

## Microeconomics, Module 8, “Competitive Firm in the Long-Run”

*Required reading for seventh edition:*

(The attached PDF file has better formatting.)

Updated: November 20, 2007

{The Landsburg textbook is excellent. We say to read certain sections and to skip others. This does not mean that certain sections are better; it means that the homework assignments and exam problems are based on the sections that you must read for this course. Some of the skipped sections are fascinating, but they are not tested.}

Module 8 covers sections 7.3, 7.4, and 7.7; skip sections 7.5 and 7.6, which are not tested on the final exam and have no homework assignments.

Read section 7.3; know especially the concept in the middle of page 186 that economic profits differ from accounting profits because they consider the foregone opportunities. The same material is covered in the corporate finance course.

Long-run competitive pricing sets price equal to minimum average total cost, which includes both fixed and variable opportunity costs; examples are

- A market return on the capital used to buy fixed assets.
- The potential labor income if the entrepreneur worked at another job.

For the short run formula of marginal revenue equals marginal cost, we include the short term opportunity costs, such as earnings in a temporary job for the entrepreneur. In most cases, the opportunity costs are long-run, not short run.

You can skip the *details* in the example about Floyd the Barber on pages 187-188, but know the formula at the bottom of page 188:  $\text{profit} = P - AC$ . Know the relation for cost minimization on page 189: “When a competitive firm breaks even, it produces at the lowest possible average cost.”

Read section 7.4 on pages 190-195; this covers the constant-cost case of the competitive industry. You can skip the “Application” on pages 206-207.

Skip section 7.5; it is not tested on the final exam and there are no homework assignments from this section. Section 7.6 is fascinating: the discussions of rent control, motel room rents, and busboy tips are wonderful applications of economic theory to everyday matters. These applications are *not* tested on the final exam. The *overview and concepts* posting on the discussion forum summarizes the applications for interested candidates.

Read section 7.7 on pages 206-208, a two page summary of the essential relations in short run and long-run competition. Read also the summary on pages 208-209, which is a less technical summary.