Answers to End-of-Chapter Review Questions

1. Corporate climbers want to increase market power for their company, and competition from other companies is viewed as a bad thing. Concerned citizens view market power and competition as bad things associated with such things as corrupt agencies, unethical business behavior, low wages, layoffs, and environmental problems. The 20th century economist perspective views market power as a bad thing because it reduces economic efficiency, but competition is a good thing because it means decentralized power and efficiency.

2. Perfect competition is characterized by: numerous small sellers and buyers, only one kind of good or service is traded on the market and all units of it are identical, producers of the good or service can freely enter or exit the industry, and buyers and sellers all have perfect information.

3. Some additional assumptions of the model of perfect competition are firms’ production functions display the smooth pattern of diminishing returns over relevant production levels, the minimum efficient scale of a producer in this industry is fairly small relative to the level of demand for the output of the industry, and exchange is envisioned as taking place in a big double-auction spot market.

4. A perfectly competitive firm is imagined to maximize profits by producing where marginal cost equals marginal revenue (price).

5. Perfectly competitive markets are seen as leading to efficiency because firms are forced to produce at the minimum long-run average cost to avoid economic losses, adopting innovations quickly.

6. The graph below illustrates both producer and consumer surplus. Consumer surplus is the area below the demand curve but above price; it is the difference between buyers’ willingness to pay and price. Producer surplus is the area above the supply curve and below price; it is the difference between producers’ willingness to supply and price.
7. See Figure 11.6.

8. See Figures 11.7 and 11.8.

9. See Figure 11.9.

10. Compare Figures 11.9 and 11.10, replacing “rent ceiling” with “price ceiling.” When supply is very inelastic, a price ceiling creates less inefficiency than when supply is elastic.