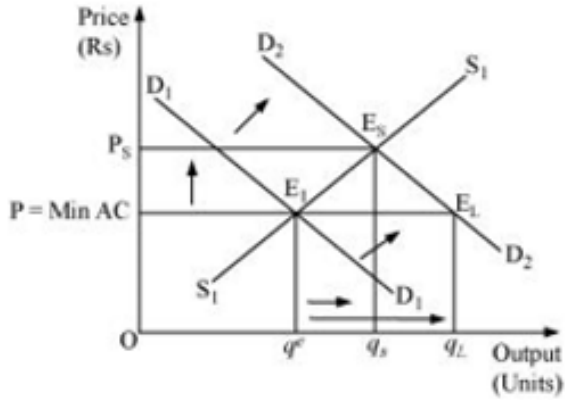
Q14. Compare the effect of shift in the demand curve on the equilibrium when the number of firms in the market is fixed with the situation when entry-exit is permitted.
Ans:



Increase in demand when free entry and exit is allowed and when not allowed

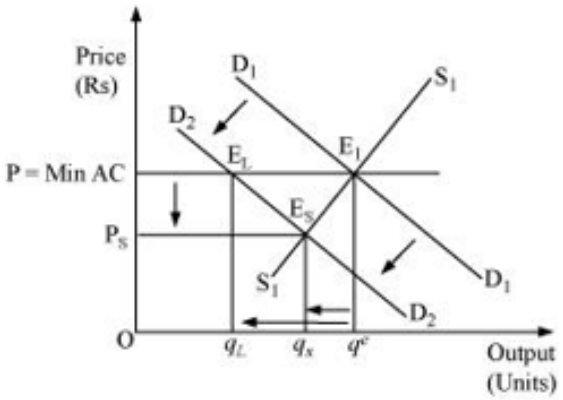
The above figure depicts the cases when the number of firms is fixed (in the short run) and when the number of firms is not fixed (in the long run). 'P = min AC' represents the long run price line, D_1D_1 and D_2D_2 represent the demands in the short run and the long run. The point E_1 represents the initial equilibrium where the demand curve and the supply curve intersect each other. Now, let us suppose that the demand curve shifts under the assumption that the number of firms are fixed; thus, the new equilibrium will be at E_S (in the short run), where the supply curve S_1S_1 and the new demand curve D_2D_2 intersect each other. The equilibrium price is P_S and equilibrium quantity is q_S.

Now let us analyses the situation under the assumption of free entry and exit.

The increase in demand will shift the demand curve rightwards to D_2D_2. The new equilibrium will be at E_2. It is the long run equilibrium with equilibrium price (P) = min AC and equilibrium quantity q_1.

Therefore, on comparing both the cases, we find that when the firms are given the freedom of entry and exit, the equilibrium price remains same and the price is lower than the short run equilibrium price (P_S); whereas, the long run equilibrium quantity q_L is more than that of the short run equilibrium (q_S).

Similarly, for leftward demand shift, it can be noted that the short run equilibrium price (P_S) is less than the long run equilibrium price and the short run equilibrium quantity (q_S) is less than the long run equilibrium quantity q_L.



Decrease in Demand when free entry and exit is allowed and when not allowed

********** END **********