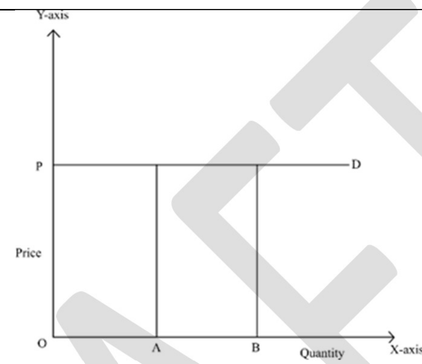
THE VILLAGE
INTERNATIONAL SCHOOL
"We Nurture Dreams"
AIM HIGH, TOGETHER WE FLY

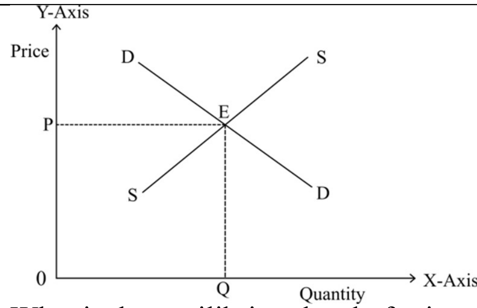
PART B: MICRO

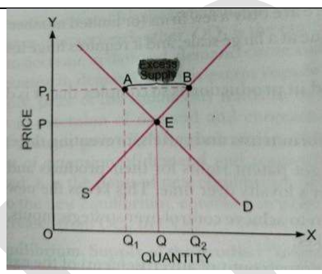
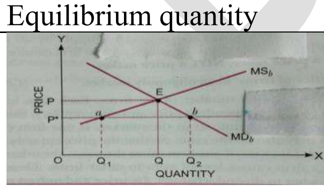
Chapter 7 : Perfect Competition - Price Determination and simple applications

Q. NO	QUESTION	MARKS
1	The market type which is known as perfect competition is __________. a) Highly competitive and companies find it challenging to earn economic profits in the long run b) Almost free from competition and companies earn large profits c) Marked by firms continuously trying to upgrade their products so that buyers prefer their products to that of their competitors' d) Dominated by fierce advertising campaigns	1
2	Which of the following is a point of difference between perfect and monopolistic competition? a) In perfect competition, the firms produce goods that are identical in all aspects, but under monopolistic competition, the goods are not identical b) There are many barriers to entry in perfect competition but monopolistic competition does not have any such problems c) There are many barriers to entry in monopolistic competition but perfect competition does not have any such problems d) Under perfect competition, there are many firms of relatively smaller size, but that is not the case for monopolistic competition	1
3	Which of the following factors is not a characteristic of perfect competition? a) A large number of buyers and sellers b) Well-informed buyers and sellers about product prices c) Individual firms spend a considerable amount on advertising d) No restrictions on entry into or exit from the industry	1
4	Which of the following markets have the fewest number of firms? a) Monopoly b) Perfect competition c) Oligopoly d) Monopolistic competition	1
5	Under perfect competition, a business has to make different types of decisions, both for the short run and the long run. Which of the following is a short run decision? a) Whether to enter or exit an industry b) The price to charge buyers for a product c) Spending on advertising and sales promotion d) The levels of output that can maximise profits	1
6	Assertion (A) : In long run under Perfect Competition, all firms invariably get only normal profit. Reason (R) : All forms incur minimum average cost and incur no selling cost due to absence of product differentiation.	1

	a) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A). b) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A). c) Assertion (A) is true, but Reason (R) is false . d) Assertion (A) is false, but Reason (R) is true	
7	Assertion (A): The determination of price in a Perfect competition market is a study of microeconomics. Reason (R): Determination of a price only affects the individual market and not the economy as a whole. a) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A). b) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A). c) Assertion (A) is true, but Reason (R) is false . d) Assertion (A) is false, but Reason (R) is true.	1
8	Assertion (A): Perfect competition prevails when the demand for the output of each producer is perfectly elastic. Reasoning (R): A single uniform price prevails under perfect competition which is determined by the interaction of demand and supply. a) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A). b) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A). c) Assertion (A) is true, but Reason (R) is false . d) Assertion (A) is false, but Reason (R) is true.	1
9	State whether the following statements are true or false. A commodity with a large number of close substitutes shows high elasticity of demand.	1
10	. Statement (1): Perfect competition hypothetical situation. Statement (2): Under perfect competition, the government decides the prices of all the products and services. (1) is correct and (2) is incorrect. (1) is incorrect and (2) is correct. Both (1) and (2) are correct. Both (1) and (2) are incorrect.	1
11	A form of the market in which there are a large number of buyers and sellers and the products are homogeneous and sold at a uniform price is called _________.	1

	a) Monopoly b) Oligopoly c) Perfect Competition Monopolistic Competition	
12	In which market form are average revenue and marginal revenue of firm always equal?	**1**
13	In the context of perfect competition, which one of the following statements is not correct? a) Firm has full control over price b) Horizontal straight line demand curve of the firm c) Freedom of entry and exit Selling cost do not exist	**1**
14	 On the basis of the above diagram, what does the perfectly elastic demand curve D indicate? a) The firm can sell any amount of its output at the prevailing price. b) The firm has no control over price. c) The firm is to accept the price as determined by the market forces of demand and supply. d) All of these.	**1**
15	Market equilibrium is a situation when a) market demand>market supply b) market demand<market supply c) market demand=market supply None of these	**1**
16	How is the price of a commodity affected when its demand increases more than supply?	**1**
17	If both demand and supply shifts right in the same direction, in the same proportion, what is the impact on price?	**1**
18	See the picture and answer.	**1**

	 What is the equilibrium level of price and quantity?	
19	Alternative name of price floor is : a) Maximum price ceiling b) Minimum price floor c) Minimum price ceiling Maximum price floor	**1**
20	State any one commodity on which price ceiling is imposed in India.	**1**
21	Which one is not a feature of Perfect competition market? (a) Perfect knowledge (b) Homogeneous product (c) Price discrimination Freedom of entry and exit	**1**
22	Which of the following is a characteristic of perfect competition market? (a) Single seller (b) Product differentiation (c) Price discrimination Perfect mobility	**1**
23	A state in which market demand is equal to market supply: (a) Equilibrium price (b) Minimum price (c) Maximum price None of these	**1**
24	Read the following statement carefully: Statement 1: Rationing is a consequence of Price floor. Statement 2: To prevent black marketing government have to resort to rationing of the products. (a) Statement 1 is true and statement 2 is false (b) Statement 1 is false and statement 2 is true (c) Both statements 1 and 2 are true Both statements 1 and 2 are false	**1**
25	Read the following statements: Assertion (A) and Reason (R). Choose the correct alternative from those given below. Assertion (A) : Equilibrium price and quantity change when there is a change in either demand or supply of the commodity. Reason (R) : When Supply increases equilibrium price and equilibrium quantity both increase. Alternatives: (a) Both Assertion (A) and Reason (R) are true and Reason (R) is the correct explanation of the Assertion (A)	**1**

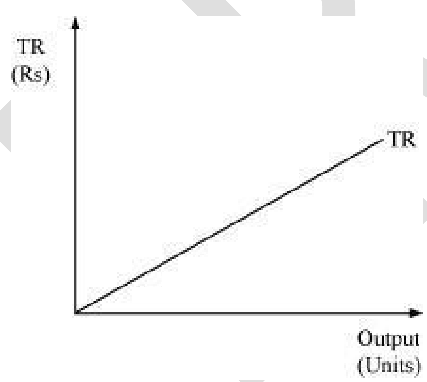
	(b) Both Assertion (A) and Reason (R) are true but Reason (R) is **not** the correct explanation of the Assertion (A) (c) Assertion (A) is true, but Reason (R) is false. Assertion (A) is false, but Reason (R) is true.	
26	Read the following statement carefully: Statement 1: Black marketing is a consequence of Price ceiling. Statement 2: Producers sell products illegally at a price greater than the price fixed by the government . (a) Statement 1 is true and statement 2 is false (b) Statement 1 is false and statement 2 is true (c) Both statements 1 and 2 are true (d) Both statements 1 and 2 are false	**1**
27	An increase in number of firms of a particular product would cause: (a) Fall in equilibrium price and quantity (b) Rise in equilibrium price and quantity (c) Equilibrium price will fall and the quantity will rise (d) Equilibrium price will rise and the quantity will fall	**1**
28	Demand curve of a firm is perfectly elastic under: (a) Perfect competition (b) Monopoly (c)Monopolistic (d) Oligopoly	**1**
29	 In the above figure point A and B shows: (a) Excess demand (b) Excess supply (c) Equilibrium price Equilibrium quantity	**1**
30	 Which of the following is shown in the above figure? (a) Price ceiling (b) Price floor (c) Excess supply Equilibrium price	**1**
31	"Under price ceiling the government fixes price higher than equilibrium price" Whether the statement is true or false. Explain with valid reason.	**3**
32	Using three valid points differentiate between Price ceiling and Price floor.	**3**

33	Explain two consequence of maximum price ceiling.	**3**
34	How are the total revenue of a firm, market price, and the quantity sold by that firm related to each other?	**3**
35	Why is the total revenue curve of a price-taking firm an upward-sloping straight line? Why does the curve pass through the origin?	**3**
36	Define the implication of :A large number of sellers in perfect competition	**3**
37	At what level of price do the firms in a perfectly competitive market supply, when free entry and exit is allowed in the market? How is equilibrium quantity determined in such a market?	**3**
38	If government reduces subsidy on LPG cylinders, how does it affect its market price? What alternative energy sources can be used by the consumers?	**3**
39	Why does government intervene to affect market equilibrium?	**3**
40	Why does a firm under perfect competition not lower the price to increase its sales?	**4**
41	In a situation of perfectly elastic supply, equilibrium price never changes, no matter what the demand is, is it true? Explain Diagrammatically.	**4**
42	In India, retail price of petrol has significantly fallen during the past six months, but demand for cars has not shown any significant rise. Explain why.	**4**
43	“Retail tomato prices have seen a significant jump, reaching close to Rs. 154/kg in major cities primarily due to heavy rain fall in the tomato – producing regions.” From the above statement explain diagrammatically the effect on equilibrium price and quantity.	**4**
44	“A decrease in price of complementary good cause a fall in equilibrium price of the commodity.” Whether the given statement is true or false. Give reason with help of diagram.	**4**
45	Why is a firm under perfect competition a price taker not a price maker? Explain.	**4**
46	Case based study: If our income rises, we generally tend to buy more of the goods. More income would mean more pens, more shirts, more shoes, more cars and so on. But there are exceptions. If initially, you are buying coarse grain, how would you take your increase in income now? Perhaps, as a first step, you would discard the consumption of inferiors. Surely, this happens in the deserts of Rajasthan where the rich minority eats wheat while the poor majority eats Bajra as their staple food. 1) The law of demand does not apply to ____________________goods. (Normal/ Giffen) 2) Inferior goods are those whose income effect is______________. (Negative/ Positive)	**4**

	3)A fall in income of the consumer (in case of normal goods) will cause a) upward movement on the demand curve. b) downward movement on the demand curve c)rightward shift of the demand curve d)leftward shift of the demand curve 4)As a result of rise in consumer's income, the demand curve for coarse-grain (inferior good) a) becomes a horizontal straight line b) becomes a vertical straight line c) shifts to the right d) shifts to the left	
47	A market for a good is in equilibrium. Demand for good 'increases'. Explain the chain effects of this change.	**4**
48	Explain the implication of free entry and free exit of a firm in the perfect competition market.	**4**
49	Perfect competition is no competition. How?	**6**
50	The following headline appeared in The Times of India: "Purchase only made-in-India gadgets." Use economic theory to analyse the impact of the statement in terms of competition in the domestic market.	**6**
51	Is FDI (foreign direct investment) in retail trading a step towards competitive market structure? concentration.	**6**
52	How will a change in price of coffee affect the equilibrium price of tea? Explain the effect on equilibrium quantity also through a diagram.	**6**
53	A situation of excess demand or excess supply is automatically corrected under perfect competition. Do you agree? Explain the process of correction.	**6**
54	Explain the price floor with the help of a diagram and write its implications.	**6**
55	In the period of COVID-19 pandemic the equilibrium price of drug Remdesivir is too high. Explain what possible steps could be taken to bring down the equilibrium price but only through the market forces. Also explain the series of changes that would occur in the market.	**6**
56	Explain the implications of the following in a perfectly competitive market: (a) Large number of buyers. (b) Large number of sellers. (c) Freedom of entry and exit to firms.	**6**
57	Explain through diagramms all three possible situations of a simultaneous rightward shift of both the demand and supply curves on equilibrium price and quantity.	**6**

ANSWER

1	Answer: a
2	Answer: a
3	Answer: c
4	Answer: a
5	Answer: d
6	Correct answer is option ‘C’
7	Correct answer is option 'A'.
8	. Correct answer is option ‘C’
9	Ans: True
10	. Answer: A
11	(C) Perfect Competition
12	In perfect competition market firm, average revenue and marginal revenue of a firm always equal.
13	(A) Firm has full control over price.
14	(D) All of these.
15	c) market demand=market supply
16	When demand increases more than supply, the equilibrium price of a commodity will rise.
17	Equilibrium price remains constant.
18	OP- equilibrium price OQ- equilibrium quantity
19	c) Minimum price ceiling
20	In India, price ceiling is imposed on wheat, rice, sugar, kerosene oil etc. (write any one)
21	(c) Price discrimination
22	(d) Perfect mobility
23	(a)Equilibrium price
24	(b) Statement 1 is false and statement 2 is true
25	(c) Assertion (A) is true, but Reason (R) is false.
26	(c) Both statements 1 and 2 are true
27	(c) Equilibrium price will fall and the quantity will rise
28	(a) Perfect competition
29	(b) Excess supply
30	(a) Price ceiling
31	False. Under price ceiling the government fixes price lower than equilibrium price to the concerned commodity remains within the reach of the poorer section to the society.
32	Price Ceiling: 1. It means maximum price of a commodity that the sellers can charge. 2. Government fixes price lower than the equilibrium market price 3. It benefits poorer section (consumer) of society Price floor: 1. It means minimum price of a commodity that producer must get.

	2. Government fixes price higher than the equilibrium market price. 3. It protects the interest of producers
33	Maximum price ceiling leads to (i) excess demand and (ii) black marketing. To prevent black marketing, the government may have to resort rationing of the product. Other valid points..
34	ANSWER: Total revenue is defined as the total sales proceeds of a producer by selling corresponding level of output. In other words, it is defined as price times the quantity of output sold. Total Revenue = Price × Quantity of output sold $TR = P \times Q$ $TR = PQ$ In a perfectly competitive market, the market price is given, i.e., a firm acts as a price taker and cannot influence the price. Hence, a particular firm can influence its TR by altering the quantity of output sold.
35	ANSWER: The total revenue curve for a firm in a perfectly competitive market is an upward sloping curve because the price or AR remains constant and MR is also equal to AR. Thus, TR can only be influenced by altering the output sold, as the price remains constant. The increase in TR is in the same proportion as the increase in the output sold. The curve passes through the origin, which implies that no matter what the price level is, if the output sold is zero, TR will also be zero. . 
36	**Answer:** A perfectly competitive market is controlled by the existence of a large number of sellers and buyers of a product, which means that no buyers or sellers will purchase and sell shares that are so large that it will impact the total purchase and sale in the market.

<table>
<tr><td>37</td><td>Free entry and exit takes place in the long run in a perfectly competitive market. Equilibrium price will always be equal to the minimum AC,

That is Price= Minimum AC

At equilibrium the quantity supplied will be determined by the market demand at that price so that they are equal. Thus, in long run due to free entry and exit of firms,P=MC=AC, and each firm supplies OQ_1 level of output.

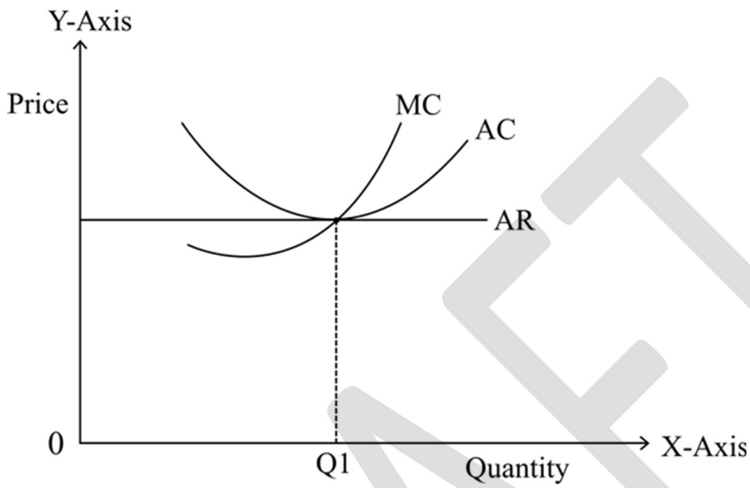
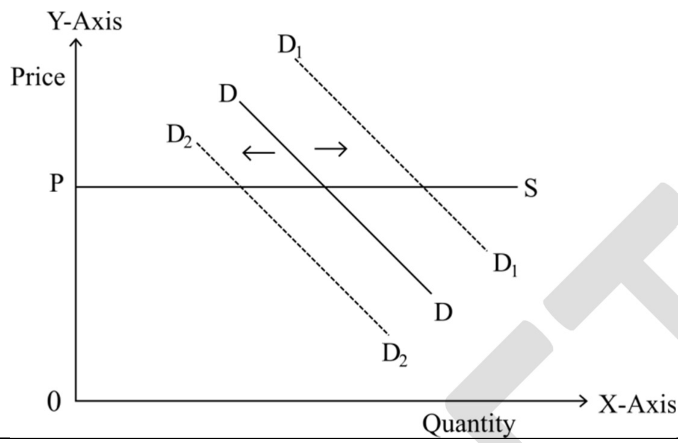


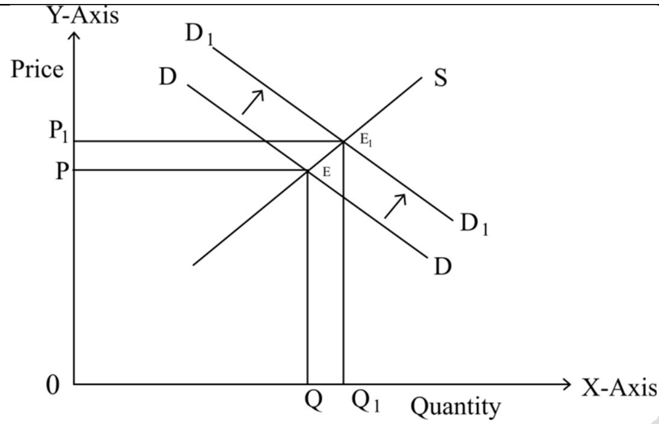
Figure 1(A)</td></tr>
<tr><td>38</td><td>If government reduces subsidy on LPG cylinders, then reduction of subsidy will increase its market price.

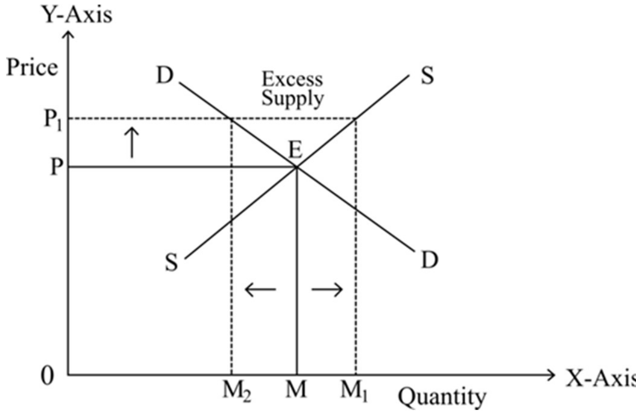
As a result the households can use the following alternative sources of energies as given below-

a) Solar energy in solar cooker
b) Kerosene oil
c) Induction cooker
d) Bio gas energy
e) Microwave</td></tr>
<tr><td>39</td><td>Government intervene to affect market equilibrium in order to regulate the prices of certain goods and services when their prices are either too high or too low in comparison to the desired levels. Price ceiling and price floor are measures of direct intervention by the government.</td></tr>
<tr><td>40</td><td>A perfectly competitive firm will not lower the price because of the following reasons,
a) A firm under perfect competition can sell whatever amount it wishes to sell at the existing price so that there is no reason to lower the price.</td></tr>
</table>

	b) An individual firm under perfect competition is such a small supplier in the market that by lowering the price, it cannot fulfill the entire market demand for the commodity. Accordingly, the policy of capturing market by lowering the price will fail.
41	Yes, it is true. Equilibrium price will remain unchanged when supply is perfectly elastic whether demand increases or decreases. In the fig here, price remains constant at OP when demand increases to D_1 and also remains constant at OP when demand decreases to D_2. 
42	Car and petrol are complementary goods. A significant fall in the price of petrol is expected to induce a rise in demand for cars. But, it did not happen. The reason is as this: Car is expensive consumer good. Demand for cars is expected to rise only due to any one or more of the following factors: (1) There is a significant rise in income of the buyers, (2) There is a significant fall in the price of cars. (3) There is a significant cut in the interest rate for car loans. None of these factors has shown any positive change during the past six months. Accordingly, demand for cars has not shown any rise in response to fall in petrol price in India.
43	The statement explains the shortage to tomato due to heavy rainfall so the supply of tomato decreases but the demand remains constant due to fastival season therefore equilibrium price rises and equilibrium quantity decreases. Expalnation with graphs of demand and supply curves-
44	Fasle. A decrease in price of complementary good cause a rise in equilibrium price of the commodity. Because decrease in price of complementary good means increase in demand for the said commodity. For example if petrol prices go upward demand of motorbike will decrease people will prefer bycycle or electric bike instead of petro bike. Diagram..
45	An individual firm under perfect competion is a price taker owing to the following reasons: (i) An individual firm under perfect competion makes sucha small contribution to the market supply, that toral supply remains unaffected by any change in the firm's supply. (ii) All firms in the market are selling homogeneous product. Accordingly, even partial control over price is not possible through product differentiation. (iii) If any firm tries to fix its own price it would not succed. Higher than market price would drive the buyers to a large number of other sellers.

	(iv) If it fixes price lower than market price would be an irrational decision when any amount of the commodity can be sold by a firm at the existing price.
46	Answer Key: 1)Giffen 2)Negative 3) Leftward shift of the demand curve 4) Shifts to the left
47	Answer: The chain effects of this change are: 1. When the price is constant, surplus demand emerges 2. This also increases the competition among the buyers insisting them to raise the price 3. A rise in the price of a product cause fall or decrease in the demand and expansion or rise in supply 4. The cost of the product continues to increase until the market is balanced at a greater price
48	Answer: The implication of free entry and free exit of a firm in the perfect competition market is that in this market structure, no company earns an unusual profit. Each company just earns a normal profit.
49	Ans. Because a firm under perfect competition can sell whatever amount it wishes to sell at the existing price. It only has to adjust its output and supply; there is no price war or price competition in the market. Also, there is no commodity competition because all producers of a commodity are selling only homogeneous product; there is no product differentiation.
50	Ans. Often this heading comes as an appeal by the government to the citizens of the country. This appeal is expected to offer protection to the domestic industry from foreign competition. Competition in the domestic market is likely to reduce. The market will drift more towards oligopolistic structure in which a few domestic firms dominate the market.
51	Ans. FDI in retail trading is expected to promote competitive market structure. But, a market structure in which there is competition among a few. Because, only big firms can bring FDI. Once big firms enter the market, they tend to increase their control of the market through heavy advertisement. Initially, these firms may sell their product at a lower price, lower than the domestic producers. This is called 'price-cutting'. But once they achieve a strong foot-hold, they start exploiting the market by charging higher and higher price. There is a competitive market structure, but with high market concentration.
52	Coffee and tea are substitute goods. Let us assume that the price of coffee increases. This will cause a shift in demand curve for tea to the right as shown in the figure 5.

	 In the figure 5, DD is the initial demand curve and SS is the initial supply curve related to tea. E is the initial equilibrium where supply and demand curves intersect each other. OP is the equilibrium price and OQ is the equilibrium quantity of tea. When the price of coffee increases, demand curve (for tea) shifts forward as indicated by D_1. Consequently, equilibrium price (of tea) increases from OP to OP_1 and equilibrium quantity increases from OQ to OQ_1. In case price of coffee decreases, demand curve for tea would shift to the left. Consequently, new equilibrium would indicate a fall in equilibrium quantity as well as a fall in equilibrium price.
53	Yes. Under perfect competition, situations of excess demand or excess supply are automatically corrected through the free play of market forces, called price mechanism. When there is excess supply: - Market price decreases. - Decrease in market price leads to extension of demand and contraction of supply. - The process of extension and contraction continues till excess supply is eliminated. - New equilibrium is established with lower price and higher quantity than before. When there is excess demand: - Market price increases. - Increase in market price causes contraction of demand and extension of supply. - The process of extension and contraction continues till excess demand is eliminated. New equilibrium is established with higher price and higher quantity than before.

<table>
<tr>
<td>54</td>
<td>


Perfect competition.

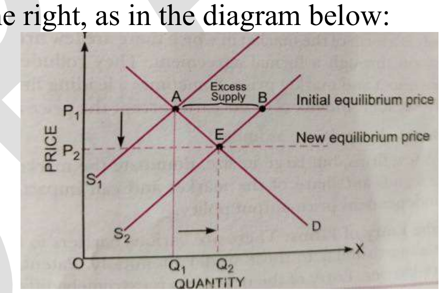
OP_1 is the minimum price (price floor)

Price floor is used or meant to protect the farmers from income fluctuations which result from price variations in the free market.

Implications:

i) Minimum Wage Legislation-
ii) Agriculturl Price Support Programmes- Buffer stock creation by the government .

Brief explanation of the above two implications.
</td>
</tr>
<tr>
<td>55</td>
<td>
Possible steps to lower the market price of the said medicine are as these:
(i) The government can lower/abolish taxes on the production of medicine.
(ii) The government can offer subsidy to the producer engaged in the production of the concerned medicine.
In either situation the market supply of the product is expected to rise, leading to a shift in the supply curve to the right, as in the diagram below:

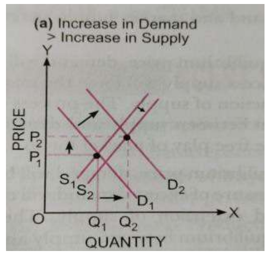


A shift in supply curve from S_1 to S_2 generates exess supply = AB. This leads to a fall in market price. Finally, new market equlibrium is struck at point E, indicating lower market price and higher equilibrium quantity.
</td>
</tr>
<tr>
<td>56</td>
<td>
(a) It implies that by varying buyer’s demand, an individual buyer cannot affect total market demand for commodity. Accordingly, an individual buyer cannot influence market price of the commodlity.
(b) It implies that any increase or decrease in supply by an individual firm hardly impacts the total market supply and consequently, an individual firm cnnot inpact market price of the commodity.
It implies that only normal profits prevail in the long run.Extra-normal profit would be eliminated when new firms join the industry, rising market supply and lowering market price. Losses would be elimkinated when some of the existing firms quit the industry, reducing market supply and raising market price.
</td>
</tr>
</table>

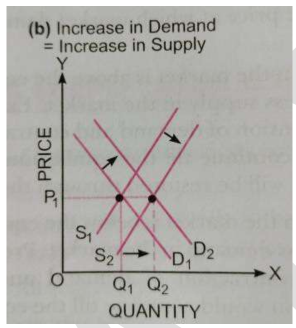
57

There are three possible situations of a simultaneous rightward shift of both the demand and supply curves:

(i) When demand increases more than supply, equilibrium price the quantity both rises.



(ii) When demand and supply increase equally, equilibrium price will remain unchange.



(iii) When demand increases less than supply, euqilibrium price will fall and equilibrium quantity will rise.