**ECON 136: Week 5, Friday**

**Supply, Profit and Rent**

I’d like to end the day with you all clear about the significance of the following concepts, all understood as applying to the full range of market output (i.e., all the goods or services exchanged in a particular market)

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 🡪 price falls

Excess demand 🡪 price rises

The market for Birds of America

Economic Rent – payments in excess of opportunity cost

The Market for Shonibare Installations

The Supply of Shonibare Installations

Shonibare Market Equilibrium

The Market for Farm Stand Strawberries

Economic Profit =

 (P – AC)xQ



Since all costs are sunk, opportunity cost is zero so

Economic Rent = ACxQ

Producer surplus = Economic Profit + Economic Rent

The Market for Farm Stand Strawberries

--end of day

Lost Economic Profit =

 (AC – P)xQ

 ($1.40-.9)x10

Since all costs are sunk, opportunity cost is zero so

Economic Rent = ACxQ

($1.40x10)

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 evenSuppose 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