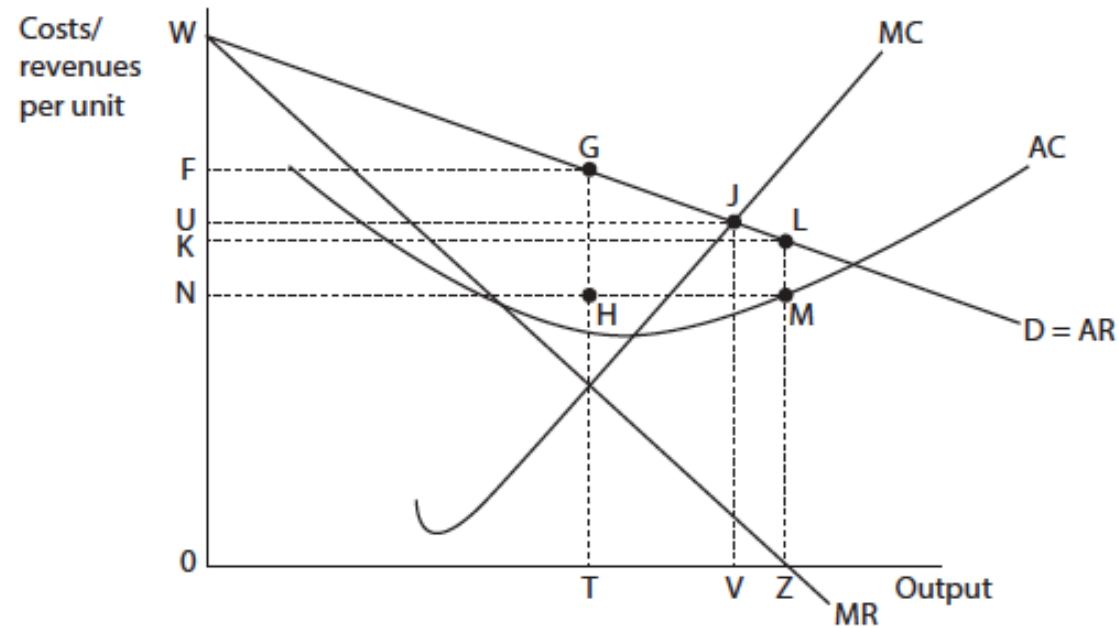


# Monopoly MC Questions

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GCE A-LEVEL ECONOMICS

7 The diagram shows the costs and revenues for a firm with monopoly power.



Which of the following statements is true?

(1)

- A At output T the firm is revenue maximising
- B At output V the firm is allocatively efficient
- C At output Z the firm is productively efficient
- D At profit maximising output the supernormal profits are KLMN
- E At output Z the price is zero

Answer

Question Number	Answer	Mark
7	<p><b>Correction Option B</b></p> <p>Definition of allocative efficiency, e.g. the price is equal to the marginal cost (<math>AR=MC</math> or <math>P=MC</math>) (1)</p> <p>Explanation of monopoly – single firm dominates or 25%+ market share (1)</p> <p>Explanation that the price has been set at a point that maximises (consumer/producer) welfare (1);</p> <p>Monopoly may do this as marginal cost pricing has been imposed by the government (1)</p> <p>Annotation of diagram showing consumer/producer welfare(1)</p> <p>Example of knock outs (can also come from annotating the diagram)</p> <p>It's not C because M is not at the lowest point of AC</p> <p>It's not D because this is revenue maximisation (or the area KLMN represents SNP for a revenue maximising firm)</p> <p>It's not D as shown by a correctly annotated profit maximising area on their diagram (connecting AR and AC at output T – this will involve a new horizontal line meeting the AC curve)</p>	(4)

5 X-inefficiency is most likely to exist in markets where

(1)

- A new firms have recently entered the market
- B there are long-term patents in place
- C there is a high level of contestability
- D the conditions for price discrimination are not met
- E concentration ratios are low

Answer

Explanation

(3)

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Question Number	Answer	Mark
5	<p>B</p> <p>Definition of <b>x-inefficiency</b>, e.g. when lack of competition means that costs are higher than they would be with competition (1); examples of x-inefficient behaviour: satisficing profits, organisational slack, rising average costs of labour as wages rise or over-manning, laziness, complexity, management with other aims such as luxury cars (1+1);</p> <p>Explanation of <b>patents</b>, e.g. legal barriers which prevent copying of names or concepts by rival firms these act as a barrier to entry (1) meaning that new firms cannot enter/force existing firms to cut their prices or costs - there is no need for existing firms to cut costs (1);</p> <p>Reasons why x-inefficiency exists: firms can become a monopoly, firms gain market power (1+1);</p> <p>Diagram showing two average costs curves, one AC higher than they would otherwise be when x-efficient, or a point above AC (1);</p> <p>Example of knock out mark: it cannot be C as barriers to entry will be high (1).</p>	(4)

- 1 A firm with monopoly power decreases the price of its product to increase its market share up to the output at which it just earns normal profit. Which of the following is the best description of the firm's objective?

(1)

- A Profit maximisation in the short run
- B Increased market contestability
- C Revenue maximisation in the long run
- D Sales maximisation
- E Loss minimisation

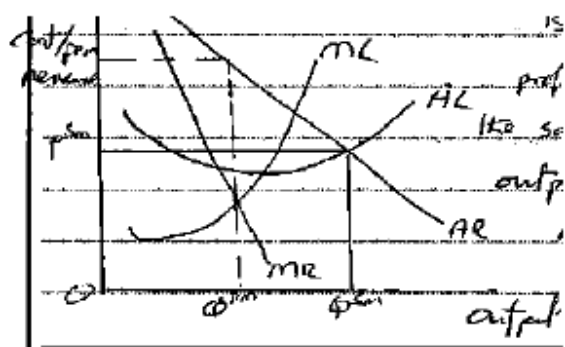
Answer

Explanation

(3)

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Question Number	Answer	Mark
1	<p><b>D</b></p> <p>Definition of <i>monopoly power</i> (not monopoly alone): firm has power to set prices or output/ firm is a price setter or price maker (1);</p> <p>Explanation of sales max: selling as much as possible without making a loss (1); where <math>AR = AC</math> (1); or maximising sales subject to the <b>constraint</b> of making <math>AR=AC</math> (normal profit) (1);</p> <p>Explanation: explanation of normal profit, e.g. just enough profit to keep resources/firms in their current use (1); market share increased at expense of competitors (1); a lower price means that more is demanded (1);</p> <p>Reasons for this objective: to remove competition (1); limit pricing (1); long run profit maximisation by removing competition or gaining loyalty (1);</p> <p>Diagram showing fall in price and/or higher output (1) at <math>AC=AR</math> (award <math>AC=AR</math> point only if not defined or otherwise used in answer) (1);</p>  <p>Examples of knock-out mark:</p> <p>It is not A because the firm is cutting prices to prevent new firms entering, so it is sacrificing short term profits for long term benefits</p> <p>It is not C because this option ignores costs, but costs must be taken into account for normal profit <math>AR=AC</math>.</p>	(4)