

Economics Workshop

Topic 7: Perfect Competition and Monopoly

The final exam will probably test your *knowledge* of the features of perfect competition and monopoly, your *ability* to draw the equilibrium diagrams for the short run and the long run, your *ability* to analyse the effect of changes in cost or revenue on the equilibrium position of the firms and the industry, and your *ability* to *evaluate* perfect competition and monopoly and *compare* them with each other.

When answering multiple-choice questions, it is often worth sketching a diagram to make sure that your answer makes sense. Therefore, the purpose of this workshop is to for you to get familiar with it.

If asked to draw equilibrium diagrams for any market structure, the following steps will be useful to ensure that your diagram turns out as it should:

1. Draw the demand curve ($D = AR$) for perfect competition and monopoly.
 - For perfect competition, each firm faces a _____ demand curve at price P^* .
 - For monopoly, it has _____ demand curve (relatively inelastic).
2. Draw the marginal revenue curve (MR) for perfect competition and monopoly.
 - For perfect competition, MR is _____ demand curve.
 - For monopoly, MR is _____ and _____ the demand curve.
3. Draw in the usual marginal cost curve (MC)
4. Find the profit-maximising output Q^* by choosing the output level where $MC = MR$.
5. Find the price that can be charged for this level of output. The demand curve (AR) tells the price.
 - For perfect competition, the price is _____.
 - For monopoly, the price will depend on _____.
6. Draw the average cost curve (AC) so that the marginal cost curve (MC) cuts through the minimum point on the average cost curve. The vertical position of the average cost curve will depend on whether we want to show the firms earning profit or losses.
 - In the short run, all three positions are possible:
 - If AR _____ AC , then profit is being earned.
 - If AR _____ AC , then the firm is just covering its average cost.
 - If AR _____ AC , then losses are being made.

- In the long run,
- Perfectly competitive firms will be able to just cover their LRAC.
 - Monopolists are likely to make _____.
7. Find the average cost of making profit-maximising output (Q^*). Mark it on the diagram as AC^* .
8. Find the level of profit. If price exceeds average cost, then the firm is making profit per unit of _____. Total profit is then calculated as _____.

Remember that cost curves have the same basic shape regardless of the market structure, but firm's revenue curves depend crucially on its market power.