Topic: Competition and Monopoly

Text Questions

1. What is the relationship between price and average total cost when a firm operates with an economic profit, takes a loss, or breaks even? Illustrate, in separate graphs, the relationship between an individual firm’s demand curve and average total cost curve in each of the following situations:

   a. A purely competitive firm in the long run
   b. A monopolist earning economic profits
   c. A purely competitive firm operating with a loss
   d. A monopolistically competitive firm in the long run
   e. A monopolistically competitive firm operating with a loss
   f. An oligopolist pricing at the kink in its demand curve and earning an economic profit

2. Why does a firm in pure competition operate efficiently in the long run while firms in the other three market structures do not? Why is it important to consumers that a firm operates efficiently?

3. Firms in monopoly and oligopoly markets are protected in varying degrees by barriers to entry, and they can earn excess profits in the long run. How do barriers to entry relate to a firm’s ability to earn excess profits in the long run?

Multiple Choice Questions

1) In a perfectly competitive market, a firm’s short-run supply is equivalent to:

   a. the production quantity where average total cost is minimized.
   b. the production quantity where fixed costs are minimized.
   c. the marginal cost curve above the average variable cost curve.
   d. the average variable cost curve above minimum average variable cost.

2) A perfectly competitive firm is producing 700 units of output in a market where the price is $50 per unit. At this output, TC=$40,000 and TVC=$30,000. The firm is currently producing a level of output where MC is $20 per unit. This output level maximizes the difference between market prices and MC. Using only this information, and assuming this firm wants to maximize profits, we can conclude that:

   a. this firm should increase output.
   b. this firm should decrease output.
   c. this firm is producing the output level that maximizes output.
   d. this firm should shut down.
3) Now, the firm in question (2) is producing at a level where MC=$30 per unit. If the firm wishes to maximize profits, with the same TC and TVC costs, we can conclude that
   a. this firm should increase output.
   b. this firm should decrease output.
   c. this firm is producing the output level that maximizes output.
   d. this firm should shut down.

4) If firms in a perfectly competitive industry are making economic profits, in the long run profits will be reduced when
   a. new firms enter leading to reduced market demand.
   b. new firms enter leading to increased market supply.
   c. some firms exit leading to an increase in demand for remaining firms.
   d. some firms exit leading to a decrease in supply by remaining firms.
5) As a result of a decline in the price of foreign steel, decreased demand for steel produced in the US has left US producers facing economic losses. If the US steel industry is a perfectly competitive industry, and imported steel prices stay at their current levels, how will the long run equilibrium for the US steel industry differ from the current short run equilibrium? In the long run:

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<tr>
<th>OUTPUT</th>
<th>PRICE</th>
<th>LOSSES</th>
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<td>decreases</td>
<td>rises</td>
<td>disappear</td>
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<tr>
<td>decreases</td>
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6) Assume a new, cost saving, technology is introduced into a perfectly competitive industry that is in long run equilibrium. Which of the following would NOT be expected to characterize the new long run for this competitive industry?

a. Prices will be lower.
b. Industry output will greater.
c. Firms’ economic profits will be greater.
d. There will be a larger number of firms.

7) Assume corn production is a perfectly competitive industry. Further assume many corn farmers are earning negative economic profits. In the long run we should see:

a. exit of firms, increasing supply, decreasing prices.
b. exit of firms, decreasing supply, increasing prices.
c. entry of firms, increasing supply, increasing demand.
d. entry of firms, increasing supply, increasing quantity demanded.

8) A single price monopoly is producing an output level of 100 units where MC=$5 and MR=$5. At this output, ATC=$12, AVC=$6, and consumers reservation price is $10. this firm should:

a. increase output and lower price.
b. decrease output and lower price.
c. increase output and increase price.
d. decrease output and increase price.

9) A single price monopoly is producing an output level of 100 units where MC=$5 and MR=$5. At this output, ATC=$12, AVC=$11, and consumers reservation price is $10. this firm should:

a. increase output and rise price.
b. close down.
c. continue to operate at a loss in the short run.
d. lower output and raise price.

10) Unlike perfectly competitive firms, profit maximizing monopolists produce an output where:

a. MR>MC.
b. P>MC.
c. fixed costs are maximized and AVC is minimized to take advantage of economies of scale.
d. All of the above would be true.