

Week #7 Worksheet – Perfect Competition ~ SR & LR Analyses

1. In the case of perfect competition, which of the following is true?
 - a. Profit maximization occurs at the level of output where $P = MC$.
 - b. Price always equals average revenue.
 - c. Profit maximization occurs at the level of output where $MR = MC$.
 - d. All of the above.

2. When price exceeds marginal cost, a profit-maximizing producer will
 - a. increase production.
 - b. decrease production.
 - c. leave the level of output unchanged.
 - d. lower price and increase production.

3. Assume that a competitive firm has the following cost and revenue characteristics at its current level of output: average revenue = \$8.00, average variable cost = \$6.00, and average fixed cost = \$4.00. This firm is
 - a. realizing an economic profit of \$2.00 per unit.
 - b. incurring a loss per unit of \$2.00, but should continue to operate in the short run.
 - c. incurring a loss of \$2.00 per unit and should shut down.
 - d. realizing only a normal profit.

4. Farmer Brown sells oats in a competitive market. This year, he decides to increase his supply by 200%. Because of this decision and the resulting increase in supply, the price of oats will
 - a. go down.
 - b. go up.
 - c. Either (a) or (b).
 - d. be unaffected.

5. The table below shows the cost of production for upholstery fabric produced by Thomas Textiles. The fabric is sold in a perfectly competitive market.

Output (yards per day)	AVC (dollars per yard)	AC (dollars per yard)	MC (dollars per yard)
1	24	84	24
2	18	48	12
3	14	34	6
4	13	28	10
5	14	26	18
6	16	26	26

If the market price of fabric is \$26 per yard and the firm maximizes profit, it will

- a. produce 6 yards per day and earn zero economic profit per day.
- b. produce 5 yards per day and earn economic profit of \$10 per day.
- c. shut down.
- d. produce 6 yards per day and earn economic profit of \$60 per day.

6. The Lambert Lumber Company sells boards in a perfectly competitive market. The marginal cost of boards at the current output of 400 board feet per month is \$2. The price of lumber is currently \$2 per board foot, and the minimum possible average variable cost of producing lumber is \$3 per board foot. If the firm wants to maximize profit, it should
- increase monthly output.
 - continue producing at its current output level.
 - decrease monthly output.
 - shut down immediately.
7. In long-run competitive equilibrium, price equals not only _____, but also _____.
- average variable costs, marginal cost.
 - marginal cost, minimum possible average cost
 - marginal cost, total benefit
 - the lowest price available to the consumer, total revenues to the firm.
8. The existence of economic profits induces _____ from/into an industry, which in turn _____ market supply and _____ market price.
- exiting, decreases, increases
 - exiting, increases, increases
 - entry, increases, decreases
 - entry, increases, increases
9. Assume the T-shirt industry is perfectly competitive. If the industry is in long-run competitive equilibrium, when the market price of T-shirts is \$10,
- the minimum possible average variable cost of producing T-shirts is \$10.
 - the minimum possible average cost of producing T-shirts is \$10.
 - the marginal cost of producing T-shirts exceeds \$10.
 - new firms will be entering the industry.
10. Suppose the minimum possible average cost of constructing homes is \$50 per square foot. As a result of a sharp drop in the demand for home construction, the equilibrium price of home construction falls to \$40 per square foot. Assuming the home construction industry is perfectly competitive, in the long run,
- the number of firms in the industry will increase.
 - the number of firms in the industry will remain constant.
 - firms will leave the industry.
 - the industry will remain in equilibrium.