

Chapter 12

Put into practice questions

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Which of the following defines:

- a. normal profits? Price equals average revenue.
- b. break-even point? Price equals average revenue.
- c. shutdown point? Price equals average variable cost
- d. abnormal profit? Price is greater than average cost.

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Imagine that a perfectly competitive market is in long-run equilibrium. Show the impact of a fall in demand in the short run and the long run on both the industry and a firm.

This will mean firms make a loss at the given price. Firms will leave shifting supply inwards and leading to a higher price until normal profits are earned.

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Figure 12.6 shows the cost and revenue curves for a firm in a perfectly competitive market.

Answer is: All other things being equal, the firm is minimising its loss by staying in the market in the short run.

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In perfect competition, which of the following statements are true and which are false? Explain your answer.

- Each firm in the market has some, but not complete, control over the price of its product. FALSE
- Firms are completely free to enter or leave the market. TRUE
- There are many producers producing similar, but not identical, products. FALSE
- Firms in the market advertise in order to shift the demand curve for their product. FALSE

The demand curve for the perfectly competitive firm is determined by:

- The firm's marginal cost of producing an extra unit of output. False

- The price that is established by the firm. False
- The market demand for, and supply of, the good. True
- The average total cost of producing a particular level of output. False

End of chapter put into practice questions

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In perfect competition all units are sold at the same price. Imagine this is £10 a unit. Plot the marginal revenue and total revenue curves for outputs between 0 and 20.

Marginal revenue is a straight line at £10

Total revenue increases at a constant rate increasing by £10 per unit

Show with a diagram that in the long-run equilibrium a perfectly competitive firm is allocatively and productively efficient.

See figure 12.4

Show the shutdown and break-even points on a marginal cost curve.

See figure 12.5

Imagine a business is making a loss in the short run in a perfectly competitive market. Using diagrams for the industry and the firm show how the industry adjusts to long-run equilibrium.

See figure 12.3

Imagine a business is making an abnormal profit in the short run in a perfectly competitive market. Using diagrams for the industry and the firm show how the industry adjusts to long-run equilibrium.

See Figure 12.2

Imagine a perfectly competitive market is in long-run equilibrium. Show the effect of an increase in marginal costs using industry and firm diagrams.

This would shift supply inwards increasing price but with higher costs firms would still make normal profits

Imagine a perfectly competitive market is in long-run equilibrium. Show the effect of an increase in fixed costs using industry and firm diagrams.

This would increase costs. Existing firms would make a loss and some would leave the industry. This would reduce supply leading to a higher price. Price increases until normal profits are made again.

Imagine improvements in technology reduced the unit costs of production in a perfectly competitive industry.

Lower costs would increase supply; this would drive price downwards but a profit could still be made as costs are lower. In the industry there would be a lower price but higher output.