

Supply, Profit and Rent

Market equilibrium – the price and quantity at which quantity demanded equals quantity supplied

Consumer surplus – the difference between maximum willingness to pay and price

Producer surplus – the difference between price and minimum needed to induce sellers to provide the good or service

Economic rent – the difference between price and opportunity cost

Economic profit – the portion of producer surplus that will be eroded away by entry

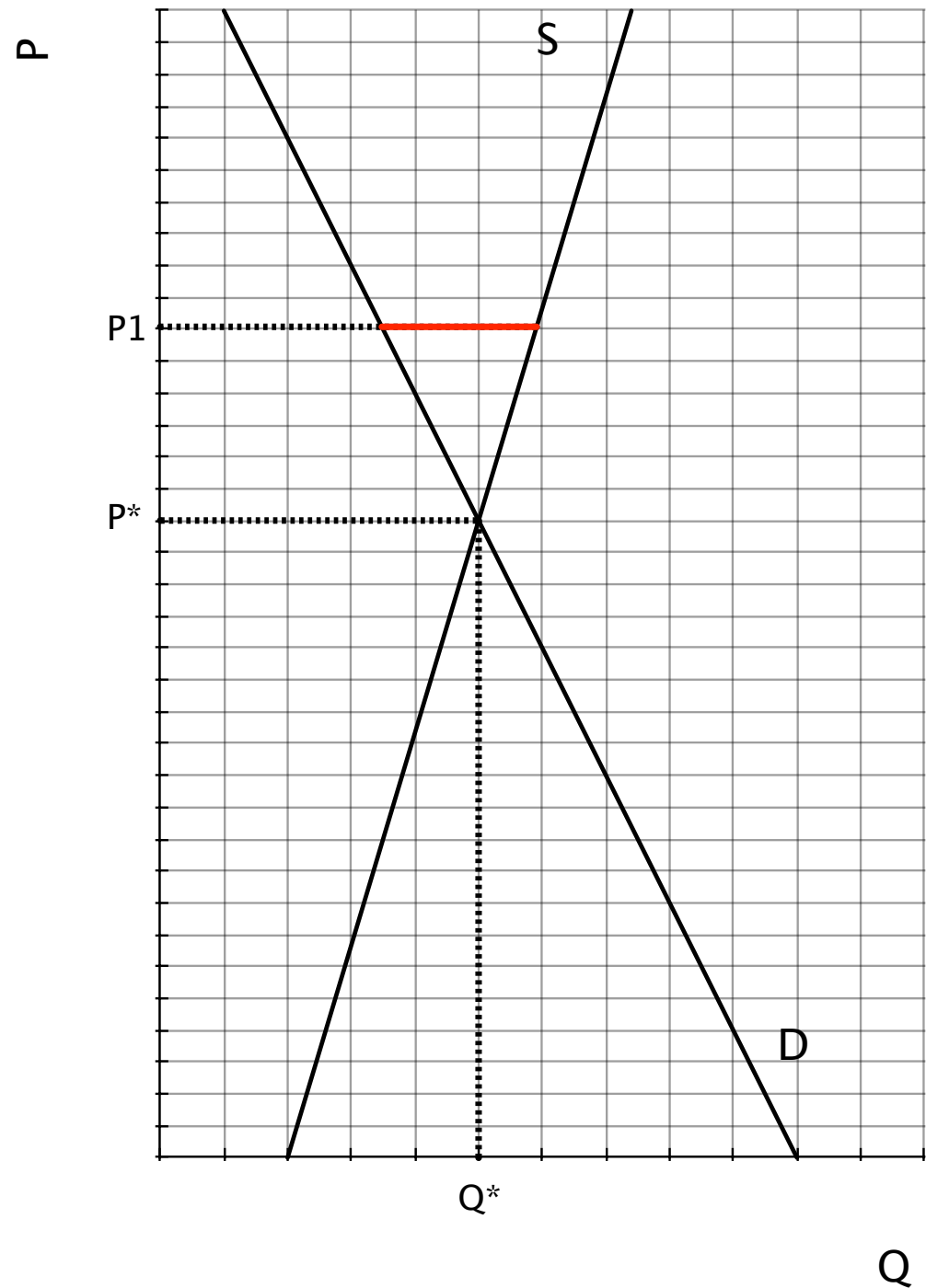
The economically desirable (efficient or optimal) value of a good or service is the price at which a market equilibrium generates zero economic profit.

Supply, Demand and Market Equilibrium

The pursuit of self interest drives markets toward a particular P-Q combination

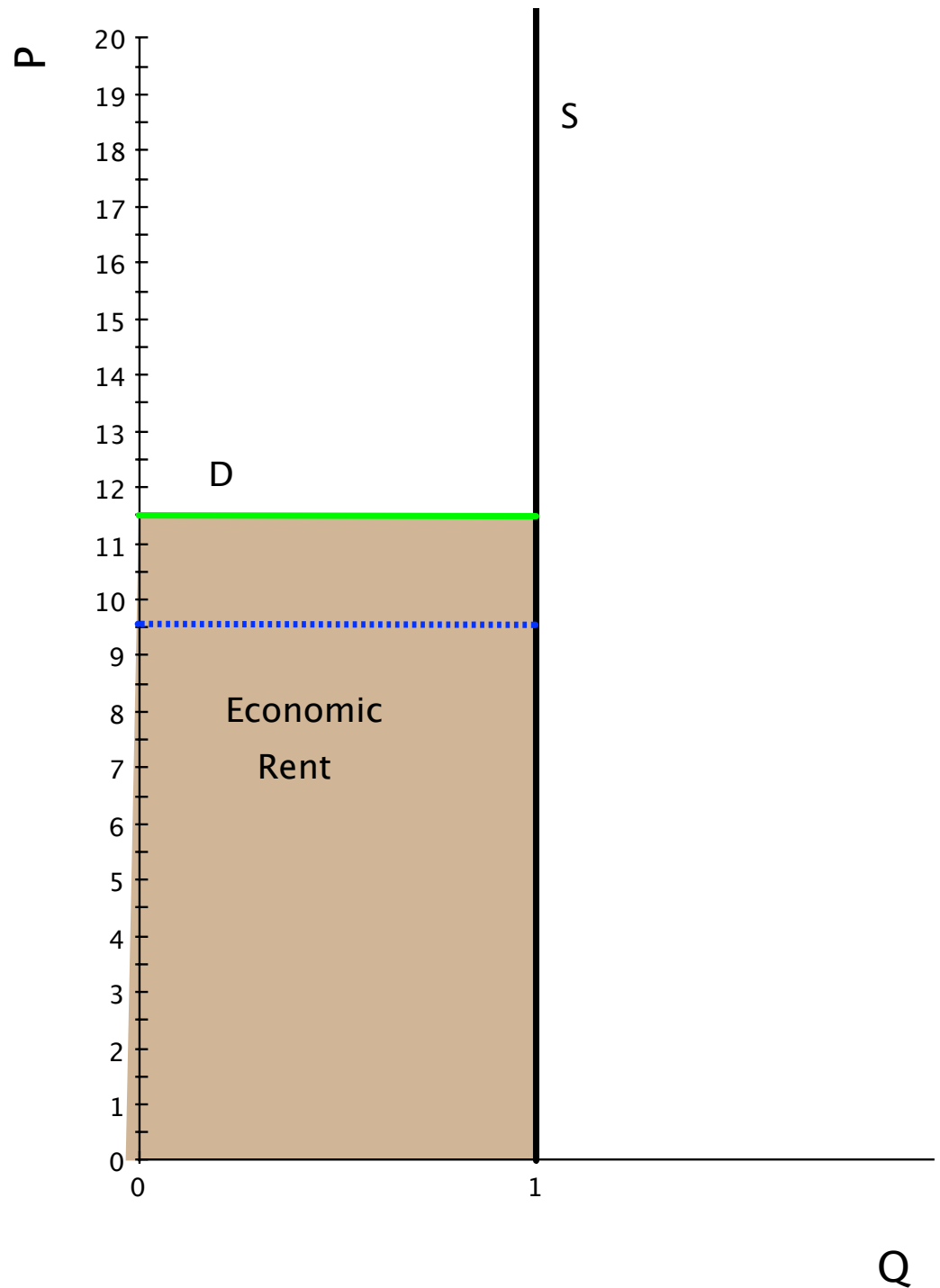
Excess supply \rightarrow price falls

Excess demand \rightarrow price rises

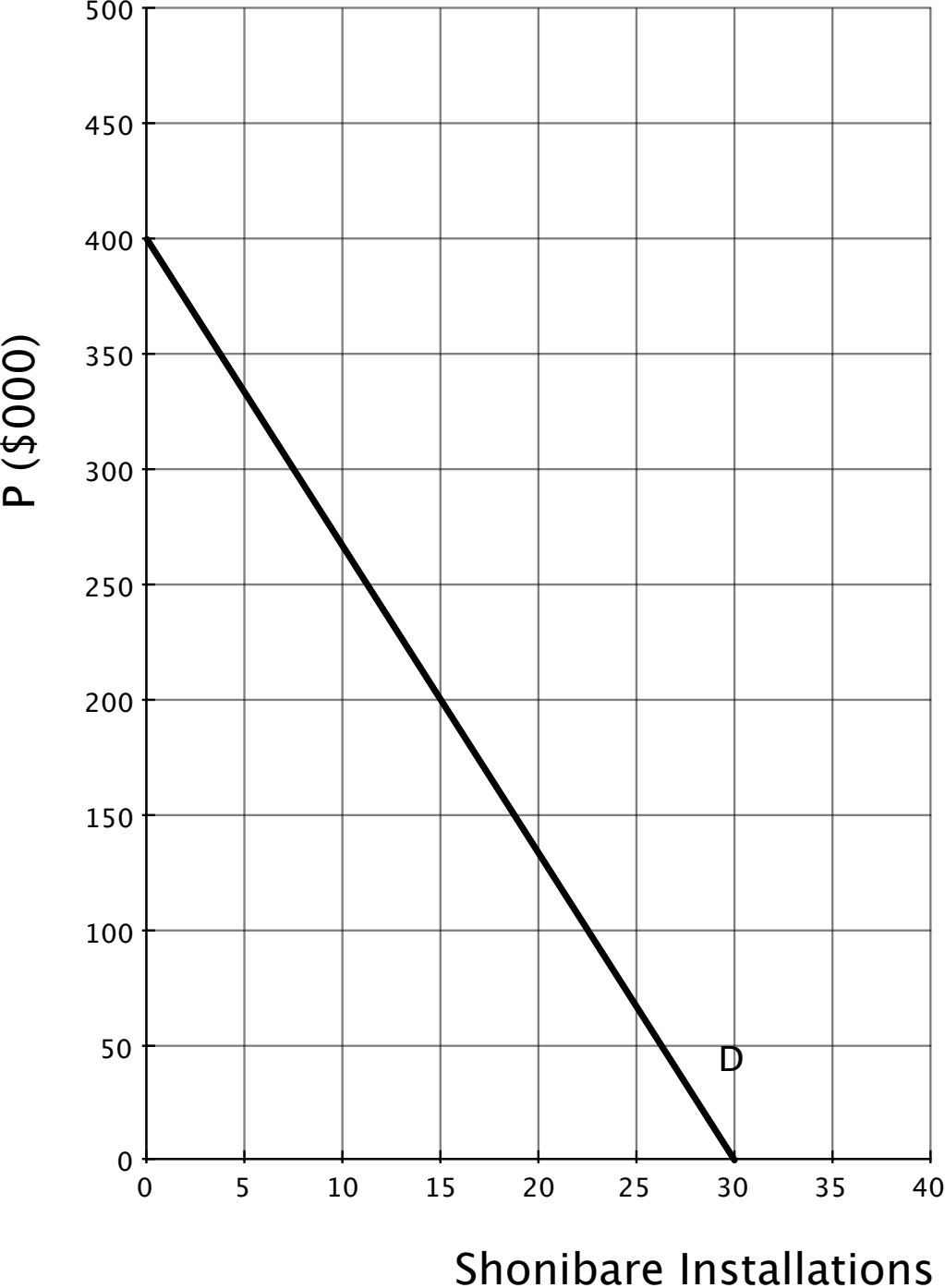


The market for Birds of America

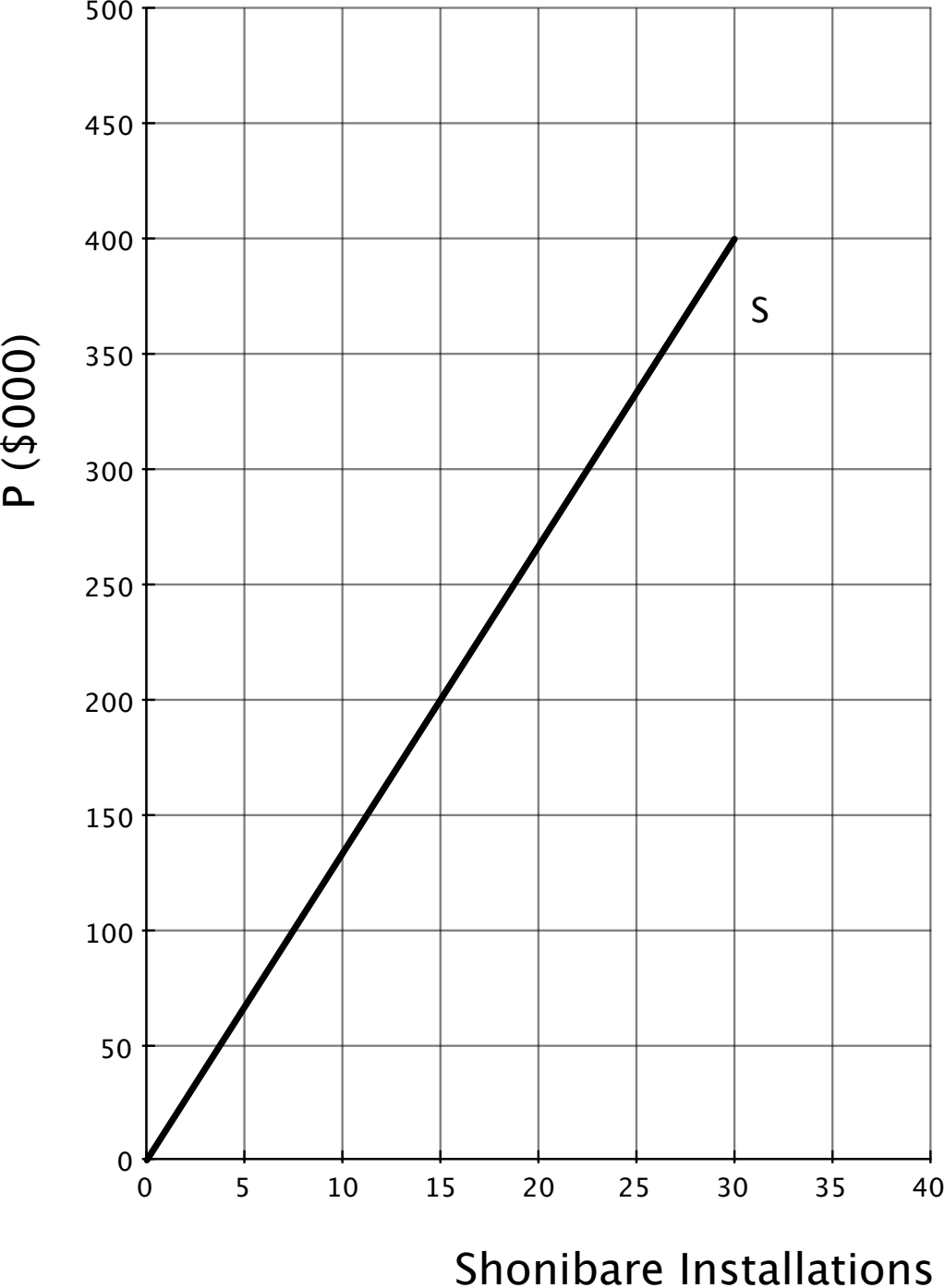
Economic Rent – payments in excess of opportunity cost



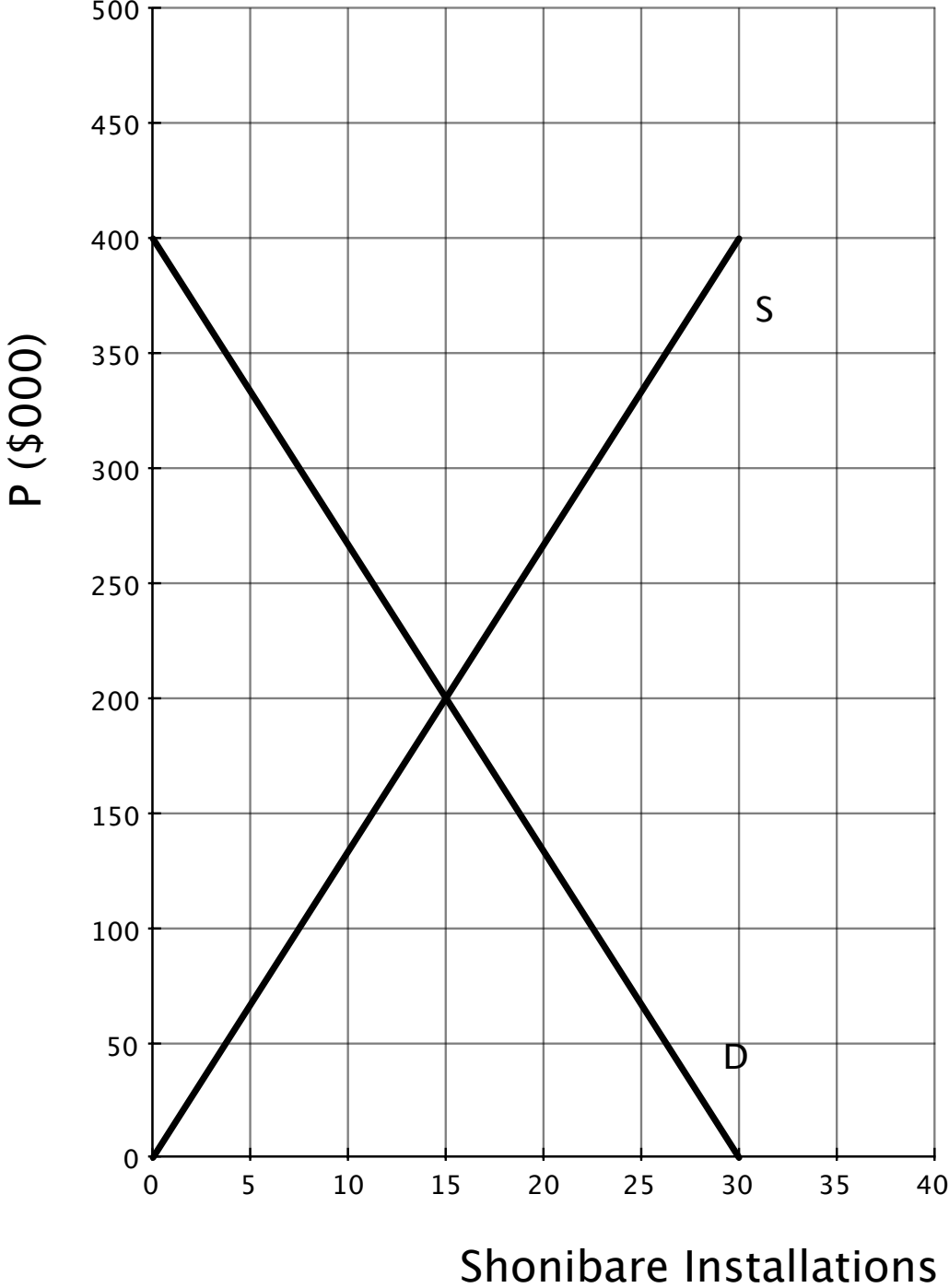
The Demand for Shonibare Installations



The Supply of Shonibare Installations



Shonibare Market Equilibrium



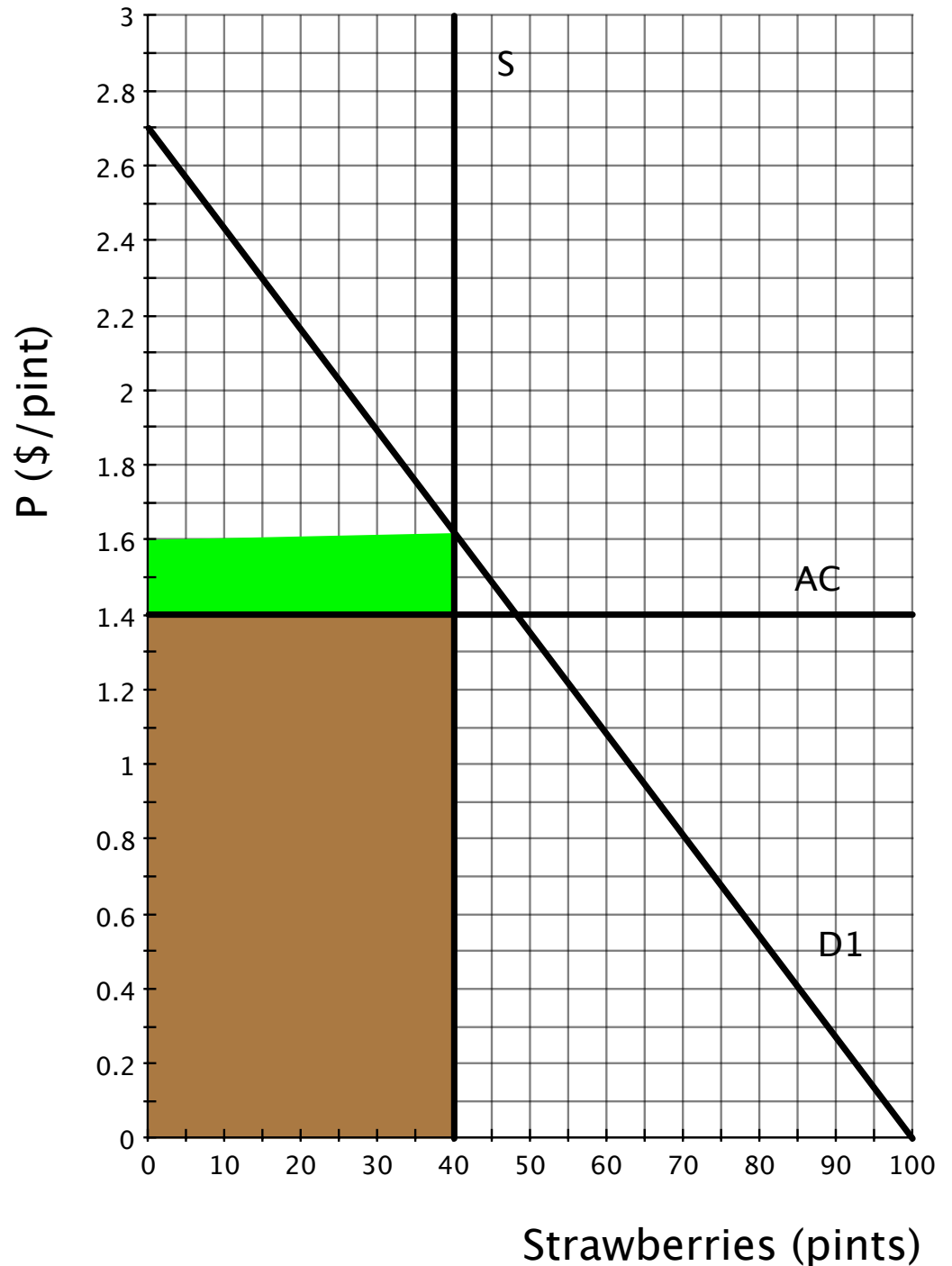
The Market for Farm Stand Strawberries

$$\text{Economic Profit} = (P - AC) \times Q$$

Since all costs are sunk, opportunity cost is zero so

$$\text{Economic Rent} = AC \times Q$$

Producer surplus =
Economic Profit + Economic Rent

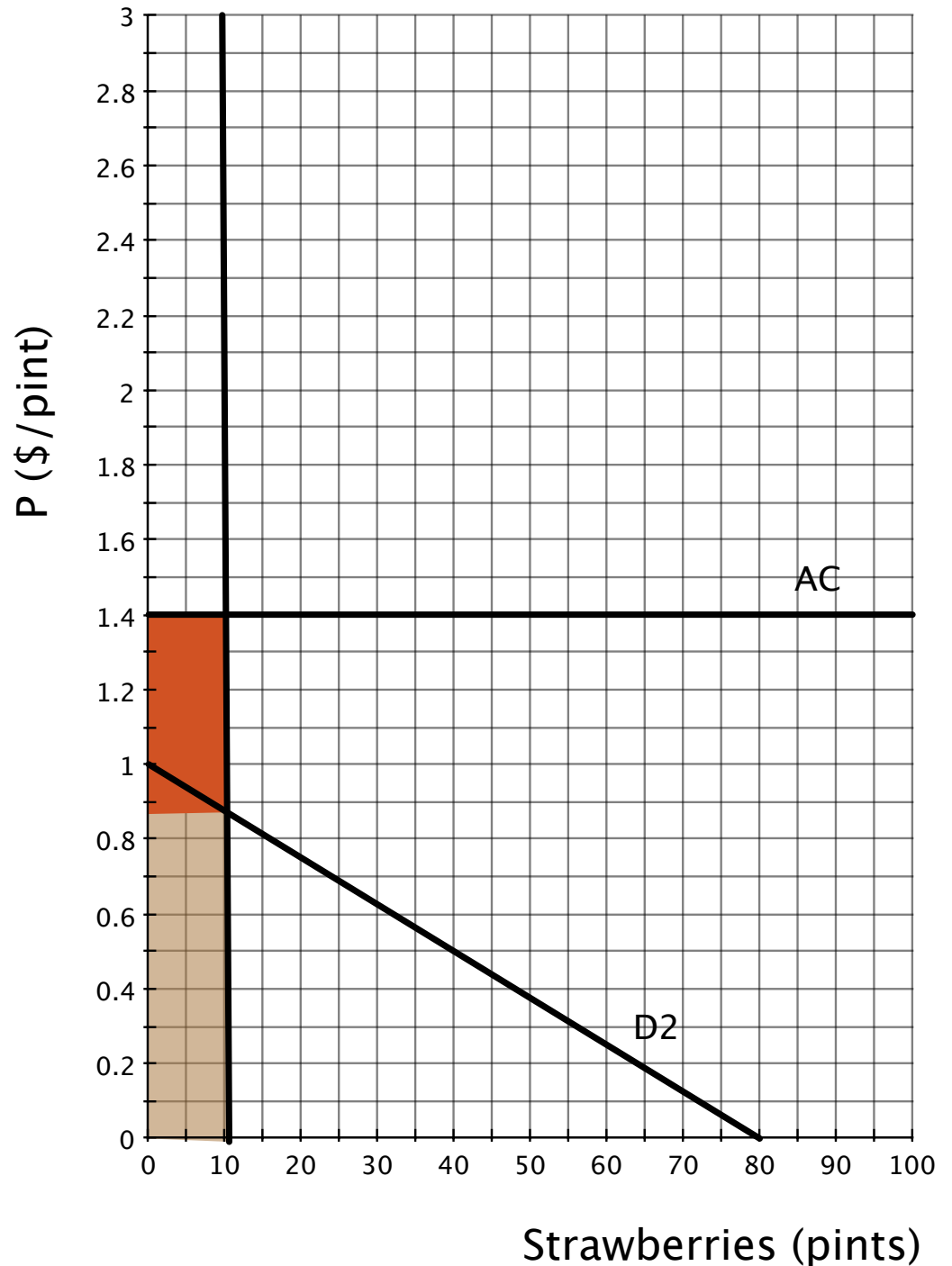


The Market for Farm Stand Strawberries --end of day

$$\text{Lost Economic Profit} = (\text{AC} - P) \times Q$$
$$(\$1.40 - .9) \times 10$$

Since all costs are sunk,
opportunity cost is zero so

$$\text{Economic Rent} = \text{AC} \times Q$$
$$(\$1.40 \times 10)$$



Supply with Production

Production is the creation of goods or services that meet people's needs through the combination of

Labor services

Capital goods services

Intermediate goods

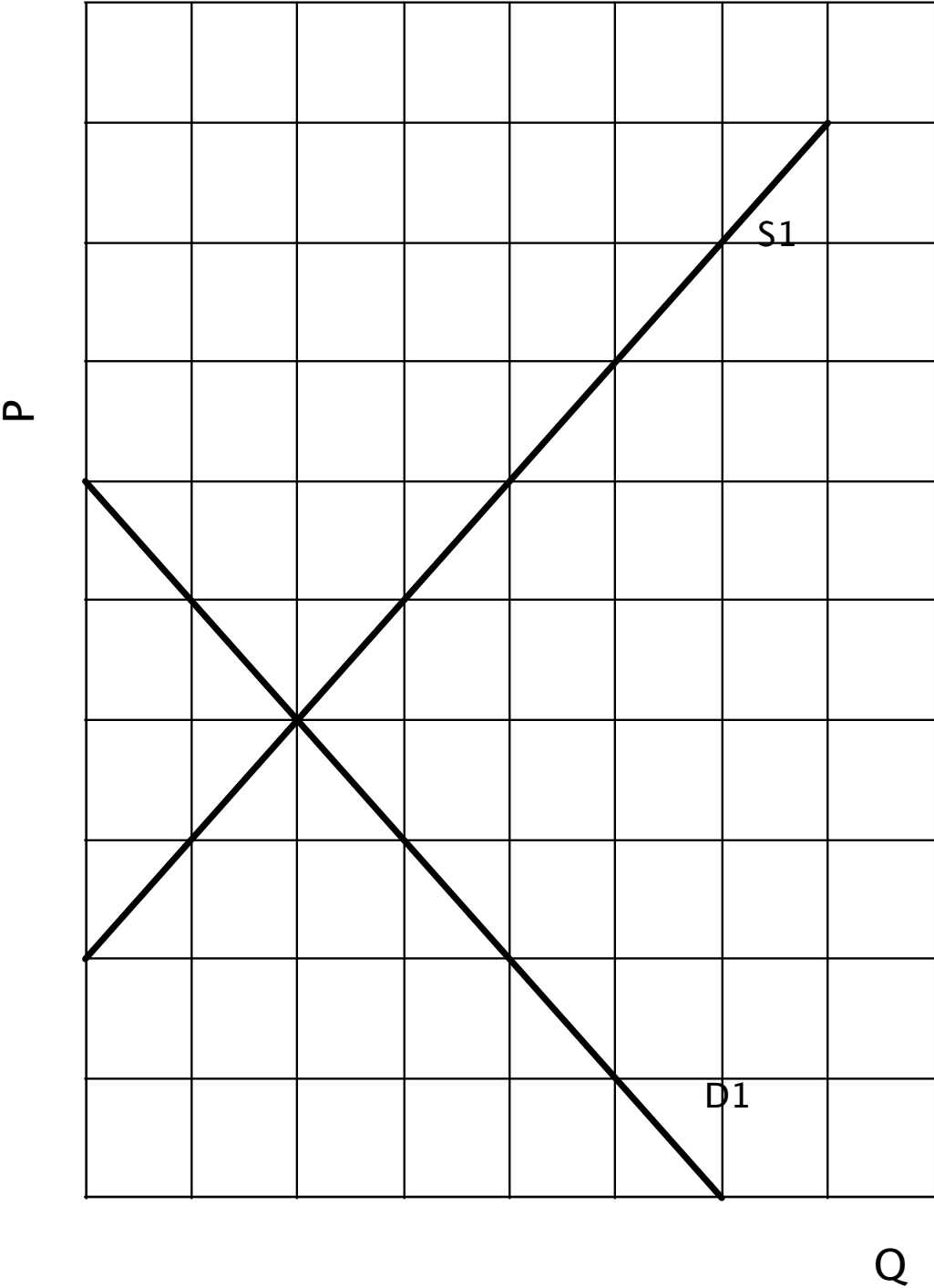
Natural resources

In the short-run, each producer's supply slopes up because of the "law" of diminishing returns to those inputs one can vary.

Market supply is the horizontal sum of each producer's supply.

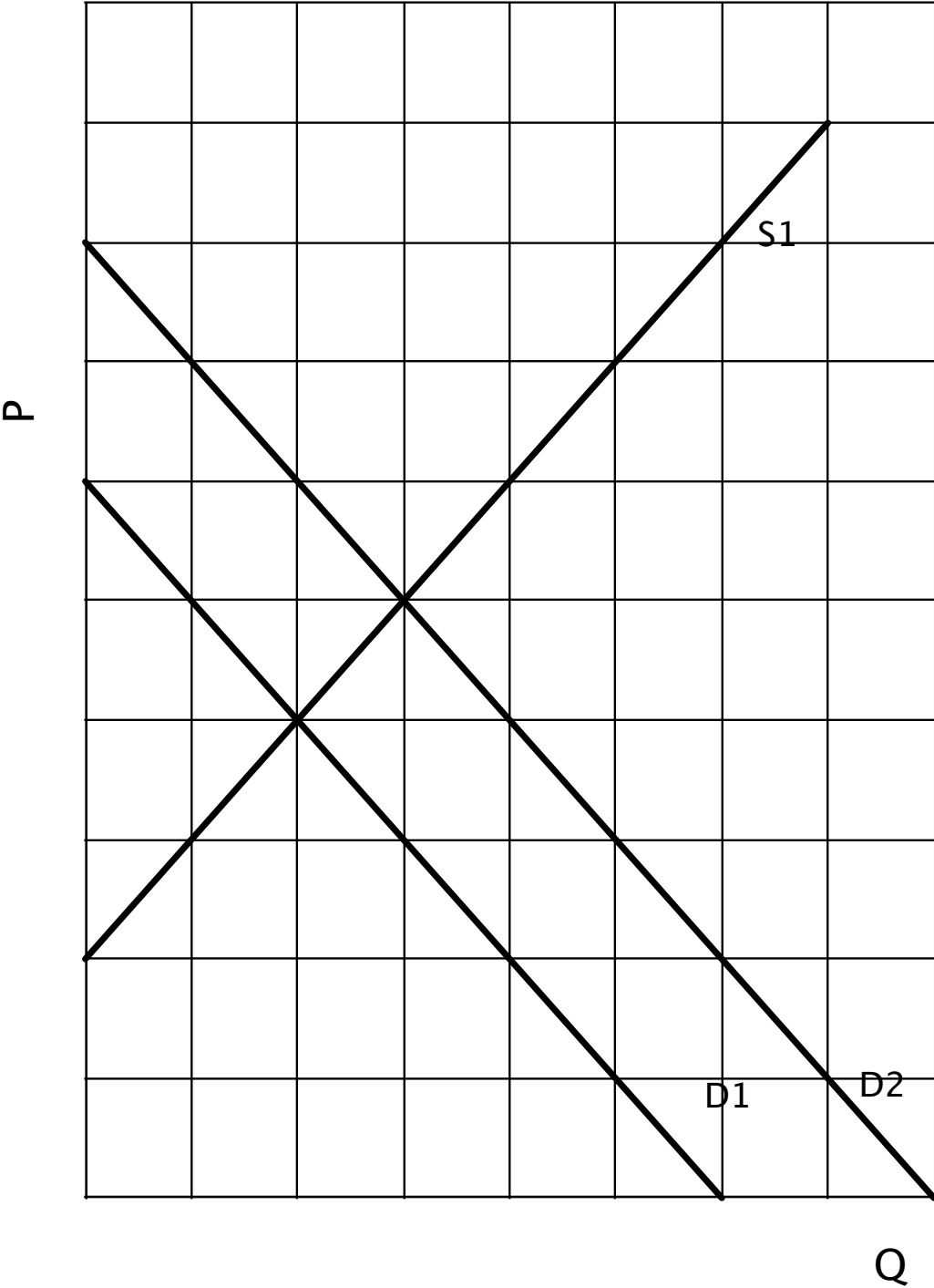
A short-run market equilibrium arises where demand and supply meet.

That will be a long-run equilibrium so long each producer is just breaking even.



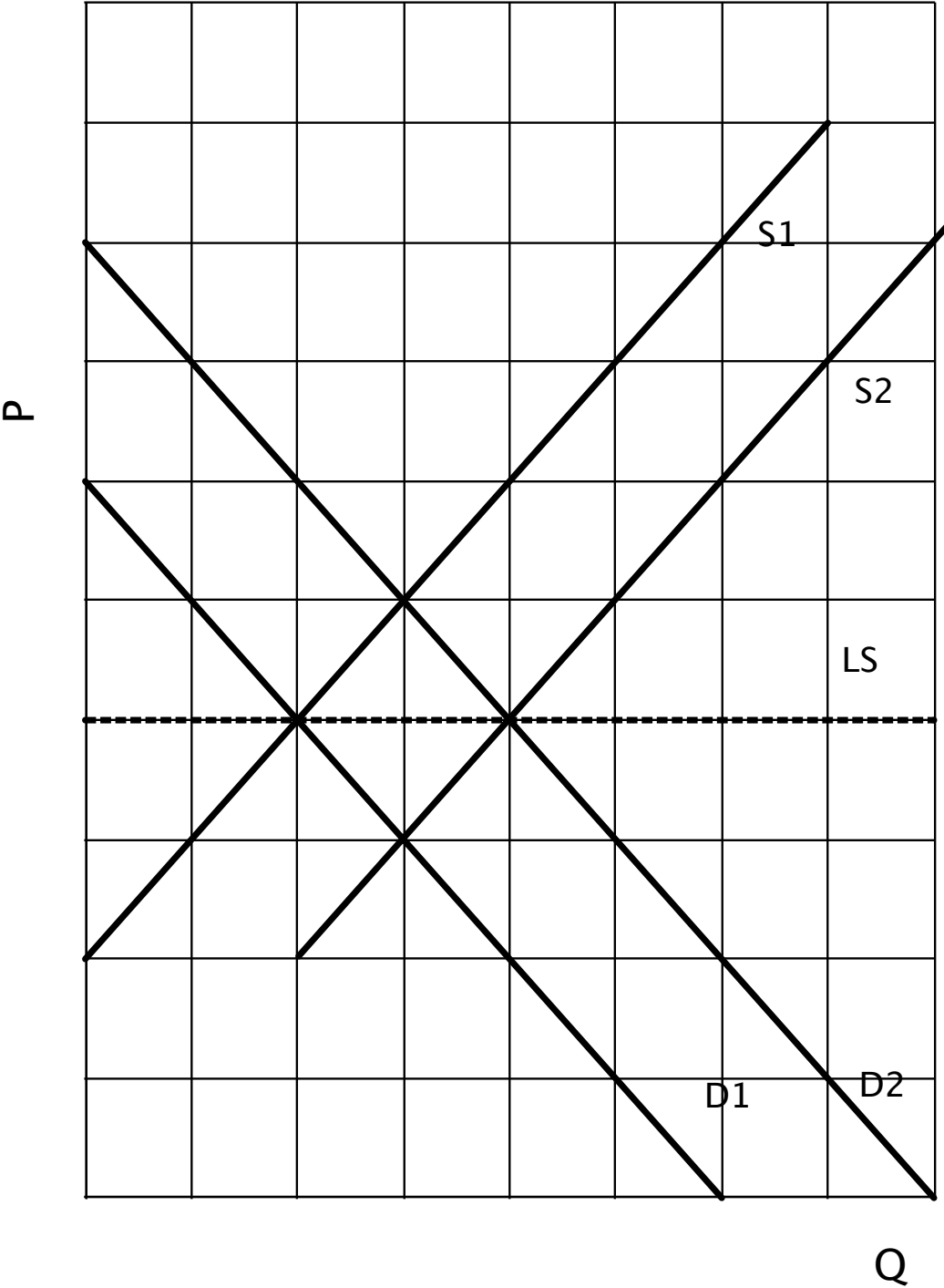
Suppose demand shifts out?

Now producers are earning profits



Entry shifts out supply until economic profits are zero.

So, long-run supply should be horizontal.



But, we know that long-run supply curves slope up! Why do they?

Quality differences
Increasing natural resource depletion costs

