

Name &amp; SID:

Date:

1. Andrew owns a Chinese restaurant that makes a yummy Kung-Pao chicken dish. Chinese restaurants are monopolistically competitive. Sketch Andrew's firm graph in Stage 1. Assume Andrew is making positive profits in Stage 1. Label Andrew's price ( $P_1$ ) and quantity ( $Q_1$ ).



2. What are the main assumptions for monopolistic competition?
3. What is the socially-optimal price and output? Does Andrew create a deadweight loss in Stage 1? Label  $P^*$ ,  $Q^*$ .
4. Lets fast forward to Stage 2. What happens to the market price and quantity of Andrew's Chinese food? Label  $P_2$ ,  $Q_2$ .

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5. Calculate Andrew's stage 2 profits.
6. True, false, or uncertain. Deadweight loss is zero in stage 2 monopolistic competition because all firms in stage 2 monopolistic competition make zero profits.
7. What is wrong with this monopolistically competitive (stage 2) firm graph?

