

Chapter 14 Practice Problems

Elements of Microeconomics (discussion section 4)

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Question 1

- (a) Draw a graph of cost curves (ATC, AVC, MC) and marginal revenue in a perfectly competitive market in the following situations and explain why they look the way they do:
- (i) The firm should shutdown in the short run and should exit in the long run
 - (ii) The firm should remain open in the short run but should exit in the long run
- (b) In each of cases (i) and (ii) above, draw and shade the profits or losses for the firm in that situation.

Question 2

Consider a firm in a perfectly competitive market which produces donuts. The firm has costs of production shown in the following table:

Q	Total FC	Total VC	AFC	AVC	ATC	MC
0	50	0				
1	50	25				
2	50	35				
3	50	55				
4	50	90				
5	50	150				

Table 1: Costs of production for a donut firm

- (a) Fill in the missing values in the table
- (b) The market price for a donut is \$35. Graph the ATC, AVC, MC, MR/P.
- (c) Should the firm remain open in the short run? Should the firm exit the market in the long run? Use the shutdown and exit conditions to defend your assertions.

Question 3

Explain why the short run shutdown condition and long run enter/exit conditions are different. What is the key factor considered in the long run that is not considered in the short run?