Economics 11 Caltech Spring 2010

QUIZ 5

The answers to the whole homework will be available Friday at 2pm.

Definitions (use words not equations)

3 lines or less

1pt Please define: Free Entry and exit.
The movement of firms in and out of an industry that is not impeded by regulation, other firms, or any other barriers

1pt Please define: Constant returns to scale
When average costs are constant, when marginal cost is constant and there are no fixed costs.

1pt Please define: short run average cost curve
Cost curve that only takes into account variable costs (fixed costs and other inputs that can only be adjusted in the long run are not taken into account).

2. Graph problem

- 3 pts Suppose corn farmers in the US can be represented by a competitive industry with no economies or diseconomies of scale. Describe how this industry would adjust to an increase in demand for corn due to a corn bread fad. Explain your answer graphically; showing the cost curves for the typical farmer as well as the market supply and demand curves for short run and long run.

- Before the shock they are in long run equilibrium P=AC=MC and there are no profits.

- in the short run existing farmers farm existing acreage and if there is an increase in the demand for corn, those farmers will increase their output by moving out along their individual marginal cost curves. So price will go up and quantity will go up. Because this is a departure from the long run equilibrium there will be profits

- in the second phase, there will be entry (either of new farmers or farmers will add more acres under corn) and there will be another increase in quantity followed by a decline in price until one returns to the long run equilibrium price (P=AC=MC) and there will be zero profits.