Economics Class 12 Important Question Chapter 4 Theory of the Firm under Perfect Competition

Q.1 Define perfect competition.

Ans: A market with perfect competition has a large number of customers and sellers selling the same product at the same price.

Q.2Define Monopoly.

Ans: A monopoly is a market arrangement in which a single supplier has complete price control.

Q.3 What is the shape of the marginal revenue curve under a monopoly?

Ans: In a monopoly market, the marginal revenue curve slopes downhill from left to right and is lower than the average revenue curve.

Q.4 What is oligopoly?

Ans: A market structure characterised by a small number of significant sellers who sell either homogeneous or differentiated commodities are defined as an oligopoly.

Q.5. What is the shape of marginal revenue curve under monopoly?

Ans: In a monopoly market, the marginal revenue curve slopes downhill from left to right and is lower than the average revenue curve.

Q.6 What is product differentiation?

Ans: It is the practice of differentiating products and services on various criteria, such as style, appearance, label, colour, size, packaging, brand name, and so on, with the goal of making them more appealing and superior to competitors' products or services.

Q.7. What is the break–even price?

Ans: The break-even price in a completely competitive market is the price at which a firm earns normal profit (Price =AC). In the long run, the break-even price is the point at which P=AR=MC.

Short Answer Questions – 3 or 4 Marks

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Q.1 Explain the implication of a firm's free entry and exit in a perfectly competitive market.

Ans: No firm can achieve an extraordinary profit in the long run if firms can freely enter and exit. That is because there is no extraordinary profit in the case of free entry and exit, each company earns a standard profit. There are many buyers and sellers in perfect competition.

'Free Entry' means that there are no barriers to new firms entering the market. When existing businesses make abnormal profits, new firms are influenced by the profit and enter the industry. This increases market supply, causing market prices and profits to fall.

'Freedom to exit' means that there are no barriers preventing existing firms from exiting the market. When they are losing money, the companies try to quit. As firms begin to exit, market supply decreases, causing market prices to rise and, as a result, losses to decrease. The firms do not stop leaving until the losses are eliminated and each remaining firm earns only normal profits.

Q.2 Which features of monopolistic competition are monopolistic in nature?

Ans: Monopolistic competition describes a market situation in which a large number of firms sell products that are similar but distinct. The following are the characteristics of monopolistic competition:

A large number of sellers: There are a large number of businesses selling related but not identical products. Each company operates on its own and has a small market share. As a result, a single firm has only limited market price control. Market competition is created by the presence of a large number of businesses.

Product Differentiation: Despite a large number of sellers, each firm can maintain some monopoly power through product differentiation. The process of distinguishing products based on their brand, size, colour, shape, and so on is known as product differentiation. A firm's product is a close but not perfect substitute for the product of another firm.

Selling costs: In monopolistic competition, products are differentiated, and these differences are communicated to buyers through selling costs. Selling costs are the expenses incurred for marketing, sales promotion, and product advertisement.

Freedom of entry & exit: Under monopolistic competition, firms have the freedom to enter and exit the industry at any time. It ensures that a company does not experience abnormal profits or losses over time.

Lack of perfect knowledge: Buyers and sellers do not have a complete understanding of market conditions due to a lack of perfect knowledge. In the minds of consumers, selling costs create an artificial superiority, making it difficult for them to evaluate different products

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on the market. As a result, even if other, less expensive products of equal quality are available, consumers still prefer a particular product.

Q.3 Why is the demand curve in monopolistically competitive firms likely to be very elastic?

Ans: In monopolistically competitive firms, the demand curve is likely to be very elastic. This is due to the fact that the products produced by monopolistically competitive enterprises are nearly identical, and the firms have less price control. If the items are close substitutes for one another and the product is not sufficiently differentiated, the elasticity of demand increases, making the firm's demand curve very elastic.

Long Answer Questions (5 or 6 Marks)

Q.1 Explain the conditions of a producer's equilibrium in terms of Marginal Cost and Marginal Revenue.

Ans: The term "producer's equilibrium" refers to a situation in which a producer produces the most output while earning the most money. It is a profitable situation. The producer will only reach equilibrium at the level of production under the MR-MC technique if the following conditions are met.

MR = MC
After MR = MC, MC must rise.
At the point of equilibrium, the MC curve must cut the MR curve from below.
The addition to TR from the sale of one additional unit of output is denoted by MR, and the addition to TC is denoted by MC. Firms compare their MR with their MC in order to maximise earnings.

In the diagram, the output is indicated on the X-axis, while revenue and cost are shown on the Y-axis. The MC curve is U-shaped, and P~MR=AR is a horizontal line parallel to the X-axis.

When the output level is higher than OQ, MR < MC, which implies that the firm is making a loss on its last unit of output. Hence, so as to maximize profit, a rational producer will keep decreasing its output as long as MC >MR. Thus, the firm moves towards producing OQ units of output.

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