Unit 2
Supply in a Competitive Market (Ch. 8)
10/9

ECON 323 – MICROECONOMIC THEORY – DR. STRICKLAND

Introduction

For some output level, firms choose the cheapest input mix

- Cost minimization problem

How much output should the firm produce?

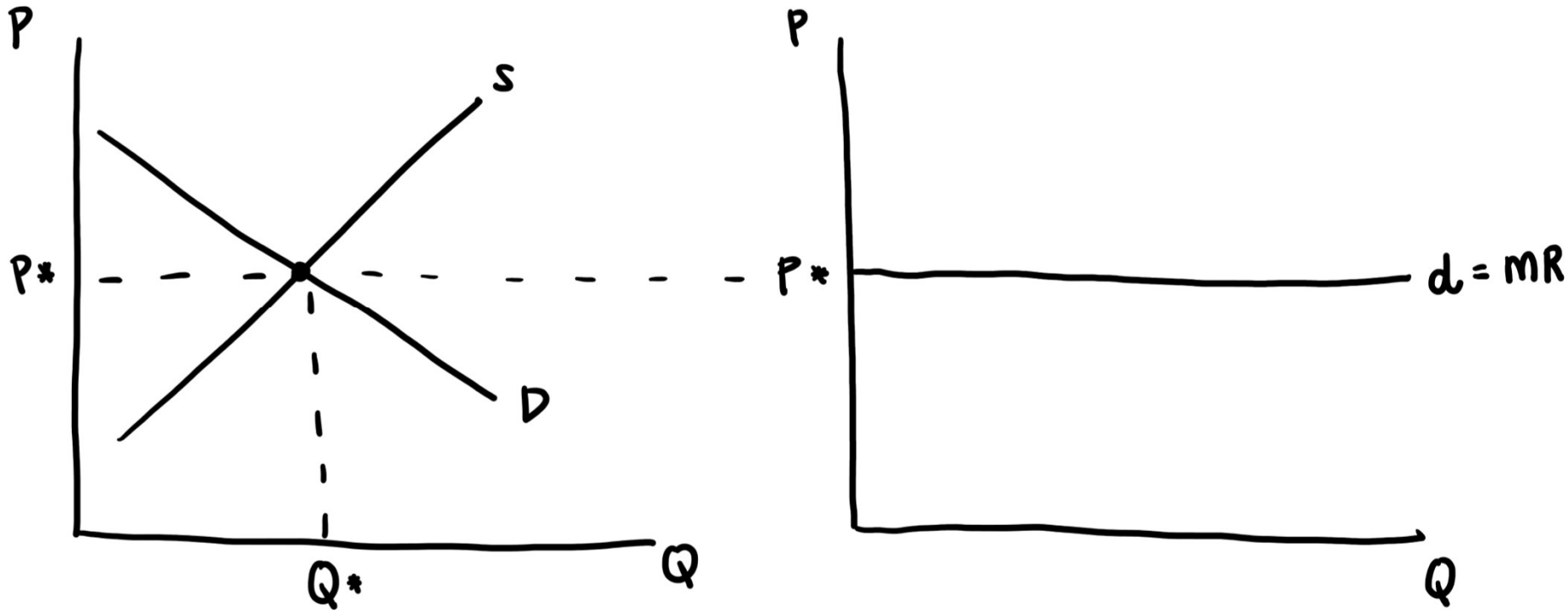
- This decision is driven by the desire to maximize profit

Profit maximizing behavior depends on a firm's market structure

- This chapter focuses on perfect competition

Demand curve for perfectly competitive firms

If a firm must sell its product at the same price, no matter the quantity produced, what does its demand curve look like?



Profit maximization

Goal: maximize **profit**

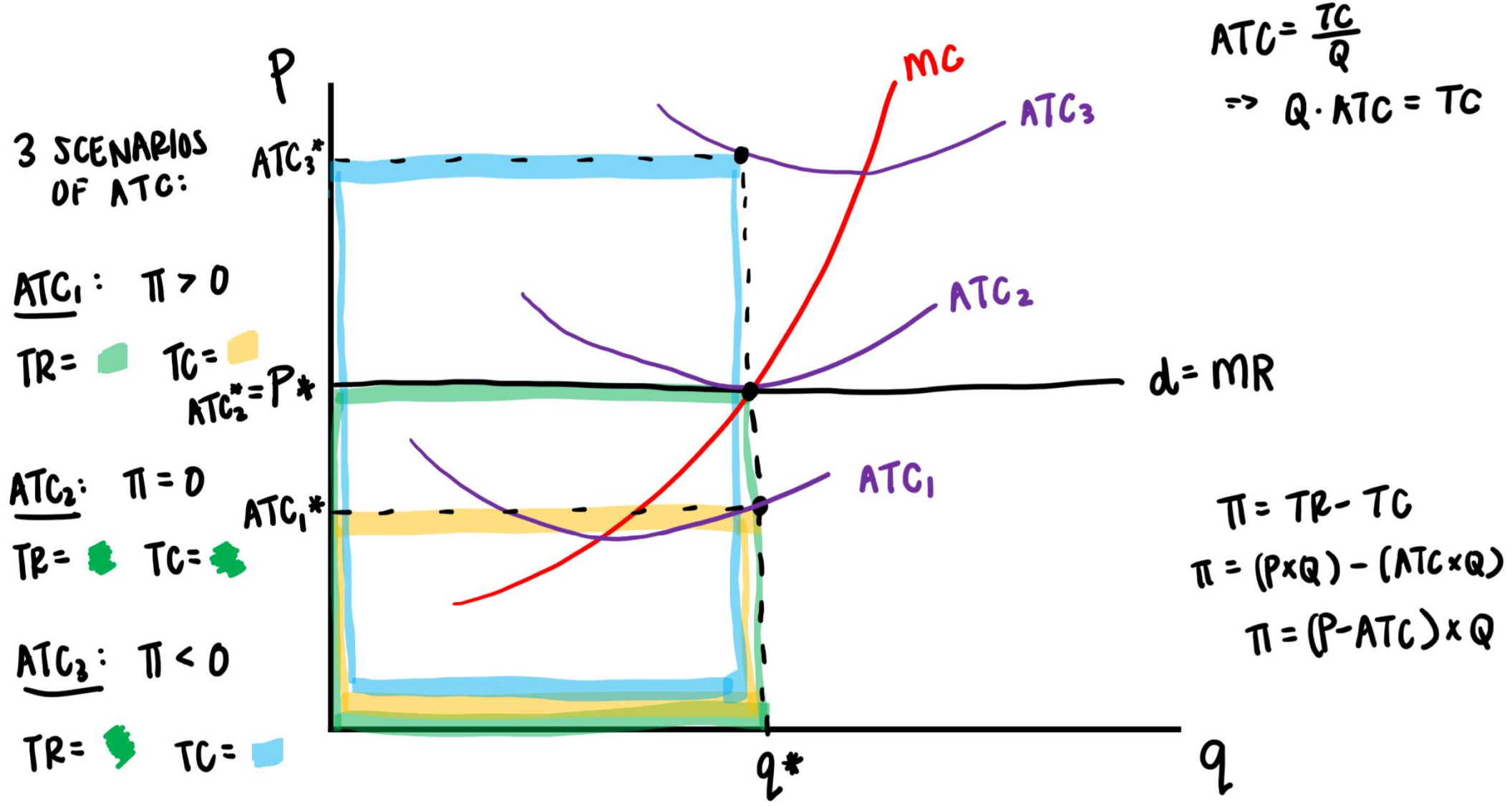
ECON PROFIT $\sim \pi = \underbrace{TR}_{P \times Q} - \underbrace{TC}_{VC + FC}$ (ECON. COST)

* π MAX RULE: $MR = MC$

*FOR PC FIRM: $P = MR$

$\Rightarrow \pi$ MAX: $P = MC$

Profit maximization



Short-run shutdown decision

What happens if profit is negative? Should a firm shut down?

LR: $\pi < 0$ => SHUT DOWN (EXIT)

SR: $\pi = TR - VC - FC$

FC → SUNK

$TR < VC$ => SHUT DOWN (STOP PRODUCING)

$P \times Q < VC$

$\Rightarrow P < \frac{VC}{Q} \Rightarrow P < AVC$

Short-run shutdown decision & firm supply curve