

Test02_Fall2004_AnalyticalQuestionAnswerNotes

1. The information you are given implies that at the given point, the slope of the isoquant is steeper than that of the isocost line (for K on the vertical axis and L on the horizontal axis). Alternatively $\frac{MP_L}{MP_K} > \frac{P_L}{P_K}$. The firm could increase output by using less capital and more labor, holding expenditure fixed (i.e., moving down the isocost line).
2. In the short run, the market demand curve shifts to the left and:

Price falls

Market quantity falls

Quantity produced by a representative firm falls (firm operates where $P=MC$, and P has fallen)

Number of firms is fixed in short-run

In the long run, market supply shifts left as exit occurs (because of negative profits) and:

Price rises, returning to original level.

Market Quantity falls.

Quantity produced by a representative firm returns to original level.

Number of firms falls due to exit.