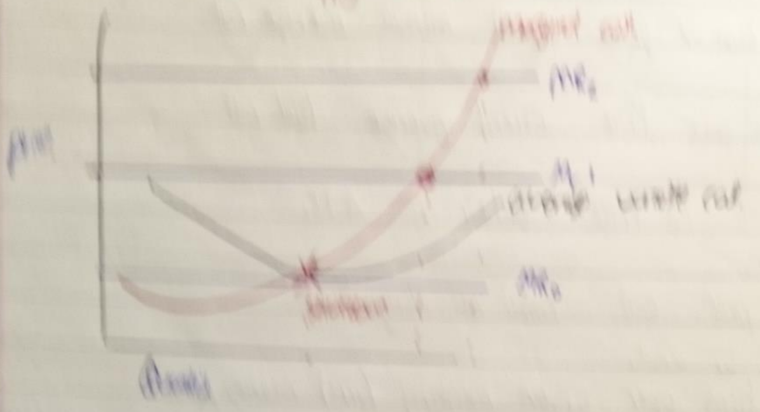
Chapter 11

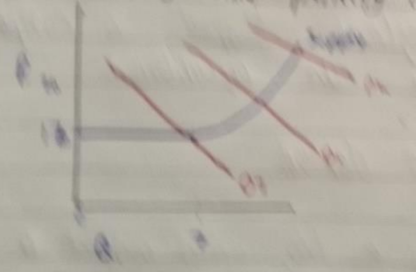
Firm's Short run Supply curve:



Perfectly competitive firm's supply curve shows how its profit maximizing output varies as market price varies.

Output, Price and Profit in the Short run

[illegible] of firms [illegible] perfectly competitive



Below 17 company shuts down, produces 0 or 7

To create supply curve sum quantities of all firms with same price

Equilibrium – where demand curve and supply curve [illegible]

In short run equilibrium, although firm produces profit maximizing output it does not necessarily make economic profit.

Three possible outcomes in short run for firm

Break even → price equals minimum average cost.

Economic profit Price exceed average total cost

Economic loss Price below ATC.

Output, price and Profit in long Run

entry or exit

- New firms enter when existing firms making profit
- Temporary economic profit and loss dont trigger entry/exit.

- When firms enter supply increase supply curve shifts rightward until profit = 0. opposite for exit

When economic profit and economic loss have been eliminated and entry/exit stopped, a competitive market is in long run equilibrium.

Permanent Change In demand

- Firm breaking even
- demand decreases, making a loss, limits output to push up price and end up breaking even

External economies and Diseconomies

external - factors beyond control of an individual firm that lower its cost as market output increases

Diseconomics - factors outside the control of a firm that raise its cost as market output increases

With no external or diseconomic price remains constant.

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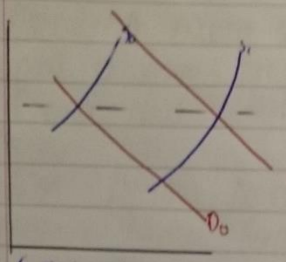
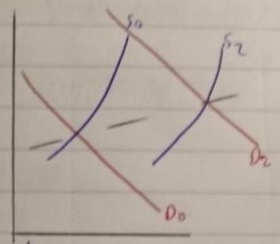
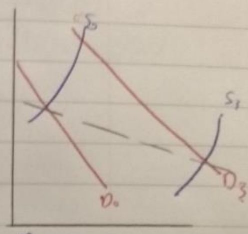


Constant cost.



Increasing cost
external diseconomies involved



Decreasing cost.
external economies

For Examiner's Use

/11/12. # Chapter 11 Perfect Competition

What is perfect competition?

Market in which:

- many firms selling identical products to many customers
- There are no restrictions to entry or exit to market.
- Established firms have no advantage (eg cost) over new ones
- sellers and buyers are very well informed about prices and costs

e.g. farming - milk?

How perfect competition arises -

- firms minimum efficient scale is small relative to market demand, so room for more firms

- each firm produces product with little differentiation, consumers dont mind what they buy

Price taker

- Price taker is a firm that cannot influence the price for product.
- each firms output is substitute for others firms output

Economic profit and revenue

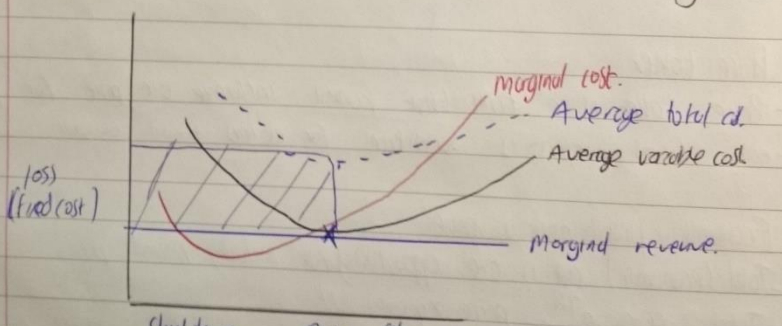
- Total (economic) cost is the opportunity cost including normal profit
- Total revenue TR = price x quantity sold
- Marginal revenue MR = change in total revenue that results from a one unit increase in quantity sold
- Average revenue AR = P = (total revenue / quantity) = Price
- ~~Total~~ Economic Profit = TR - TC.

Marginal analysis:

- Compares marginal revenue MR and marginal cost MC
- As output increases marginal revenue remains constant but Marginal cost changes
- First MC decreases as output increases but eventually increases
- If $MR = MC$ then firm makes maximum economic profit

Temporary Shutdown Decision

- When your Max profit is actually a minimum loss
- Economic loss = Total fixed costs + (average variable cost − price) x Quantity
- firm shuts down $Q = 0$ but still pays fixed cost
- Shutdown point is when AVC are at a lowest meaning loss is the fixed cost.
- It is price and quantity at which it is indifferent between producing and shutting down (losses = fixed costs either way)



Shutdown point at minimum average variable cost.
Minimised economic loss.