Which of the following events will induce firms to enter an industry? Which will induce firms to exit? When will entry or exit cease? Explain your answer.

1. Technological advance lowers the fixed cost of production of every firm in the industry. A fall in the fixed cost of production generates a fall in the average total cost of production and, in the short run, an increase in each firm’s profit at the current output level. So in the long run new firms will enter the industry. The increase in supply drives down price and profits. Once profits are driven back to zero, entry will cease.
2. The wages paid to workers in the industry go up for an extended period of time. An increase in wages generates an increase in the average variable and the average total cost of production at every output level. In the short run, firms incur losses at the current output level, and so in the long run some firms will exit the industry. (If the average variable cost rises sufficiently, some firms may even shut down in the short run.) As firms exit, supply decreases, price rises, and losses are reduced. Exit will cease once losses return to zero.
3. A permanent change in consumer tastes increases demand for the good. Price will rise as a result of the increased demand, leading to a short-run increase in profits at the current output level. In the long run, firms will enter the industry, generating an increase in supply, a fall in price, and a fall in profits. Once profits are driven back to zero, entry will cease.
4. The price of a key input rises due to the long-term shortage of that input. The shortage of a key input causes that input’s price to increase, resulting in an increase in average variable and average total cost for producers. Firms incur losses in the short run, and some firms will exit the industry in the long run. The fall in supply generates an increase in price and decreased losses. Exit will cease when the losses for remaining firms have returned to zero.