Notes on Chapter 9

Maximizing Profit:

This chapter combines the idea of revenue with the idea of cost and defines economic profit. It shows that revenue is nothing but price × quantity. In the process it shows that the average revenue, therefore, is nothing but the price itself. Throughout the chapter we assumed a fixed price, which also makes the MR to equal the price. However, at this point it is important to point out that although the condition that AR=P is always true, MR is not always necessarily equal to price. In this chapter it is, but students should not consider that to be a guaranteed thing. With an elaborate example, we established the condition that is necessary for profit maximization. We showed that profit maximization will require,

\[ MR = MC \]

Throughout the chapter we kept on emphasizing the importance of this rule and tried to apply it under different situations. We also showed that under the assumption that the fixed cost is sunk, how a firm can continue to operate in the short run even when it is making an economic loss. We showed that a firm would continue to operate in the short run as long it is making enough to cover its total variable cost. In other words, if the price is equal or above the average variable cost, the firm continues to operate in the short run even though it is incurring economic loss. If price falls below the average variable cost, then the firm quits or shuts down even in the short run. In the long run there is no distinction between average total cost and average variable cost (in the long run no cost is considered to be fixed). As a result, in the long run as long as price falls below the average total cost curve, the firm shuts down. I also distinguished between economic profit and accounting profit.

Notes on Chapter 10 and 11

Market Structure:

Market structure is the economic environment in which a firm operates. In this course we shall discuss four different market structures. Namely, Perfect Competition, Monopoly, Monopolistic Competition and Oligopoly. Perfect Competition and Monopoly are the two extremes. Monopolistic Competition and Oligopoly lie somewhere in between. Unlike the book, we shall discuss Perfect Competition first. We shall also move back and forth between chapter 10 and 11 to complete the discussion of one specific market structure before beginning the other.

Perfect Competition: In the book, the discussion on Perfect Competition begins from page 245 and continues up to page 247. The discussion then is continued in chapter 11 from pp. 261 to pp. 271. In class, we slightly deviated from the book. Your class notes
should get precedence over the book in this matter. Please look at the handout that I made available through the web.

**Monopoly:** For Monopoly, read the book in the following sequence. First read pp. 235 to 239 in Chapter 10 and then read pp. 255 to 258 in chapter 11. Once again, concentrate more on the lecture and lecture notes.

**Monopolistic Competition:** For Monopolistic Competition, read the book in the following sequence. First read pp. 239 to 245 in Chapter 10 and then read pp. 258 to 261 in chapter 11. Once again, concentrate more on the lecture and lecture notes.

**Notes on Chapter 12**

**Oligopoly:** We emphasized that in Oligopoly market structure, the other firms are treated as rivals. This market structure is often compared to the game of chase since each firm takes strategy based on the anticipated move of the rivals. Under this structure we covered three models. The Price Leadership Model, the Kinked Demand Curve model and Centralized Cartels. We also talked about brand multiplication and price discrimination under this market structure.