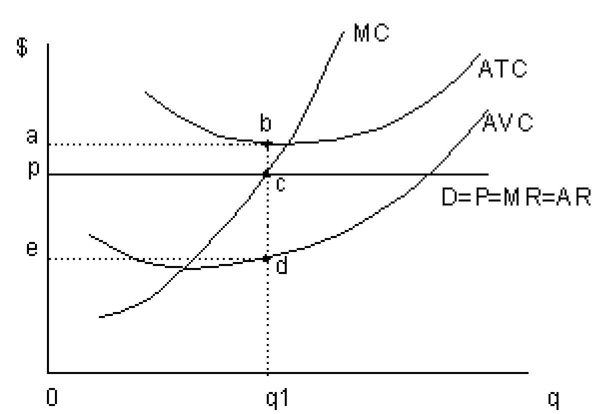
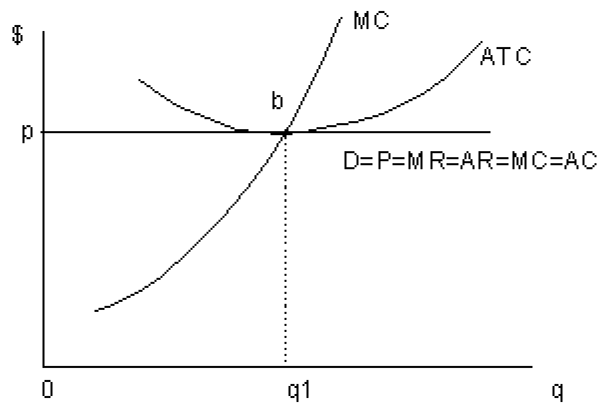
Review Notes - Perfect Competition

- Characteristics of P.C. market
  - many buyers and sellers
  - all small relative to the market
  - homogeneous product
  - no entry/exit barriers
  - full information to all parties
- Characteristics of monopoly market
  - many buyers but one seller
  - seller is the market
  - homogeneous product
  - entry barriers
  - does not require full information to all parties but may exist
- What is firm D in a P.C. market? Market Demand?
- What is firm D in a monopoly market? Market Demand?
- Definitions
  - Profit
  - Total Revenue/Total Cost
  - Marginal revenue
  - Average Revenue
  - Price Taker
- profit maximization by P.C. firms (the same principles apply to <u>all</u> firms).
  - definition of MR = change in TR ÷ change in q. What does this mean?
  - if MR > MC => continue to produce (increase q).
  - if MR < MC => do not produce this unit (decreases q).
  - if MR = MC => profit is maximized. why?
- profit maximization graphically (see the following figure). You must answer the following questions (again, the same principles apply to <u>all</u> firms).
  - What is the profit maximizing quantity level?
  - what is the highest price the firm can charge for this quantity?
  - Be prepared to find on the graph: profit maximizing q and p, profit, TR, TC, TVC, TFC, AFC, AVC, ATC.



- Should this firm produce in the short-run? Where is the short-run shutdown point?
- Should this firm produce in the long-run? Where is the long-run shutdown point?
- What is the Firm's short-run supply curve? What is the industry's short-run supply curve?

- the long-run in P.C. markets.
  - the crucial characteristic = free entry and exit.
  - profit serves as a signal for entry/exit. If profit > 0 => entry in the long-run. If profit < 0 => exit in the long-run. If profit = 0 => no entry and no exit => long-run equilibrium.
  - When in long-run equilibrium => (1) P=MR=MC=AC, (2) q is such that AC is at its minimum point, etc. Make sure you know all of the results when in long-run equilibrium.
  - What is the long-run industry supply?
    - Increasing Cost Industry?
    - Decreasing Cost Industry?
    - Constant Cost Industry?



- Are Perfectly Competitive Markets Efficient?
  - Technological Efficiency?
  - Define Allocative Efficiency.
    - Consumer Surplus
    - Producer Surplus
    - Total Surplus
    - Allocative efficiency occurs when total surplus is maximized
    - Marginal Social Cost (MSC) and Marginal Social Benefit Approach to allocative efficiency
      - Define both MSC and MSB
      - Show how this approach yields the same answer as to when the market is efficient as the total surplus approach
  - In the absence of externalities, perfectly competitive markets are allocatively efficient
  - Deadweight losses
    - Definition
    - Of an externality
      - Positive Externality
      - Negative Externality
    - Of a Price Ceiling
    - Of Health Insurance
