**PACK 3: Representing profit maximization using the “Cost and Revenue Curves”**

ECONOMICS TEXTBOOK – pp 56 – 67 (MUST READ BEFORE ATTEMPTING QUESTIONS BELOW)

**MONOPOLY FIRM**

*TASK: Draw the AC, MC, AR and MR curves onto one diagram to show the price and quantity of a monopoly firm whose main objective is to maximize short run profit*

HINT 1: Remember the monopoly firm is a price maker and therefore faces the revenue curves of ‘the industry’ as theoretically it is the only firm in the industry

HINT 2: Remember that the profit maximization point is the Quantity of production where MR=MC

HINT 3: Remember that the MC curve must cut the AC curve at it’s lowest point

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|  | **Initial Questions:**1. Shade in the area where the monopoly firm is making profit
2. Is this profit ‘NORMAL’ or ‘SUPERNORMAL’? Why?

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**Subsequent Questions:**1. How can you use this graph to explain why monopolies might be considered to be allocative inefficient?

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1. How can you use this graph to explain why monopolies might be considered to be productively efficient?

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1. However, why might monopoly firms arguably be allocatively and productively efficient? (you cannot use the graph here but perhaps you could use other economic analysis or real life examples to explain your point?)

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**PERFECTLY COMPETITIVE FIRM**

*TASK: Draw the AC, MC, AR and MR curves onto one diagram to show the price and quantity of a perfectly competitive firm whose main objective is to maximize short run profit*

HINT 1: Remember the perfectly competitive firm is a ‘price taker’, it has to accept the price given by the market/industry. Therefore it faces the revenue curves of ‘competitive firm’ as theoretically it is one of many firms operating in the industry.

HINT 2: Remember that the profit maximization point is the Quantity of production where MR=MC

HINT 3: Remember that the MC curve must cut the AC curve at it’s lowest point

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|  | **Initial Questions:**1. Identify the area where the firm is making profit
2. Is this profit ‘NORMAL’ or ‘SUPERNORMAL’?

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**Subsequent Questions:**1. How can you use this graph to explain why perfectly competitive firms might be considered to be allocative efficient?

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1. How can you use this graph to explain why perfectly competitive firms are productively efficient?

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1. However, why might perfectly competitive firms arguably be allocatively and productively inefficient? (you cannot use the graph here but perhaps you could use other economic analysis or real life examples to explain your point?)

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**QUESTIONS TO CHALLENGE YOU FURTHER:**

**MONOPOLY FIRM DIAGRAM**

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| *Draw a profit maximization diagram to show a monopoly firm earning abnormal or supernormal profit* | *Draw a profit maximization diagram to show a monopoly firm earning normal profit* | *Draw a profit maximization diagram to show a monopoly firm making a loss* |

**PERFECTLY COMPETITIVE FIRM DIAGRAM**

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| --- | --- | --- |
| *Draw a profit maximization diagram to show a perfectly competitive firm earning abnormal or supernormal profit* | *Draw a profit maximization diagram to show a perfectly competitive firm earning normal profit* | *Draw a profit maximization diagram to show a perfectly competitive firm making a loss* |