**Revisiting your theory of the firm content**

**Useful resources include**

* **Your first and second year textbooks**
* **Tutor2u**
* **Economicshelp.org**
* **Econplusdal**
* **Bryn Jones and paj holden clips**

**Revisiting Production Costs and Revenue and the model of Perfect Competition**

1. **Production Theory: Costs, Revenue, Profit and Marginal Analysis.**

* Distinguish between variable and fixed costs which make up total costs using an example. How would you calculate average cost?
* Draw a curve for average cost and marginal cost. Explain the law of ‘marginal returns’ (including increasing and decreasing marginal returns) in the short run and it’s effect on the average and marginal cost.
* What are ‘returns to scale’ (including economies of scale and diseconomies of scale) and why are they different from increasing or diminishing marginal returns? What impact do economies of scale have on ‘barriers to entry’ into a market? Explain the possible sources of economies of scale
* Draw a MR, AR and TR curve and explain the relationship between them. Draw a MC, AC and TC curve and explain the relationship between them.
* Emphasise that the AR curve is just the Demand curve and the MC curve is the supply curve.
* Distinguish between normal and abnormal (or supernormal) profits.

1. **Introduction to market structures and revenue curve elasticities**

* Provide the conditions of perfect competition, pure monopoly, monopolistic competition and oligopoly using examples for each
* Explain whether firms in these markets are likely to make abnormal or normal profit in the short run and long run (you could do this in a table).
* What is the difference between firms who are ‘price takers’ and firms who are ‘price makers’?
* Why might we argue that the demand curve (AR) facing a perfectly competitive firm might be perfectly elastic? In other words, why would a perfectly competitive firm not be able to either increase or decrease the price?

1. **Evaluating the dynamics of competition**

* What are the features of a market facing lots of competition and explain the effect on firms in a market: price, quality of products and costs of production.
* Explain the importance of technology and the concept of ‘creative destruction’ using examples

1. **Profit maximization and ‘static’ efficiency conditions under perfect competition.**

* Draw a MR and MC curve together and explain where the firm would produce up to and why (this is called the profit maximization condition)?
* What is the role of profit in the economy? (what can profit be used for which benefits the economy?)
* Draw an AC curve and explain the condition of productive efficiency
* Draw an AR and MC curve and explain the condition of allocative efficiency.

1. **Perfect competition model**

* Draw the AR,AC,MR,MC curves for a firm facing a perfectly competitive market where the firm is producing normal profit
* Indicate where the firm is producing and at what price.
* Explain why the perfectly competitive firm is arguably statically efficient (remember this is both productive and allocative efficiency)
* Would a firm in a perfectly competitive market be able to earn abnormal profits?

**Revisiting Monopoly**

**Monopoly and Monopoly Power**

1. What is the difference between a firm in an industry with ‘pure monopoly’ and ‘monopoly power’…use the concept of ‘concentration ratios’ to explain your answer and provide examples for each.
2. Monopolies derive their market power (price maker) from significant ‘barriers to entry’. Explain what barriers to entry are using specific examples.
3. Explain why the industry revenue curves are downward sloping. Also explain why the monopoly firm revenue curves are the same as the industry. Finally, explain why the demand curve (or AR curve) is NOT perfectly inelastic?

**The Monopoly Model and Efficiency**

1. Draw the monopoly model diagram and show where a monopolist will produce (profit maximisation point). Explain why this is both allocatively and productively inefficient.
2. Draw a second monopoly model diagram with the profit maximisation point and then draw a second price and quantity to show where the monopoly would be allocatively and productively efficient (HINT: Draw the AC curve so that it’s lowest point is equal to the AR). Explain from this diagram, why a monopoly is therefore considered to be a market failure.
3. Draw three further monopoly diagrams: one showing a loss, one showing normal profit and one showing abnormal profit.
4. What is dynamic efficiency and using an example, explain why monopoly firms might be dynamically efficient and what positive effects this might have.

**Evaluating Market Structure: Welfare**

1. Define the concepts of consumer and producer surplus using a supply and demand diagram
2. Draw a monopoly diagram and explain why there is a ‘deadweight loss’ under monopoly. Make sure that you clearly define the term ‘deadweight loss’.
3. Define price discrimination in general and then 1st, 2nd and 3rd degree using an example for each. Explain, what the conditions must exist for the monopolist to be able to engage in price discrimination.
4. Evaluate whether price discrimination is a positive or negative force for society. Draw up a table perhaps for the advantages and disadvantages and write a brief conclusion at the end.

**Comparing Perfect Competition and Monopoly Models**

1. Draw two separate profit maximisation models for the perfectly competitive firm and the monopoly firm
2. Evaluate perfect competition and monopoly using the table below and by referring to the models you have drawn where appropriate (do not have to draw them again!) and any real life examples you can include.
3. Now try drawing one diagram that enables you to compare perfect competition and monopoly (make sure you label it correctly).
4. Build an evaluative conclusion as to whether monopoly is good or bad.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  |  | **Perfectly Competitive Market** | | **Pure Monopoly Market** | |
|  |  | Yes | No | Yes | No |
| Static Efficiency | Allocative Efficiency |  |  |  |  |
| Productive Efficiency |  |  |  |  |
| Dynamic Efficiency | Technical Efficiency |  |  |  |  |

**Monopolistic Competition**

1. Define monopolistic competition drawing on the main characteristics of this market structure and use an example to illustrate your explanation.
2. Draw a costs and revenue diagram for the profit maximising monopolistic competitive firm in the short run. Explain why the demand curve is downward sloping and why the firm is able to earn abnormal profits in the short run and why this creates a deadweight loss.
3. Draw a costs and revenue diagram for the profit maximising monopolistic competitive firm in the long run. Why is the firm only earning normal profits now (HINT: Refer to what has happened on this diagram compared to the short run diagram above be very careful with your explanation in relation to which curve has shifted and why) and why it is still arguably statically inefficient (although evaluate this by explaining why the greater choice might lead to allocative efficiency – see your textbook pp 74 for discussions on this).

**Oligopoly**

1. Define Oligopoly and use examples from both the supermarket industry **AND** the Energy market to highlight the key elements (i.e. barriers to entry, interdependence and a small number of larger firms in the industry)
2. What do characteristics of interdependence and uncertainty mean for analysing strategy in an oligopolistic market?
3. STRATEGY1: Price Competition. Define different pricing strategies such as ‘Predatory pricing’ and ‘Limit pricing’. Draw a cost/revenue diagram for an oligopoly employing a limit pricing or predatory pricing strategy. In your explanation provide reasons why the firm is able to adopt this strategy?
4. STRATEGY2: Non-Price Competition. Explain how non-price competition might work in a market using examples. Draw and explain the kinked demand curve model to suggest why non-price competition is a common characteristic in oligopolistic markets. Then explain the problems with the kinked demand curve model.
5. STRATEGY 3: Collusion: Explain the difference between tacit and overt price collusion using examples. Draw a costs and revenue diagram to explain what collusion might mean to an oligopolistic market in terms of static efficiency. What are the advantages and disadvantages of collusion for an oligopolistic firm?

**Theory of contestable markets**

1. Define contestability and the concept of ‘Barriers to entry and exit’ using examples– make sure you draw a distinction between natural and artificial barriers to entry
2. Discuss whether the energy, grocery, rail, bus and airline industries are contestable or not (this might be most usefully done in a table with arguments on both sides)
3. What does the theory of contestable markets suggest about competition policy?
4. What factors might it be argued are making markets more contestable in recent years?