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 $\times$ 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,

$$\text{MR} = \text{MC}$$

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.