Changes in Factor Prices

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• The Impact of a change in factor prices on the market

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• Remember our basic cost function
  \[ C = C(q,r,w) \]
• The Impact of a change in factor prices on the market
• How a shift in market demand can cause a change in factor prices

An Exogenous Change

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• While there is obviously some substitution, there will be an increase in cost.
• This is called an exogenous (external) change.
An Exogenous Change

Price goes up. Quantity sold does down. Average size of firm and number of firms indeterminate.

An Endogenous Change

Now let’s talk about how a change in demand can affect factor prices.
An Endogenous Change

No change in factor prices means no long run change in product price.

\[ p_{\min} \quad p_1 \]

\[ S_{LR} \quad S_{SR} \]

D D'

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But it does not have to be this way.

The demand for lumber

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The demand for lumber

- Lumber is a highly competitive business.
- It has a key factor of production: timber.
- A change in the demand for lumber can have feedback effects on the price of timber.
- This is the case of a pecuniary external diseconomy.

The Demand for Lumber and Timber
If lumber production is increasing due to a demand shift, then there is a shift in the demand for timber. Timber prices will be going up.
Because of external pecuniary diseconomies, we get an upward sloping supply curve for lumber.

Initial effect is movement along SR Supply Curve

Then, a movement down new demand curve.

Net effect is movement along LR supply curve.
Long Run and Short Run Changes

Price goes up, even though industry is perfectly competitive and all firms are alike.

End