

Revision Worksheet Answers

A2 Economics

Answer: Perfect Competition

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WORKSHEET ..Answer..

Revision Topic : Market Structures : Perfect Competition

Answers to Multiple Choice Questions

Question 1

Correct Answer A (1 mark)

Answer Guide :

Only in the market for sterling are there many buyers and sellers, trading an homogeneous good, under conditions of perfect information, and with relatively low barriers to entry. (1 mark each for a maximum of three of these conditions). However, there needs to be some applications to the foreign exchange market for full marks. [A maximum of two marks should be awarded to candidates who relate these assumptions to high street coffee shops or to computer software production].

Question 2

Correct Answer A (1 mark)

Answer Guide :

Definition of productive efficiency (1 mark) Diagrams of a firm in perfect competition, with both a short-run and long-run solution indicated (2 marks), Or a written explanation (2 marks).

Question 3

Correct Answer C (1 mark)

Answer Guide :

Explanation or diagrams that short-run supernormal profits will be eroded in perfect competition *or* explanation/diagrams of the long-run equilibrium position of a firm in perfect competition. (2 marks). Correct definition of normal profit *or* explanation that the firm is producing where $AR=AC$ (1 mark)

Question 4

Correct Answer C (1 mark)

Answer Guide :

Definition of allocative efficiency ($p = MC$) (1 mark). Diagram showing firm in perfect competition and that it is allocatively efficient in short (1 mark) and long run (1 mark). Also award: at least one assumption of perfect competition (1 mark) verbal argument about efficient resource allocation issue (1 mark)

Question 5

Correct Answer B (1 mark)

Answer Guide :

Statement of an assumption of perfect competition (1 mark). Related to characteristic (flat AR) of diagram, or reference to "price taker" (1 mark). Indication on diagram (1 mark) or explanation of supernormal profit (1 mark).(3 marks) Also award recognition that the firm is in the short run (1 mark)

Question 6

Correct Answer B (1 mark)

Answer Guide :

Three characteristics of perfect competition, at least one applied to wheat / agriculture (1 + 1 +1). If no reference to wheat award a maximum of two explanation marks. Many buyers and sellers (farmers)/homogenous product/price takes/low entry and exit barriers/normal profits in long-run/perfect market knowledge. Also award for diagram of a perfectly competitive firm in short-short-run or long-run equilibrium. (1 mark)

Question 7

Correct Answer E (1 mark)

Answer Guide :

Short-run since supernormal profits are being made by the firm (1 mark) (this may be shown on the diagram) (1 mark) Productive efficiency is not achieved since firm is not

producing where $MC=AC$ (1 mark). Allocative efficiency is achieved since firm is producing where $MC=Price$ or $MC=AR$ (1 mark)

Also award:

Correct annotation of diagram showing allocative efficiency, productive efficiency and supernormal profits for short run perfectly competitive firm (3 marks).

Note: If candidate selects option D and explains how supernormal profits are competed away, award up to 2 marks.

Question 8

Correct Answer C (1 mark)

Answer Guide :

Identification of the inability to a firm to maintain super normal profits in the long run (1 mark) because of a lack of barriers to entry (1 mark). A diagram showing industry supply increasing, industry price falling and consequential impact on the firm or written explanation to the same effect (2 marks).

Question 9

Correct Answer D (1 mark)

Answer Guide :

Perfect competition since Average Revenue = Marginal Revenue (1 mark) so firm is a price taker or has a perfectly elastic demand (1 mark). Normal profits since $AR=AC$ at output OQ_e (1 mark) Also award for any one characteristic of perfect completion

Note: A maximum of 3 marks if no reference to normal profit (1 mark)

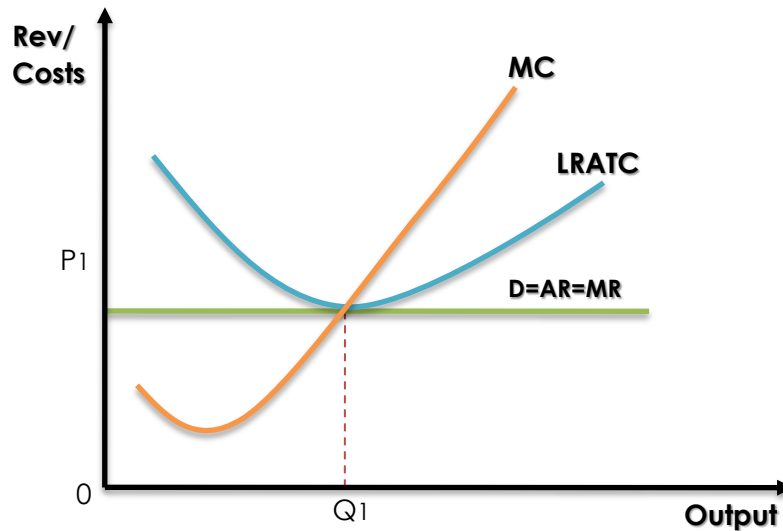
Question 10

Correct Answer C (1 mark)

Answer Guide :

Definition of productive efficiency (the most output for the least inputs or lowest point on the average cost curve or minimum efficient scale) or identifying it as output

where $AC=MC$ (1 mark) Definition of allocative efficiency or identifying it is output position where $MC=AR$ or price= MC (1 mark) Diagrammatic analysis of firm in long run perfect competition (1 mark) indicating productive (1 mark) and allocative (1 mark) efficiency at an output of Q_1 .



Question 11

Correct Answer D (1 mark)

Answer Guide :

Identification That the firm is making a loss (1 mark) OR annotation of loss on diagram (1 mark). Identification of shut-down point at bottom of AVC (1 mark). Will operate at current level of output making a contribution toward fixed costs (1 mark) Only in the short run, as they can shutdown and leave industry in the long run (1 mark)

Question 12

Correct Answer C (1 mark)

Answer Guide :

Correct completion of column to show rising marginal costs (at least three figures to be shown). (1 mark)

Correct completion of column to show constant marginal revenue (at least three figures to be shown). (1 mark) Correct definition or formula for marginal cost, marginal revenue or average revenue. (MC is the addition to total cost from producing one more unit of a goods or $MC = \Delta TC \div \Delta TQ$). (MR is the addition to total revenue from production of one more unit of a good or $MR = \Delta TR \div \Delta TQ$) . (AR is revenue per unit of

good or $AR = TR \div TQ$).(1 mark). Perfect competition since marginal revenue equals average revenue or firm is price taker or demand is perfectly price elastic. (1 mark)

Total Output	Total Cost (£)	Total Revenue (£)	Marginal Cost (£)	Marginal Revenue (£)
0	40	0	---	---
1	80	100	40	100
2	140	200	60	100
3	220	300	80	100
4	320	400	100	100
5	440	500	120	100

The MR can also be labeled AR.

Also award: Diagram of perfectly competitive firm with horizontal MR curve and rising MC curve (accept SR and LR). (1 mark)

NB No marks for other characteristics of perfect competition.

Question 13

Correct Answer E (1 mark)

Answer Guide :

Definition of cost-plus pricing policies (add a percentage profit mark-up (1 mark) to average cost in order to set price) (1 mark) Application to manufacture of jeans via numerical example or diagram (1 mark). Also award for reference to an advantage of cost-plus pricing e.g. it protects firm against unforeseen increases in production costs; easy to calculate; useful in long-term projects where costs may vary significantly

Question 14

Correct Answer E (1 mark)

Answer Guide :

Identification of profit maximization condition $MC=MR$ (1 mark) Identification of revenue maximization condition $MR=0$ (1 mark). Diagram or reference to change in price and output (2 marks).