The Competitive Firm's Short Run Supply Curve

M. Edelstein, April 30, 2010

1. **A firm maximizes profit or minimizes losses by operating at the output level where P=MC.** Below that level, P>MC, the firm can increase total profit by increasing its output level. Above that level, P>MC, the firm can increase total profit by decreasing its output level.

2. **A firm makes Economist's Profit (above opportunity costs) when operating at an output level where P > ATC.**

3. **A firm just makes its opportunity costs when operating at an output level where P = ATC.**

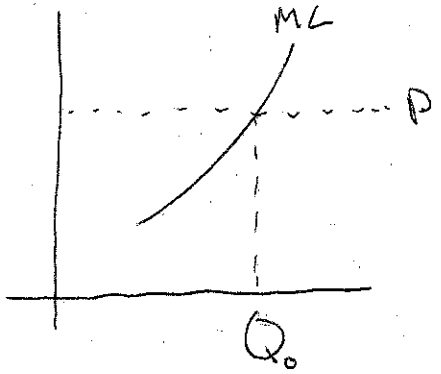
4. **A firm makes losses when operating at an output level where P < ATC.**

5. **A firm operating at an output level which makes losses will stay open in the short run if P < ATC but P > AVC.** In this case the firm is able to pay its VC and a portion of its fixed costs. (The alternative is to shut down and pay all of its fixed costs and thus not loss minimizing.

6. **A firm operating at an output level which makes losses will shut down in the short run if P < AVC.** In this case the firm is not able to pay all of its VC and, of course, none of its fixed costs. So, in shutting down, it only has to pay its fixed costs.

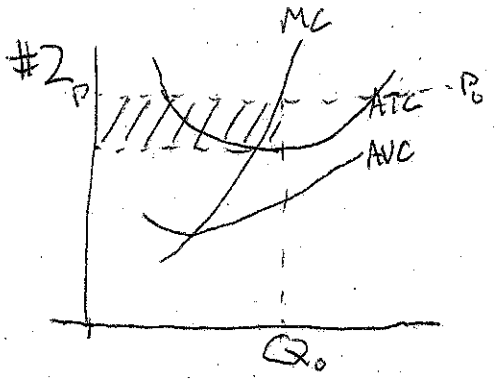
7. **Thus, the short run supply curve of a competitive firm is the MC curve, above P = min AVC.** That is, the competitive firm is willing and able to supply the Q where P=MC for each given price, as long as the price is above min AVC.

#1



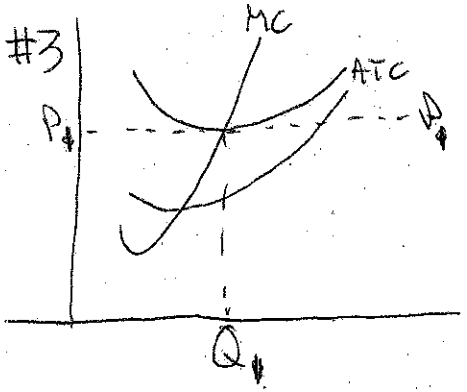
Π Maximizing Output

#2



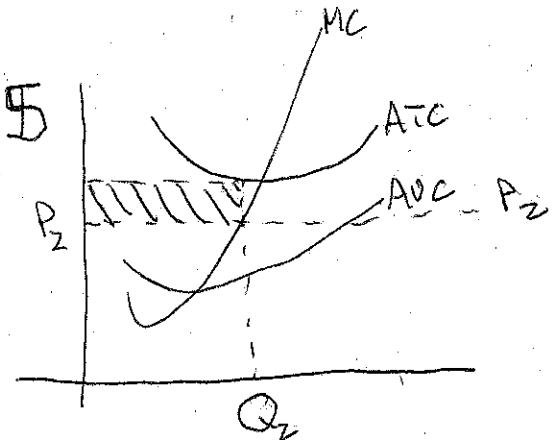
When P > ATC at Q_0 Abnormal Profit appears.

#3



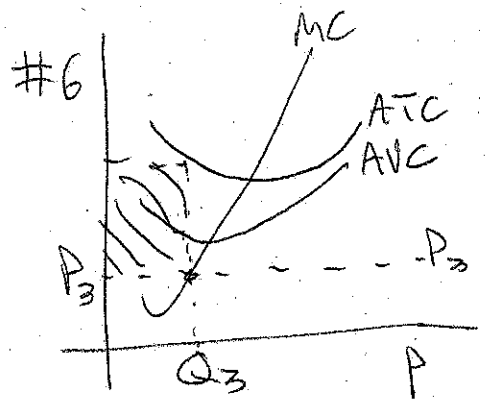
When P = ATC at Q_1 no Abnormal Profit is earned

#5



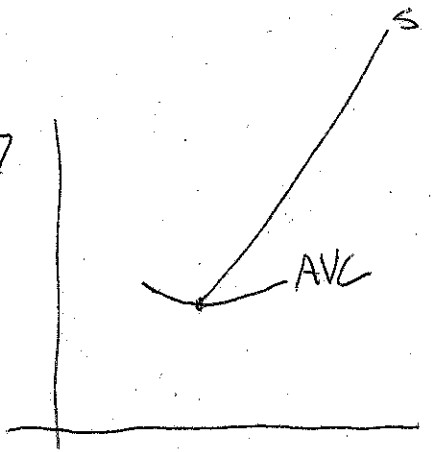
When P < ATC but P > AVC Losses Appear. Yet the firm minimizes losses by staying open.

#6



When P < AVC the losses are so large that the firm shuts down & only pays out its FC

#7



The firm max Π s or min losses by supplying Q where P = MC, above min AVC