Econ 601: Basic Economic Analysis
Assignment #4
Answer Key

Text Questions:
1. When a firm operates with an economic profit, the price is greater than the average total cost of the product. When a firm operates with a loss, the price is less than the average total cost of the product. When a firm breaks even, the price is equal to the average total cost of the product.

2. A firm in pure competition operates efficiently in the long run because it operates at the lowest possible costs while firms in the other market structures may not. It is important to consumers that a firm operate efficiently because under this condition consumers pay no more than necessary to receive a good or service. They are receiving the most value possible for their money.

3. In a market with few or no barriers to entry, the existence of economic profits would attract new firms to enter that market. As a result of this increased competition, the economic profits would be competed away and the firms in the market would earn only normal profits. In an oligopoly or a monopoly where barriers to entry exits, economic profits would not attract firms because of the difficulty or the impossibility of gaining entry. If no new firms enter the market, the economic profits are not competed away.

Multiple Choice:
1. C
2. A
3. A
4. B
5. A
6. C
7. B
8. D
9. B
10. B