Chapter 14

Put into practice questions

Page 299

Which of the following statements are true and which are false? Explain your answer.

a. An oligopoly occurs when many firms dominate a market. FALSE- a few large firms
b. A cartel is a collusive oligopoly. TRUE
c. A price war occurs when firms compete with each other. TRUE
d. Game theory occurs when one business plans ahead based on the predicted actions of others. TRUE

Page 300

Can you remember the following?

- The equation for the price elasticity of demand. (Percentage change in quantity demanded/percentage change in price)
- The difference between price elastic demand and price inelastic demand. Price elastic demand has a value of more than 1; price inelastic has a value of less than 1.
- The effect of a price change on revenue when demand is price elastic or price inelastic. A price increase leads to an increase in revenue when demand is price inelastic.

Page 306

Which of the following are true and which are false? Explain your answer
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a. In the kinked demand curve model it is assumed that a price increase is not followed by other firms. TRUE
b. In the kinked demand curve model it is assumed that a price decrease is not followed by other firms. TRUE
c. A cartel profit maximizes when marginal revenue equals total costs. FALSE; profit maximise when marginal revenue eulas marginal cost
d. A cartel acts like a monopolist. TRUE

Page 310

Which of the following statements are true and which are false? Explain your answer.

a. A business would be more likely to cut price if demand was price elastic. TRUE
b. If products are close substitutes they have a high positive cross-price elasticity. TRUE
c. A strong brand is likely to be price elastic. FALSE; price inelastic

End of chapter put into practice questions

Page 312

If a firm moves from being monopolistically competitive to becoming an oligopoly what happens to its concentration ratio? Why?

Increases; the market share of the largest few firms increases

A cartel usually has a collusive agreement to

Answer is C. restrict output.

Draw a kinked demand curve and explain how the price elasticity varies on different parts of the demand curve.

See figure 14.3

Draw a kinked demand curve and show how a change in marginal costs may not affect the price in the market.

See figure 14.4

Draw a diagram to show a cartel acting like a monopolist and the price and output of a member firm.

See figure 14.5

On your diagram of a cartel acting like a monopolist show the welfare loss.

This is the area where the marginal benefit (shown by the demand curve) is greater than the marginal cost

In Figure 14.10 there are two businesses A and B which could cooperate with each other or attack each other with aggressive marketing strategies.
Do you recommend business B cooperates or attacks? Why?

Depends on assumptions about the other business

The kinked demand curve model of oligopoly predicts that:

Answer is A: the price the firm sets does not change if there are small changes in the firm's marginal
costs.