

Chapter 1 : Long run and short run - Wikipedia

In economics, it's extremely important to understand the distinction between the short run and the long run. As it turns out, the definition of these terms depends on whether they are being used in a microeconomic or macroeconomic context.

The most prominent application of these two terms is in the study of economics. A short run can be any period of time ranging from a couple of weeks to months or even a year. On the other hand, a long run can also span over the same period of time depending on the company and the set parameters. In economics, a short run and a long run are used as reference time approaches. Various economic concepts like supply, demand, input, costs, and other variables are set into either a short run or a long run to predict or examine changes from one timeframe to another or from one variable to another. This ability to predict or presuppose allows the company the opportunity to strategize, recover losses, prevent bankruptcy, and closure. In economics, a short run characterizes the time when one factor of production is fixed and another factor is variable. The limitation of time also contributes to the limitation to stabilize or change some of the variables or factors in the business. For a business, the short run is a good period to increase raw materials or labor since these variables can be easily accomplished in comparison to other factors of production. Companies in this period of time are in the status quo. There are no new competitors or new companies, but there are also no companies getting out of the industry. In contrast, the short run period includes no fixed factors of production or all factors are variable. In addition, the business has fully adjusted to the operating schedule, activities, as well as economic situation. The long run is also considered a time for re-evaluating and assessing the company. A long run implies stability and continuity; the business can expand by acquiring more capital or increasing production for more profit. Another scenario can include competition in the industry. New companies can enter the industry in the market, while bankrupt businesses can exit without restriction. It is not a specific period of time but rather more of an estimation. In economics, it is present in many contexts, models, theories, and approaches. Both terms refer to the period of time where all factors of production are both fixed and varied or all varied. A short run is a period of time characterized by some fixed and variable factors. Since factors are stilted, a limited number of factors like the amount of raw materials or personnel can be changed or manipulated. The business can now initiate expansion activities or competition. Another difference is the state of the industry in these two periods. In a short run, companies cannot enter or exit an industry, while the long run period has more flexibility; companies have excess to go in or out depending on their development and progress. If you like this article or our site. Please spread the word.

Chapter 2 : Perfect competition - Wikipedia

In macroeconomics, the long run is the period when the general price level, contractual wage rates, and expectations adjust fully to the state of the economy, in contrast to the short run when.

Perfect information – All consumers and producers know all prices of products and utilities each person would get from owning each product. Homogeneous products – The products are perfect substitutes for each other, i. Well defined property rights – These determine what may be sold, as well as what rights are conferred on the buyer. Every participant is a price taker – No participant with market power to set prices Perfect factor mobility – In the long run factors of production are perfectly mobile, allowing free long term adjustments to changing market conditions. Profit maximization of sellers – Firms sell where the most profit is generated, where marginal costs meet marginal revenue. Buyers make all trades that increase their economic utility and make no trades that do not increase their utility. No externalities – Costs or benefits of an activity do not affect third parties. This criteria also excludes any government intervention. Zero transaction costs – Buyers and sellers do not incur costs in making an exchange of goods in a perfectly competitive market. Non-increasing returns to scale and no network effects – The lack of economies of scale or network effects ensures that there will always be a sufficient number of firms in the industry. Anti-competitive regulation - It is assumed that a market of perfect competition shall provide the regulations and protections implicit in the control of and elimination of anti-competitive activity in the market place. Normal profit[edit] In a perfect market the sellers operate at zero economic surplus: Normal profit is a component of implicit costs and not a component of business profit at all. It represents the opportunity cost, as the time that the owner spends running the firm could be spent on running a different firm. The enterprise component of normal profit is thus the profit that a business owner considers necessary to make running the business worth her or his while i. Only normal profits arise in circumstances of perfect competition when long run economic equilibrium is reached; there is no incentive for firms to either enter or leave the industry. Economic profit does not occur in perfect competition in long run equilibrium; if it did, there would be an incentive for new firms to enter the industry, aided by a lack of barriers to entry until there was no longer any economic profit. New firms will continue to enter the industry until the price of the product is lowered to the point that it is the same as the average cost of producing the product, and all of the economic profit disappears. Normally, a firm that introduces a differentiated product can initially secure a temporary market power for a short while See "Persistence" in Monopoly Profit. At this stage, the initial price the consumer must pay for the product is high, and the demand for, as well as the availability of the product in the market , will be limited. In the long run, however, when the profitability of the product is well established, and because there are few barriers to entry , [7] [8] [9] the number of firms that produce this product will increase until the available supply of the product eventually becomes relatively large, the price of the product shrinks down to the level of the average cost of producing the product. When this finally occurs, all monopoly profit associated with producing and selling the product disappears, and the initial monopoly turns into a competitive industry. Profit can, however, occur in competitive and contestable markets in the short run, as firms jostle for market position. Once risk is accounted for, long-lasting economic profit in a competitive market is thus viewed as the result of constant cost-cutting and performance improvement ahead of industry competitors, allowing costs to be below the market-set price. In uncompetitive markets[edit] A monopolist can set a price in excess of costs, making an economic profit shaded. Economic profit is, however, much more prevalent in uncompetitive markets such as in a perfect monopoly or oligopoly situation. In these scenarios, individual firms have some element of market power: Though monopolists are constrained by consumer demand , they are not price takers, but instead either price-setters or quantity setters. This allows the firm to set a price which is higher than that which would be found in a similar but more competitive industry, allowing them economic profit in both the long and short run. In cases where barriers are present, but more than one firm, firms can collude to limit production, thereby restricting supply in order to ensure the price of the product remains high enough to ensure all of the firms in the industry achieve an economic profit. The economic profit is equal to the quantity of output multiplied by

the difference between the average cost and the price. Government intervention[edit] Often, governments will try to intervene in uncompetitive markets to make them more competitive. Antitrust US or competition elsewhere laws were created to prevent powerful firms from using their economic power to artificially create the barriers to entry they need to protect their economic profits. Microsoft ; after a successful appeal on technical grounds, Microsoft agreed to a settlement with the Department of Justice in which they were faced with stringent oversight procedures and explicit requirements [12] designed to prevent this predatory behaviour. With lower barriers, new firms can enter the market again, making the long run equilibrium much more like that of a competitive industry, with no economic profit for firms. This does not necessarily ensure zero Economic profit for the firm, but eliminates a "Pure Monopoly" Profit. Although a regulated firm will not have an economic profit as large as it would in an unregulated situation, it can still make profits well above a competitive firm in a truly competitive market. This situation is shown in this diagram, as the price or average revenue, denoted by P , is above the average cost denoted by C . However, in the long run, economic profit cannot be sustained. The arrival of new firms or expansion of existing firms if returns to scale are constant in the market causes the horizontal demand curve of each individual firm to shift downward, bringing down at the same time the price, the average revenue and marginal revenue curve. The final outcome is that, in the long run, the firm will make only normal profit zero economic profit. Its horizontal demand curve will touch its average total cost curve at its lowest point. In a perfectly competitive market, the demand curve facing a firm is perfectly elastic. As mentioned above, the perfect competition model, if interpreted as applying also to short-period or very-short-period behaviour, is approximated only by markets of homogeneous products produced and purchased by very many sellers and buyers, usually organized markets for agricultural products or raw materials. In real-world markets, assumptions such as perfect information cannot be verified and are only approximated in organized double-auction markets where most agents wait and observe the behaviour of prices before deciding to exchange but in the long-period interpretation perfect information is not necessary, the analysis only aims at determining the average around which market prices gravitate, and for gravitation to operate one does not need perfect information. In the absence of externalities and public goods, perfectly competitive equilibria are Pareto-efficient, i. This is called the First Theorem of Welfare Economics. The basic reason is that no productive factor with a non-zero marginal product is left unutilized, and the units of each factor are so allocated as to yield the same indirect marginal utility in all uses, a basic efficiency condition if this indirect marginal utility were higher in one use than in other ones, a Pareto improvement could be achieved by transferring a small amount of the factor to the use where it yields a higher marginal utility. A simple proof assuming differentiable utility functions and production functions is the following. With our choice of units the marginal utility of the amount of the factor consumed directly by the optimizing consumer is again w , so the amount supplied of the factor too satisfies the condition of optimal allocation. Monopoly violates this optimal allocation condition, because in a monopolized industry market price is above marginal cost, and this means that factors are underutilized in the monopolized industry, they have a higher indirect marginal utility than in their uses in competitive industries. Of course this theorem is considered irrelevant by economists who do not believe that general equilibrium theory correctly predicts the functioning of market economies; but it is given great importance by neoclassical economists and it is the theoretical reason given by them for combating monopolies and for antitrust legislation. Profit[edit] In contrast to a monopoly or oligopoly , in perfect competition it is impossible for a firm to earn economic profit in the long run, which is to say that a firm cannot make any more money than is necessary to cover its economic costs. Neoclassical theory defines profit as what is left of revenue after all costs have been subtracted; including normal interest on capital plus the normal excess over it required to cover risk, and normal salary for managerial activity. This means that profit is calculated after the actors are compensated for their opportunity costs. Thus, the classical approach does not account for opportunity costs. Profits in the classical meaning do not necessarily disappear in the long period but tend to normal profit. With this terminology, if a firm is earning abnormal profit in the short term, this will act as a trigger for other firms to enter the market. As other firms enter the market, the market supply curve will shift out, causing prices to fall. Existing firms will react to this lower price by adjusting their capital stock downward. Laboratory experiments in which participants have significant price

setting power and little or no information about their counterparts consistently produce efficient results given the proper trading institutions. By shutting down a firm avoids all variable costs. The size of the fixed costs is irrelevant as it is a sunk cost. The same consideration is used whether fixed costs are one dollar or one million dollars. The rule is conventionally stated in terms of price average revenue and average variable costs. If the firm decides to operate, the firm will continue to produce where marginal revenue equals marginal costs because these conditions insure not only profit maximization loss minimization but also maximum contribution. Another way to state the rule is that a firm should compare the profits from operating to those realized if it shutdown and select the option that produces the greater profit. However, the firm still has to pay fixed cost. A decision to shut down means that the firm is temporarily suspending production. It does not mean that the firm is going out of business exiting the industry. Shutting down is a short-run decision. A firm that has shut down is not producing. The firm still retains its capital assets; however, the firm cannot leave the industry or avoid its fixed costs in the short run. Exit is a long-term decision. A firm that has exited an industry has avoided all commitments and freed all capital for use in more profitable enterprises. In the long run, the firm will have to earn sufficient revenue to cover all its expenses and must decide whether to continue in business or to leave the industry and pursue profits elsewhere. The long-run decision is based on the relationship of the price and long-run average costs. These comparisons will be made after the firm has made the necessary and feasible long-term adjustments. In the long run a firm operates where marginal revenue equals long-run marginal costs. Portions of the marginal cost curve below the shut down point are not part of the SR supply curve because the firm is not producing in that range. Technically the SR supply curve is a discontinuous function composed of the segment of the MC curve at and above minimum of the average variable cost curve and a segment that runs with the vertical axis from the origin to but not including a point "parallel" to minimum average variable costs. An example is that of a large action of identical goods with all potential buyers and sellers present. By design, a stock exchange resembles this, not as a complete description for no markets may satisfy all requirements of the model but as an approximation. The flaw in considering the stock exchange as an example of Perfect Competition is the fact that large institutional investors e. This, of course, violates the condition that "no one seller can influence market price". Horse betting is also quite a close approximation. When placing bets, consumers can just look down the line to see who is offering the best odds, and so no one bookie can offer worse odds than those being offered by the market as a whole, since consumers will just go to another bookie. This makes the bookies price-takers. Furthermore, the product on offer is very homogeneous, with the only differences between individual bets being the pay-off and the horse. Of course, there are not an infinite amount of bookies, and some barriers to entry exist, such as a license and the capital required to set up. These criticisms point to the frequent lack of realism of the assumptions of product homogeneity and impossibility to differentiate it, but apart from this the accusation of passivity appears correct only for short-period or very-short-period analyses, in long-period analyses the inability of price to diverge from the natural or long-period price is due to active reactions of entry or exit. Some economists have a different kind of criticism concerning perfect competition model. They are not criticizing the price taker assumption because it makes economic agents too "passive", but because it then raises the question of who sets the prices. Indeed, if everyone is price taker, there is the need for a benevolent planner who gives and sets the prices, in other word, there is a need for a "price maker". Therefore, it makes the perfect competition model appropriate not to describe a decentralize "market" economy but a centralized one. This in turn means that such kind of model has more to do with communism than capitalism. The Austrian School insists strongly on this criticism, and yet the neoclassical view of the working of market economies as fundamentally efficient, reflecting consumer choices and assigning to each agent his contribution to social welfare, is esteemed to be fundamentally correct. On this few economists, it would seem, would disagree, even among the neoclassical ones. Thus when the issue is normal, or long-period, product prices, differences on the validity of the perfect competition assumption do not appear to imply important differences on the existence or not of a tendency of rates of return toward uniformity as long as entry is possible, and what is found fundamentally lacking in the perfect competition model is the absence of marketing expenses and innovation as causes of costs that do enter normal average cost.

Chapter 3 : Perfect Competition: Short and Long Run - Managerial Economics (MBA/BBA)

In the study of economics, the long run and the short run don't refer to a specific period of time, such as five years versus three months. Rather, they are conceptual time periods, the primary difference being the flexibility and options decision-makers have in a given scenario.

Because the conditions for perfect competition are strict, there are few if any perfectly competitive markets. Specific characteristics may include: A large number buyers and sellers A large number of consumers with the willingness and ability to buy the product at a certain price, and a large number of producers with the willingness and ability to supply the product at a certain price. Perfect information All consumers and producers are assumed to have perfect knowledge of price, utility, quality and production methods of products. Zero transaction costs Buyers and sellers do not incur costs in making an exchange of goods in a perfectly competitive market. Homogeneous products The products are perfect substitutes for each other;i. Property rights Well defined property rights determine what may be sold, as well as what rights are conferred on the buyer. Rational buyers Buyers are capable of making rational purchases based on information given. No externalities Costs or benefits of an activity do not affect third parties. In the long run, perfectly competitive markets are both allocatively and productively efficient. The abandonment of price taking creates considerable difficulties for the demonstration of a general equilibrium except under other, very specific conditions such as that of monopolistic competition. Approaches and conditions In neoclassical economics there have been two strands of looking at what perfect competition is. The first emphasis is on the inability of any one agent to affect prices. Both approaches lead to the same result. The second view of perfect competition conceives of it in terms of agents taking advantage of " and hence, eliminating " profitable exchange opportunities. The implication is that the more competitive a market is Perfect Competition: The arrival of new firms or expansion of existing firms if returns to scale are constant in the market causes the horizontal demand curve of each individual firm to shift downward, bringing down at the same time the price, the average revenue and marginal revenue curve. The final outcome is that, in the long run, the firm will make only normal profit zero economic profit. Its horizontal demand curve will touch its average total cost curve at its lowest point. As mentioned above, the perfect competition model, if interpreted as applying also to short-period or very-short-period behaviour, is approximated only by markets of homogeneous products produced and purchased by very many sellers and buyers, usually organized markets for agricultural products or raw materials. In real-world markets, assumptions such as perfect information cannot be verified and are only approximated in organized double-auction markets where most agents wait and observe the behaviour of prices before deciding to exchange but in the long-period interpretation perfect information is not necessary, the analysis only aims at determining the average around which market prices gravitate, and for gravitation to operate one does not need perfect information. In the absence of externalities and public goods, perfectly competitive equilibria are Pareto-efficient, i. The basic reason is that no productive factor with a non-zero marginal product is left unutilized, and the units of each factor are so allocated as to yield the same indirect marginal utility in all uses, a basic efficiency condition if this indirect marginal utility were higher in one use than in other ones, a Pareto improvement could be achieved by transferring a small amount of the factor to the use where it yields a higher marginal utility. A simple proof assuming differentiable utility functions and production functions is the following. With our choice of units the marginal utility of the amount of the factor consumed directly by the optimizing consumer is again w , so the amount supplied of the factor too satisfies the condition of optimal allocation. Monopoly violates this optimal allocation condition, because in a monopolized industry market price is above marginal cost, and this means that factors are underutilized in the monopolized industry, they have a higher indirect marginal utility than in their uses in competitive industries. Of course this theorem is considered irrelevant by economists who do not believe that general equilibrium theory correctly predicts the functioning of market economies; but it is given great importance by neoclassical economists and it is the theoretical reason given by them for combating monopolies and for antitrust legislation. This means that profit is calculated after the actors are compensated for their opportunity costs.

Classical economists on the contrary define profit as what is left after subtracting costs except interest and risk coverage. Thus, the classical approach does not account for opportunity costs. Thus, if one leaves aside risk coverage for simplicity, the neoclassical zero-long-run-profit thesis would be re-expressed in classical parlance as profits coinciding with interest in the long period i . With this terminology, if a firm is earning abnormal profit in the short term, this will act as a trigger for other firms to enter the market. As other firms enter the market, the market supply curve will shift out, causing prices to fall. Existing firms will react to this lower price by adjusting their capital stock downward. This adjustment will cause their marginal cost to shift to the left causing the market supply curve to shift inward. However, the net effect of entry by new firms and adjustment by existing firms will be to shift the supply curve outward. The market price will be driven down until all firms are earning normal profit only. Laboratory experiments in which participants have significant price setting power and little or no information about their counterparts consistently produce efficient results given the proper trading institutions. The rationale for the rule is straightforward. By shutting down a firm avoids all variable costs. However, the firm must still pay fixed costs. Because fixed cost must be paid regardless of whether a firm operates they should not be considered in deciding whether to produce or shutdown. The size of the fixed costs is irrelevant as it is a sunk cost. The same consideration is used whether fixed costs are one dollar or one million dollars. The rule is conventionally stated in terms of price average revenue and average variable costs. If the firm decides to operate, the firm will continue to produce where marginal revenue equals marginal costs because these conditions insure not only profit maximization loss minimization but also maximum contribution. Another way to state the rule is that a firm should compare the profits from operating to those realized if it shutdown and select the option that produces the greater profit. A firm that is shutdown is generating zero revenue and incurring no variable costs. However, the firm still has to pay fixed cost. An operating firm is generating revenue, incurring variable costs and paying fixed costs. The difference between revenue, R , and variable costs, VC , is the contribution to fixed costs and any contribution is better than none. A decision to shut down means that the firm is temporarily suspending production. It does not mean that the firm is going out of business exiting the industry. If market conditions improve, and prices increase, the firm can resume production. Shutting down is a short-run decision. A firm that has shut down is not producing. The firm still retains its capital assets; however, the firm cannot leave the industry. In The long-run decision is based on the relationship of the price and long-run average costs. These comparisons will be made after the firm has made the necessary and feasible long-term adjustments. In the long run a firm operates where marginal revenue equals long-run marginal costs. Short-run supply curve The short run supply curve for a perfectly competitive firm is the marginal cost MC curve at and above the shutdown point. Portions of the marginal cost curve below the shut down point are not part of the SR supply curve because the firm is not producing in that range. Examples Though there is no actual perfectly competitive market in the real world, a number of approximations exist: An example is that of a large auction of identical goods with all potential buyers and sellers present. The flaw in considering the stock exchange as an example of Perfect Competition is the fact that large institutional investors e . Horse betting is also quite a close approximation. When placing bets, consumers can just look down the line to see who is offering the best odds, and so no one bookie can offer worse odds than those being offered by the market as a whole, since consumers will just go to another bookie. This makes the bookies price-takers. Furthermore, the product on offer is very homogeneous, with the only differences between individual bets being the pay-off and the horse. Of course, there are not an infinite amount of bookies, and some barriers to entry exist, such as a license and the capital required to set up. Anyone is free to enter and leave the market at no cost. All code is freely accessible and modifiable, and individuals are free to behave independently. Free software may be bought or sold at whatever price that the market may allow. There are large number of buyers and sellers. There are no entry or exit barriers. There is perfect mobility of the factors, i . The products are homogeneous.

Chapter 4 : Definition of Short Run in Economics | www.nxgvision.com

Long run. In the long run, firms change production levels in response to (expected) economic profits or losses, and the land, labour, capital goods and entrepreneurship vary to reach the minimum level of long-run average cost.

The short run, long run and very long run are different time periods in economics. Quick definition Short run "where one factor of production is fixed. This is a time period of fewer than six months. Long run "where all factors of production of a firm are variable. Short run In the short run one factor of production is fixed, e.g. capital. This means that if a firm wants to increase output, it could employ more workers, but not increase capital in the short run it takes time to expand. Therefore in the short run, we can get diminishing marginal returns, and marginal costs may start to increase quickly. Also, in the short run, we can see prices and wages out of equilibrium, e.g. during a recession. Long run The long run is a situation where all main factors of production are variable. The firm has time to build a bigger factory and respond to changes in demand. In the long run: We have time to build a bigger factory. Firms can enter or leave a market. Prices have time to adjust. For example, we may get a temporary surge in prices, but in the long-run, supply will increase to meet it. The SRAC is u-shaped because of diminishing returns in the short run. See cost curves The very long run The very long run is a situation where technology and factors beyond the control of a firm can change significantly, e.g. New technology may make current working processes outdated, e.g. Government policy may change, e.g. Short run long run in macroeconomics We can also see the short run and long run in macroeconomics. This entry was posted in.

Chapter 5 : Short-run, long-run, very long-run | Economics Help

Short run - where one factor of production (e.g. capital) is fixed. This is a time period of fewer than six months. Long run - where all factors of production of a firm are variable (e.g. a firm can build a bigger factory) A time period of greater than six months/one year Very long run - Where.

Chapter 6 : Short-Run Adjustment in Economics | Bizfluent

Rosenof explores the conflicts that arose among long-run theorists, arguing that such disputes served eventually to set the stage for the emergence and domination of a short-run Keynesian approach to economic policy that collapsed under the impact of stagflation.

Chapter 7 : Difference Between Short Run and Long Run | Difference Between

Economic Growth in the Short-run and Long-run by Jason Welker In this lesson we'll have a close look at two different types of economic growth: short-run "actual" growth and long-run "potential" growth.