Microeconomics, Module 5: The Behavior of Firms

Reading: Landsburg, Chapter 5

(Outline for candidates: what to focus on and what the final exam will test)

(The attached PDF file has better formatting.)

Updated: June 7, 2005

Module 5 deals with the economic decision making of a firm.

- Section 5.1 shows how the equimarginal principle compares benefits and costs.
- Section 5.2 applies the principle to production and pricing scenarios.

Focus on the following topics:

Section 5.1: Marginal benefit is the additional benefit from the last unit of an economic activity; marginal cost is the additional cost for the last unit of that activity.

Equimarginal principle: An activity should be done up to the point where marginal cost equals marginal benefit, if marginal benefit is decreasing and marginal cost is increasing. We could generalize the definition as “if marginal cost is increasing faster or decreasing slower than marginal benefit.”

Section 5.2: To maximize profit, a firm produces where marginal cost equals marginal revenue. Changes in marginal cost or in demand change the price and quantity. Changes in fixed cost do not affect price or quantity unless they cause the firm to shut down.