

Place your name on the back of this sheet of paper and nowhere else. Staple your answers face up on the front of this sheet of paper. Failure to follow these directions will cost you 10 points. Your assignment will be typed, except graphs can be drawn by hand and mathematical equations can be done by hand. Failure to type it will cost you 10 points. If you use double-sided printing or print on the back of scrap paper, I will give you one additional point.

- 1) (35 points) Draw the supply and demand for a perfectly competitive industry and the ATC/AVC/MC/D diagram for one firm in that industry which is making zero economic profit. Illustrate the short-run effects of an increase in the price of raw materials. Explain why the curves moved as drawn. Is the firm now making losses or profits? Show the area on the graph and explain how you found it.
- 2) (35 points) Draw the supply and demand for a perfectly competitive industry and the ATC/AVC/MC/D diagram for one firm in that industry which is making positive economic profits. Show the area on the graph which is the profits and explain how you found it. Illustrate the effects of the industry going back to the long-run equilibrium. Assume it is a constant cost industry. Explain why the curves moved as drawn. Show the area on the graph which is the profits and explain how you found it.
- 3) (15 points) We said the supply curve is part of the MC curve for a perfectly competitive firm. Why is it the MC curve? Why only part of the curve?
- 4) (15 points) What is meant by a decreasing cost industry? What could result in that type of industry?