

a firm can earn economic profits in the short run

A Firm Can Earn Economic Profits in the Short Run: An In-Depth Analysis

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Keywords: economic profits, short run, firm profitability, market power, barriers to entry, competitive advantage, imperfect competition, supply and demand, economic rents, innovation.

Abstract: This report explores the conditions under which a firm can earn economic profits in the short run, a scenario that contradicts the assumptions of perfect competition in the long run. We examine how factors such as market power, barriers to entry, innovation, and temporary demand shocks can create opportunities for short-run economic profits. Empirical evidence and real-world examples are presented to support the assertion that a firm can earn economic profits in the short run.

1. Introduction: Challenging the Perfect Competition Paradigm

The standard economic model of perfect competition posits that in the long run, firms earn zero economic profits. This is due to the assumptions of free entry and exit, homogeneous products, and perfect information. However, the reality is that firms frequently earn positive economic profits, at least temporarily. Understanding how a firm can earn economic profits in the short run is crucial for both

theoretical and practical reasons. This report delves into the microeconomic principles and market conditions that allow for short-run profitability.

1. Defining Economic Profit

Before examining the conditions under which a firm can earn economic profits in the short run, it's crucial to define the term. Economic profit differs from accounting profit. Accounting profit considers only explicit costs (e.g., wages, rent, materials). Economic profit, however, incorporates both explicit and implicit costs. Implicit costs represent the opportunity cost of using resources already owned by the firm. For example, the forgone salary a business owner could have earned working elsewhere is an implicit cost. Only when revenue exceeds both explicit and implicit costs does a firm earn a positive economic profit.

1. Market Power as a Driver of Short-Run Economic Profits

One primary reason a firm can earn economic profits in the short run is market power. Market power refers to a firm's ability to influence the price of its output. In perfectly competitive markets, firms are price takers; they have no control over the market price. However, in imperfectly competitive markets (e.g., monopolies, oligopolies, monopolistic competition), firms possess some degree of market power. This allows them to charge prices above marginal cost, leading to positive economic profits, at least until competitors enter the market or substitutes emerge.

Data & Research: Numerous empirical studies have shown a strong positive correlation between market concentration (a measure of market power) and profitability. For instance, a study by Bain (1956) demonstrated that highly concentrated industries tend to exhibit higher profit margins than less concentrated industries.

1. Barriers to Entry: Protecting Short-Run Profits

High barriers to entry prevent new firms from easily entering a market and competing away economic profits. These barriers can be natural (e.g., economies of scale, control of essential resources) or artificial (e.g., patents, government regulations, licensing requirements). If a firm enjoys a significant barrier to entry, a firm can earn economic profits in the short run and possibly for an extended period.

Data & Research: Porter's Five Forces framework (Porter, 1979) provides a robust analytical tool for assessing the impact of barriers to entry on industry profitability. Empirical studies consistently show that industries with strong barriers to entry tend to have higher average profit rates.

1. Innovation and Technological Advantage:

Innovation can provide a firm with a temporary competitive advantage, allowing it to earn economic profits before competitors can imitate or surpass its innovation. This is particularly true in rapidly evolving industries where technological advancements occur frequently. A groundbreaking new product or process can create significant demand and allow the innovator to capture substantial short-run profits. A firm can earn economic profits in the short run through such innovative leaps.

Data & Research: Schumpeter's theory of creative destruction (Schumpeter, 1942) highlights the role of innovation in driving economic growth and creating temporary monopolies. Numerous case studies illustrate how companies that successfully innovate experience periods of high profitability.

1. Short-Run Demand Shocks:

Unexpected increases in demand can create temporary opportunities for firms to earn economic profits. For example, a sudden surge in demand for a particular product due to a natural disaster or a change in consumer preferences can allow firms to temporarily raise prices and increase profits before supply adjustments occur. A firm can earn economic profits in the short run as a result of these unpredictable market fluctuations.

Data & Research: Time-series analysis of industry-level data can reveal the impact of demand shocks on firm profitability. Studies examining the impact of unexpected events on specific industries often show a temporary spike in profitability.

1. The Role of Managerial Efficiency:

While market conditions play a significant role, efficient management practices also contribute to short-run profitability. Firms that effectively manage costs, optimize production processes, and successfully market their products are better positioned to generate higher profits than less efficient competitors. Even in competitive markets, superior managerial skills can help a firm can earn economic profits in the short run, at least until competitors catch up.

Data & Research: Studies on operational efficiency and its relationship to firm performance consistently demonstrate that firms with superior operational efficiency tend to have higher profit margins.

1. Conclusion:

Contrary to the long-run predictions of perfect competition, a firm can earn economic profits in the short run. This is possible due to various factors such as market power, barriers to entry, innovation, demand shocks, and superior managerial efficiency. Understanding these factors is critical for businesses seeking to enhance their profitability and for economists analyzing market dynamics. The ability to capture short-run economic profits often depends on the firm's ability to adapt, innovate, and exploit temporary market advantages.

FAQs:

1. What is the difference between economic profit and accounting profit? Economic profit considers both explicit and implicit costs, while accounting profit only considers explicit costs.
1. Can a firm earn economic profits in the long run? In perfectly competitive markets, no. However, in imperfectly competitive markets, firms can earn long-run economic profits if they maintain a sustainable competitive advantage.
1. How do barriers to entry influence short-run profits? High barriers to entry prevent competitors from eroding a firm's economic profits.
1. What role does innovation play in short-run profitability? Innovation can create temporary monopolies, enabling firms to earn substantial short-run profits.
1. Can demand shocks lead to short-run economic profits? Yes, unexpected increases in demand can create opportunities for temporary price increases and higher profits.

1. How does managerial efficiency affect a firm's profitability? Efficient management can reduce costs and improve market positioning, leading to higher profits.
1. What are some examples of industries with high short-run profitability? Pharmaceuticals (due to patents), technology (due to innovation), and some resource-based industries (due to limited resources) are examples.
1. Is it sustainable to rely solely on short-run economic profits? No, firms should strive to develop sustainable competitive advantages to maintain long-term profitability.
1. What strategies can firms use to maximize short-run profits? Strategies include effective cost management, aggressive marketing, innovation, and exploiting temporary market opportunities.

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a firm can earn economic profits in the short run: Economics Paul R. Krugman, Robin Wells, 2009-02-28 Offering an accessible and thorough introduction to economics, this text offers real-world examples to bring theory to life. Students and lecturers will benefit from the vast array of supplements, including a companion website with extra material and resources

a firm can earn economic profits in the short run: Microeconomic Principles and Problems Geoffrey Schneider, 2019-05-29 Microeconomic Principles and Problems offers a comprehensive introduction to all major perspectives in modern economics, including mainstream and heterodox approaches. Through providing multiple views of markets and how they work, it will leave readers better able to understand and analyse the complex behaviours of consumers, firms, and government officials, as well as the likely impact of a variety of economic events and policies. Most principles of microeconomics textbooks cover only mainstream economics, ignoring rich heterodox ideas. They also lack material on the great economists, including the important ideas of Adam Smith, Karl Marx, Thorstein Veblen, John Maynard Keynes and Friedrich Hayek. Mainstream books neglect the kind of historical analysis that is crucial to understanding trends that help us predict the future. Moreover, they focus on abstract models more than existing economic realities. This engaging book addresses these inadequacies. Including explicit coverage of the major heterodox schools of thought, it allows the reader to choose which ideas they find most compelling in explaining modern economic realities. Written in an engaging style focused on real world examples, this ground-breaking book brings economics to life. It offers the most contemporary and complete package for any pluralistic microeconomics class.

a firm can earn economic profits in the short run: Economics Patrick J. Welch, Gerry F. Welch, 2009-11-23 The ninth edition introduces business professionals to basic economic concepts, institutions, relationships, and terminology. It has been updated with the most current qualitative data. Over 20 new applications have been added that help them connect economics to real-world experiences. They'll gain insight into green economics and how business and the environment are related. Critical Thinking Cases are presented at the end of the chapter to show how concepts are applied. Up for Debate sections also examine the different sides of current economic issues. These updates prepare business professionals to apply their economic knowledge in the field.

Additional Resources

Equilibrium of Firm Under Perfect Competition: Long & Short ...

In the short run, a firm under perfect competition can make normal profits, economic profits, or suffer losses. Short run equilibrium is that state at which the firm attains maximum profit or ...

Intermediate Microeconomics - Purdue University

The erosion of profits only occurs in the long run, though, so competitive firms can earn temporary economic profits.

Intermediate Microeconomics W3211 Lecture 17: Equilibrium ...

Consequently, in a short-run equilibrium, some firms may earn positive economics profits, others may suffer economic losses, and still others may earn zero economic profit. (Notice: not true in ...

Chapter 14 Firms in Competitive Markets - hsto.info

ANSWER: In a competitive market where firms are earning economic profits, new firms will have an incentive to enter the market. This entry will expand the number of firms, increase the ...

Lecture 14 Spring 2009 Profit Maximization - Molly Dahl

Therefore, when a firm's technology exhibits constant returns-to-scale, earning a positive economic profit is inconsistent with firms being perfectly competitive. Hence constant returns-to ...

Chapter 8: Pure Competition in the Short Run - McGraw Hill...

cost is greater than total revenue, the firm incurs a loss; where total revenue is greater than total cost, the firm experiences an economic profit. Using this model, the firm maximizes profit at the ...

Short-run and Long-run Equilibrium in Perfect Competition ...

We can use this model to analyze a change in demand both in the short and in the long run. Suppose demand rises from D_0 to D_1 , as shown below. In the short run, no new firms can ...

Chapter 7: Producers in the Short Run Answers to Study ...

c) Economic profits are equal to accounting profits minus the opportunity cost of the owner's financial capital. Thus economic profits for Spruce Décor in 2019 are $\$115\,000 - \$64\,000 = \$51\,000$...

CHAPTER 8 PROFIT MAXIMIZATION AND COMPETITIVE SUPPLY

A firm will produce in the short run if the revenues it receives are greater than its variable costs. Remember that the firm's short-run supply curve is its marginal cost

PERFECTLY COMPETITIVE MARKETS - Boston University

In it, you will learn how perfectly competitive firms theoretically make production decisions to maximize their profits. Perhaps the most surprising concept in the chapter is the idea that ...

Ch. 9 Price searchers – sellers who can choose a price so as to ...

To find out how much profit the firm makes we also need to know where the ATC curve is on the graph (this is usually given to students in this course). We then look at the profit-maximizing ...

PRINCIPLES OF MICROECONOMICS 2e - Valdosta State ...

Does maximizing profit (producing where $MR = MC$) imply an actual economic profit? The answer depends on the relationship between price and average total cost, which is the average profit ...

Long-Run Costs and Output Decisions - UPJ

in three short-run circumstances: (1) firms earning economic profits, (2) firms suffering economic losses but continuing to operate to reduce or minimize those losses, and (3) firms that decide ...

PRINCIPLES OF MICROECONOMICS - University of Houston

While a firm can do nothing about its fixed costs in short-run decisions (by definition), it stops production if its revenues do not cover the costs that it can control (variable costs).

Perfectly Competitive Markets - Felix Munoz-Garcia

Economic Profit is the difference between a firm's sales revenue and the totality of its economic costs, including all relevant opportunity costs.

MARKETS WITHOUT POWER - Boston University

In it, you will learn how perfectly competitive firms theoretically make production decisions to maximize their profits. Perhaps the most surprising concept in the chapter is the idea that ...

Student Overview - questions and answers frq ordered

(a) Assume that a profit-maximizing firm in a perfectly competitive industry is earning economic profits. For a given market price, draw a correctly labeled graph and show each of the following ...

MPP 801 Perfect Competition K. Wainwright Study Questions

1. Comparing the short-run and long-run profit-maximizing positions of a perfectly competitive firm, which statement is true? A) The firm may have unexploited economies of scale in both the ...

Chapter 11 Perfect Competition - University of Victoria

In the short-run, the supply function of a competitive firm shows the quantity supplied at each price when one factor of production is fixed. When the firm decides to shut down production, $[q=0]$, ...

Chapter 14: Firms in Competitive Markets Principles of ...

(2)Economic profits have an essential role in the dynamics of markets. (a) When they are positive, firms have an incentive to enter. (b)When they are negative, firms have an incentive to exit.

Lecture # 14 – Profit Maximization - Syracuse University

This occurs until we reach zero economic profits. • Lesson: in long-run equilibrium, there are zero economic profits. • Definition of long- run equilibrium: o. All firms are maximizing profits. o. No ...

Chapter 14: Firms in Competitive Markets Principles of...

Figure 3: The Competitive Firm's Short Run Supply Curve. P. 275. iv. Spilt Milk and Other Sunk Costs

(1)Sunk cost is a cost that has already been committed and cannot be recovered. P. ...

Introduction to Monopolistic Competition - Fairfax County ...

short run and then on how an industry moves from the short run to the long run. Panels (a) and (b) of Figure 67.1 show two possible situations that a typical firm in a monopolistically competitive ...

MPP 801 Perfect Competition K. Wainwright Study...

The short-run shut down price for a perfectly competitive firm is A) P3.B)P1.C)P2.D)P4.E)P5. 8) 9) If the output level required to achieve the minimum long-run average cost is so great that it will ...

Economics 1220 Chapter 9 Practice Questions Note that ...

short run. In the short run, as a result of fixed costs, a firm can be profit maximizing and earning negative economic profits (this occurs if the price is less than average total cost at all levels of ...

PRINCIPLES OF MICROECONOMICS - University of Houston

Figure 4 Competitive Firm Shutdown Decision The rule for short-run profit maximization speaks only of marginal costs and revenues. While a firm can ... economic profits disappear. The long ...

EDCONFIDENCE

Profit Maximization in the Short-run Produce where $MC=MR$ If $P>ATC$, short-run economic profits can be earned Profit Maximization in the Long run Easy entry and exit assure firms will only ...

F.Y.B.COM. SEMESTER - II BUSINESS ECONOMICS - B.Com

profits. In the short-run, it is possible for a firm to earn profits which can be positive, negative, or zero. Economic profits which the firm earns will be zero in the long-run. In the short-run, if a ...

Economics 101 Goal - Social Science Computing Cooperative

both in the short run and in the long run. 1. Let the demand curve in some market be given by: ... how much is the economic profit each firm can earn? d. When $q_1 = 4$ and $q_2 = 4$, how much ...

Ch. 9 Price searchers – sellers who can choose a price so as to ...

short-run if it expects to make profits in the long-run. If a firm was making ... variable costs are covered. Therefore, the portion of the firm's short-run marginal cost curve that lies above the ...

Chapter 9: Pure Competition in the Long Run - McGraw Hill ...

and demand, so the firm's short-term profit or loss depends on the firm's cost structure. If a purely competitive firm achieves a profit, will it be able to sustain that profit in the long run? ...

Economics 2 Emmanuel Saez Fall 2024 - University of ...

Three Decisions a Firm Has to Make •Short-run choice of output: How much to produce today with the existing set-up? ... •The definition of economic profits: $\text{Profits} = \text{Total Revenue} - \text{Total ...}$

1. Refer to Figure 1. represents the excess burden is (a) ABCE.

If this firm is regulated so that it can earn a normal return on invested capital, the firm will sell _____ ... For this monopsonist to maximize profits she should hire _____ units of labor and ...

Lecture14 Spring2009 ProfitMaximization - Molly Dahl

Short-Run Profit-Maximization The firm's problem is to locate the production plan that attains the highest possible iso-profit line, given the firm's constraint on choices of production plans. 8 ...

UNIT - 3: PRICE-OUTPUT DETERMINATION UNDER ...

Short-Run Profit Maximization by a Competitive Firm We shall begin with the short-run output decision and then move on to the long run. In the short run, a firm operates with a fixed ...

MONOPOLY PROFITS, EFFICIENCY PROFITS, AND TEACHING ...

Both theories focus on how economic profits are generated. Such profits exist when a firm's revenues are greater than its costs. The theory of perfect competition ...

Microeconomics in Context (Goodwin, et al.), 4th Edition

1. Over the long run, which of the following statements is true about profit-maximizing firms in a perfectly competitive market? a. Economic profits are zero. b. Economic profits are negative. ...

Which of the following statements is true about ...

competition similar to perfect competition is that, in the short run, neither can earn positive economic profit. b long run, both are guaranteed positive economic profit. c long run, both will ...

EC 205 Exam 2 Review Total economic cost to a firm that's ...

1. Total economic cost to a firm that's earning zero economic profit is a. equal to total implicit costs b. equal to total accounting cost c. zero d. equal to the price of the firm's output times ...

AP MICROECONOMICS 2015 SCORING GUIDELINES - College ...

- One point is earned for stating that the firm's quantity will remain the same in the short run and for explaining that MR or MC will not change in the short run. (Or, because the lump sum ...

Market Structure and Antitrust - George Mason University

run. We discuss each of the scenarios below. 1. Short-Run Production In the short-run, at least one input used in the production process cannot be altered. Inputs that can be altered within ...

Imperfect UNIT 4 MONOPOLISTIC COMPETITION - eGyanKosh

However this condition is subject to the long-run equilibrium. In the short-run firms enjoy supernormal profits. We will now illustrate the short run and long run equilibrium graphically. ...

Chapter 14 Firms in Competitive Markets - hsto.info

Firms can freely enter or exit the market. Use a graph to demonstrate the circumstances that would prevail in a competitive market where firms are earning economic profits. Can this ...

Answers to Questions from Chapter 10 - California State ...

typical firm is earning economic profits in the short run. This encourages the entry of new firms into the industry, increasing the industry supply, and thereby reducing price until profits are ...

M01 BROO6651 1E SG C01 - Kimoon

Firms enter an industry when they expect to earn economic profit, even if the profit will be short-lived.

These short-run economic profits are enough to encourage entry because there is no ...

Profit maximisation under imperfect competition - Pearson

or 'representative' firm may only earn normal profit in the long run, other firms may be able to earn long-run supernormal profit. They may have some cost advantage or produce a product ...

Chapter 5. Monopolistic Competition and Oligopoly

Aug 23, 2019 · Figure 5.1 Short Run and Long Run Equilibria for a Perfectly Competitive Firm Positive profits in the short run ($\pi_{SR} > 0$) lead to entry of other firms, as there are no barriers ...

UNIT 7 PERFECT COMPETITION - eGyanKosh

Fig. 7. 6: Long-run Adjustments in Plants for a Firm Let the market price be OP. The firm has a plant size whose costs are represented by short-run average cost (SAC1) and short-run ...

Weebly

capacity for innovation or research because they earn no real long-run profits. In this chapter, you are going to examine two models that are more commonly found in the real world: ...

Perfectly Competitive Markets - Felix Munoz-Garcia

Short Run Example (cont.) Short-run Supply Curve For $p < 20$, we have $Q = 0$ (vertical spike) For $p \geq 20$, we have Supply (P) = 0 if $p \geq 20$ p 2 10 if $p \geq 20$ Query #2 The short-run supply curve for a ...

Lesson 8 - Pure Competition - Brigham Young ...

produce and if so, how much. With the goal of maximizing profits, firms in pure competition must evaluate both the price they can sell the good for and the respective costs of producing the ...

Name: Team: Problem Set FRQs - Murrieta Valley Unified...

Consider two profit-maximizing firms that earn short-run economic profits. One is a perfectly competitive firm and the other is a monopoly. (a) For each firm, draw a correctly labeled graph ...

PROBLEM SET #7: PERFECT COMPETITION, - UC Davis

e. Describe the adjustment process from the short-run to the long-run. In the short run, each firm will supply $(0.5)(8) = 4$ shirts, and make an (economic) profit of $(8)(4) - (9+16) = \$7$. Over time, ...

AP 2005 microeconomics form b free-response questions

(ii) Area of economic profits (b) Assume that Petsall hires its production workers in a perfectly competitive labor market at the wage rate of \$20 per hour. (i) State the marginal conditions for ...

Long-Run Costs and Output Decisions - UPJ

SHORT-RUN CONDITIONS AND LONG-RUN DIRECTIONS LONG-RUN DIRECTIONS: A REVIEW

TABLE 9.4 Profits, Losses, and Perfectly Competitive Firm Decisions in the Long ...

Graphing Perfect Competition - Fairfax County Public Schools

shut-down price, the price at which the firm ceases production in the short run. When price is greater than minimum average variable cost, however, the firm should produce in the short ...

MIC Student Study Guide Ch16 - Boston University

1. Over the long run, which of the following statements is true about profit-maximizing firms in a perfectly competitive market? a. Economic profits are zero. b. Economic profits are negative. ...

Final Exam - 06.12.2010, 9:00-10:30 a.m. Test Version: B

a. can earn economic profits in the long run. b. can earn economic profits in the short run. c. charge a price above marginal cost. d. All of the above are correct. ____ 28. Carlos goes to ...

lab 10 perfect competition sr and lr - University of Victoria

a. In the short run, the firm should produce. If it shuts down, its short-run annual loss will be \$15,000; but if it produces, its loss will be only \$10,000. In the long run, the business should ...

Student Performance Q&A - College Board

run equilibrium. The subsidy reduces the average cost for the firm; this creates positive economic profits in the short run. Positive profits for firms attract entry into the industry, so new firms ...

Joseph mod Mankiw 09F Ch16

If $P > AVC$, a firm maximizes profit by producing the quantity where $MR = MC$. If $P < AVC$, a firm will shut down in the short run. If $P < ATC$, a firm will exit in the long run. In the short run, ...

CHAPTER 8 PROFIT MAXIMIZATION AND COMPETITIVE SUPPLY

This means that the firm produces in the short run as long as price is positive. 4. Use the same information as in Exercise 1 to answer the following. a. Derive the firm's short-run supply ...

Exam MULTIPLE CHOICE. Choose the one alternative that best ...

In the long run, if cost conditions do not change, this firm will earn a zero economic profit if price is 14) A) \$10. B) \$15. C) \$20. D) \$28. ... Beef producers will now earn economic profits in the ...

Lecture 7b: Monopolistic competition - University of ...

Assumption 4: Because firms can enter and exit the industry freely, profits are zero in the long run. • Firms will enter as long as it is possible to make monopoly profits, and the more firms ...

A Firm Will Earn Economic Profits Whenever - es.pir.org

1. Q: How can firms maintain economic profits in the long run? A: Continuous innovation, strategic diversification, efficient resource allocation, and adapting to evolving market ...

Joseph mod Mankiw ch17 08F

If $P > AVC$, a firm maximizes profit by producing the quantity where $MR = MC$. If $P < AVC$, a firm will shut down in the short run. If $P < ATC$, a firm will exit in the long run. In the short run, ...

Economics 3070 Fall 2014 - Institute of Behavioral Science

Economics 3070 Fall 2014 3. Ch 9, Problem 9.12 The coal industry consists of 60 producers, all of whom have an identical short-run total cost curve, $STC(Q) = 64 + 2Q^2$, where Q is the monthly ...

The Firm and the Industry under Perfect Competition The ...

Since Q is identical here, we can graphically compare P and AC to see if the firm earns short run profits or losses. If $P > AC$ then the firm earns profits and if $P < AC$ then the firm incurs losses. ...

A Firm Can Earn Economic Profits In The Short Run

A Firm Can Earn Economic Profits In The Short Run

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