

Chapter – 8

Producer's Equilibrium

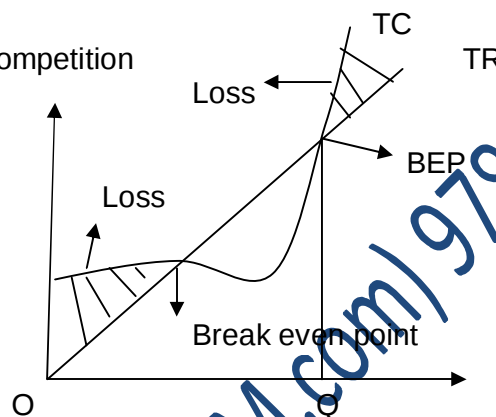
Just like consumer equilibrium, objective of every producer is to get the max output with the help of min cost. To maximize the profit is the objective of firm & this can be found out with the help of producer equilibrium.

The producer equilibrium refers to the situation in which producer maximizes his profit & minimize his loss.

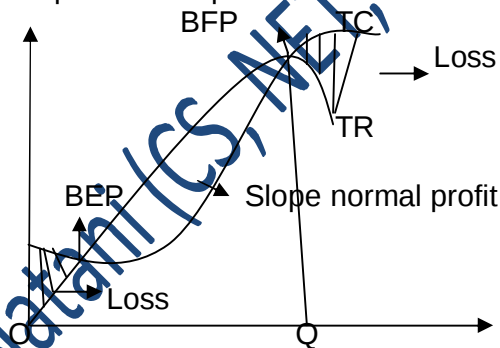
Condition of producer equilibrium

1) TR –TC Approach

a) In case of perfect competition



b) In case of imperfect competition

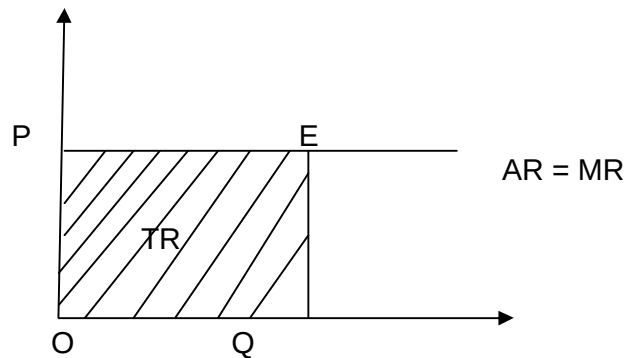


Initially when firm starts the production, then firm has to incur the fixed cost, even at the zero level of output because of this it appears loss to the firm but when production continues with the help of variable cost, then TR will be greater than, TC & firm can earn SNP but, when due to diminishing returns when TC starts rising then it interest to T.R. which is also called break-even point of the firm and producer's equilibrium.

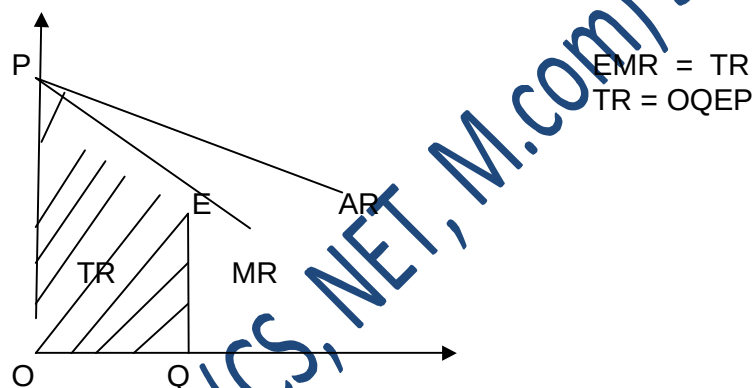
2) MR & MC Approach (Profit maximization) :- before to understand this approach we have to under stand the related topics or concepts.

a) Area under price – Line is T.R under perfect competition.

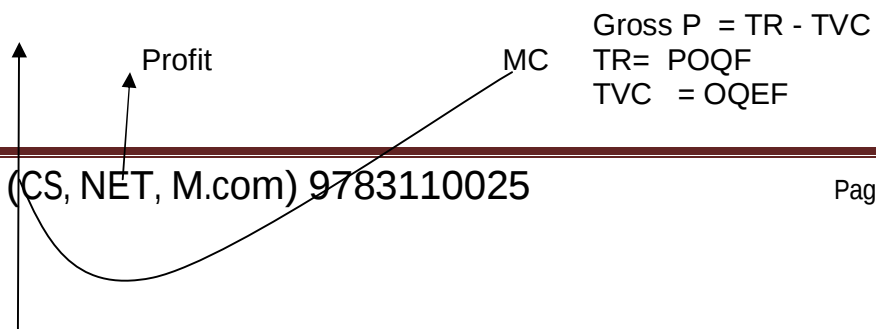
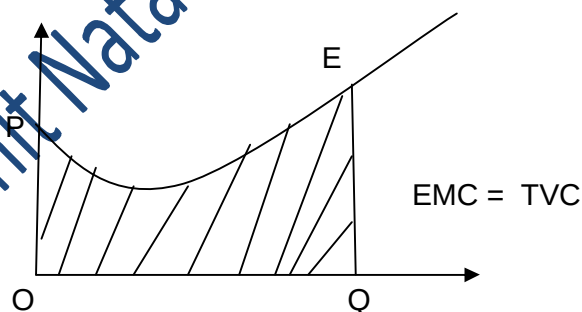
AR = Price
 AR = MR
 EMR = TR
 EAR = TR

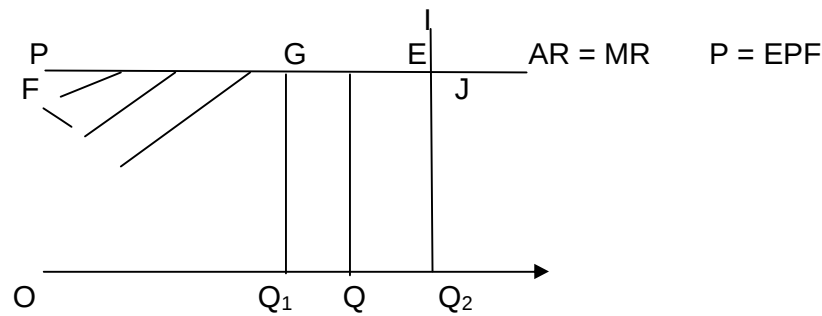


b) Under imperfect competition:



c) Area under MC is TVC.

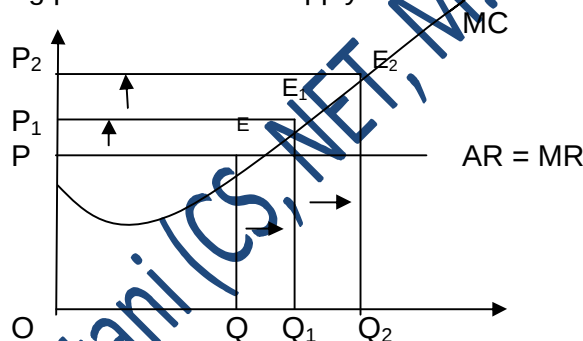




Gross P is equal to $TR - TVC$ because TFC is constant & necessary for production. Under perfect competition, P of a commodity is determined by the industry & firm is a price taker, which is fixed. Hence AR & MR would be $\parallel$ to X' 's axis. Under this line, area is equal to TR whereas area under MC is equal to TVC . According to this diagram, equilibrium is determined at that point where a firm should produce OQ level of output at which TR is equal to $OQEP$ & TVC is equal to $OQEF$. Hence $P = EPF$.

If we consider the equilibrium before this at point OQ_1 , then firm will not be able to get the profit equal to ΔEGH on other hand, if a firm continue the production till OQ_2 then firm has to bear the loss equal to EGI . P is equal to MC is at profit maximizing condition.

Show that rising portion of MC is supply curve.



In perfect competition, P is equal to MC is a profit maximization condition when P is OP & Q is OQ . But if a firm want to increase the output from OQ to OQ_1 then equilibrium will shift at E_1 where P has to be OP_1 . In the same way if a producer want to increase the S to OQ_2 , then equilibrium will shift to E_2 where P has to be OP_2 . It implies that a firm is ready to S more but P should be more & rising portion of MC curve is like a supply curve.

Should a firm continue a production, when production means loss?

In short- period, a firm can continue the production even when production means loss, but a firm can bear the loss equal to fixed cost. On a firm can continue tea production as long as firm is able to recover the variable cost, but if a firm is not able to recover the cost, then firm has to stop the production. This point is 'Shut down Point'.

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