UNIVERSITY OF ALBERTA
ALBERTA SCHOOL OF BUSINESS

BUEC 311: Business Economics, Organization and Management

Problem Set #7

Firm Theory and Perfect Competition

November 19, 2020

Single Answer

1) A ________ is a governance structure where owners are not personally liable.

A) sole proprietorship
B) partnership
C) mixed enterprise
D) corporation

Answer: D

2) Economists typically assume that the owners of firms wish to

A) produce efficiently.
B) maximize sales revenues.
C) maximize profits.
D) All of the above.

Answer: C

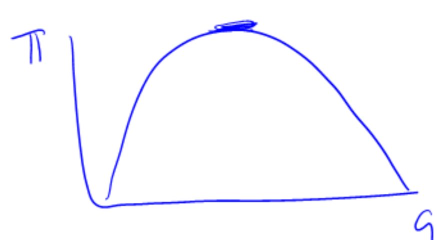
3) A small business owner earns $50,000 in revenue annually. The explicit annual costs equal $30,000. The owner could work for someone else and earn $25,000 annually. The owner's accountant would likely measure profit as 20K________ but an economic assessment would estimate a profit of 5k________.

A) $20,000, $20,000
B) $20,000, -$5,000
C) $25,000, -$5,000
D) $25,000, $20,000

Answer: B

4) A firm optimally sets its output where

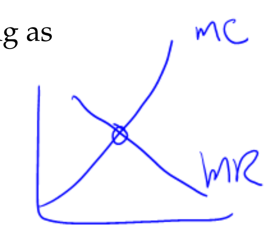
A) marginal profit is zero.
B) marginal revenue is maximized.
C) marginal profit equals marginal revenue.
D) marginal profit is maximized.



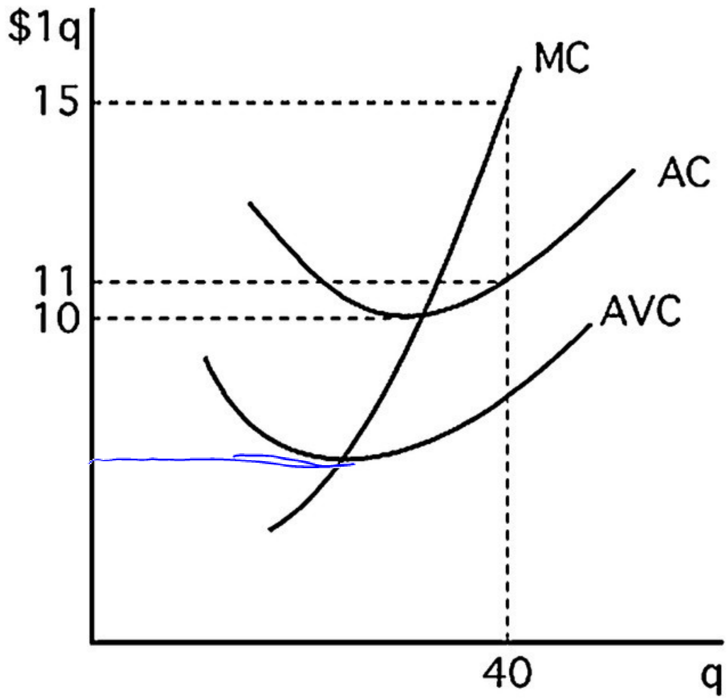
Answer: A

5) If marginal revenue equals marginal cost, the firm is maximizing profits as long as

A) the resulting profits are positive.
B) marginal cost exceeds marginal revenue for greater levels of output.
C) the average cost curve lies above the demand curve.
D) All of the above are required.



Answer: B



6) The above figure shows the cost curves for a competitive firm. If the firm is to earn economic profit, price must exceed

A) $0.
B) $5.
C) $10.
D) $11.

Answer: C

7) Using the above figure which shows the cost curves for a competitive firm, you can conclude that the firm should shut down in the short run if the price is equal to any number below:

A) $15.
B) $10.
C) $11
D) None of the above

Answer: D

8) If a competitive firm maximizes short-run profits by producing some quantity of output, which of the following must be TRUE at that level of output?

A) $p = MC$
B) $MR = MC$
C) $p \geq AVC$
D) All of the above.

Answer: D

9) If a profit-maximizing firm finds that, at its current level of production, MR<MC, it will

A) decrease output.
B) increase output.
C) shut down.
D) operate at a loss.

Answer: A

10) True or false: If a firm sets marginal revenue equal to marginal cost it will make an economic profit.

Answer: False. When a firm sets MR = MC it maximizes profits, but the profit-maximizing level of output might still be negative (the smallest loss possible).

11) Economists define a market to be competitive when the firms

A) spend large amounts of money on advertising to lure customers away from the competition.
B) watch each other's behavior closely.
C) are price takers.
D) All of the above.

Answer: C

12) Firms that exhibit price-taking behavior

A) wait for other firms to set price, take it as given, and charge a higher price.
B) have outputs that are too small to influence market price and thus take it as given.
C) take pricing behavior in their own hands.
D) are independently capable of setting price.

Answer: B

13) In a perfectly competitive market

A) firms can freely enter and exit.
B) firms sell a differentiated product.
C) transaction costs are high.
D) All of the above.

Answer: A

14) In a perfectly competitive market

A) buyers are price-takers.
B) buyers view products from different firms as differentiated.
C) individual buyers have horizontal demand curves.
D) firms' demand curves are vertical.

Answer: A

15) The economist's definition of the short run is

A) usually 3-6 months.
B) when at least one of the firm's input choices are fixed

C) when a firm has to decide whether or not to exit.
D) identical to the long run for most firms.
E) All of the above

Answer: B

16) In the short run

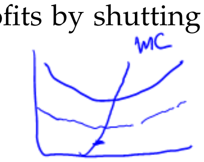
A) firms will shut down if operating at a loss.
B) profit maximizing firms have identical short run supply curves.
C) firms may choose to operate at a loss.
D) most firms have short run supply curves that are the same as their long run supply curves.

Answer: C

16) In the long run

A) firms will shut down if operating at a loss.
B) profit maximizing firms have identical supply curves.
C) firms may choose to operate at a loss.
D) most firms have supply curves that are the same as their long run average cost curves.
E) all of the above Answer: A

17) If a competitive firm finds that it maximizes short-run profits by shutting down, which of the following must be TRUE?



A) p < AVC for all levels of output.
B) p < AVC only for the level of output at which p = MC.
C) p < AVC only if the firm has no fixed costs.
D) The firm will earn zero profit. Answer: A

18) The competitive firm's supply curve is equal to

A) its marginal cost curve. short run vs long run
B) the portion of its marginal cost curve that lies above AC.
C) the portion of its marginal cost curve that lies above AVC.
D) the portion of its marginal cost curve that lies above AFC. Answer: C

19) In the long run, profits will equal zero in a competitive market because of

A) constant returns to scale.
B) identical products being produced by all firms.
C) the availability of information.
D) free entry and exit. Answer: D, although you'd win an argument if you said that this only holds with identical firms

20) A firm will enter a competitive market when

A) it can gather market share at the expense of incumbent firms.
B) it would not be the last firm entering.
C) it can earn a positive long-run profit.
D) the long-run supply curve is upward sloping. Answer: C