An Introduction to Microeconomics
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Lecture – 121
Short Run Supply Vs. Long Run Supply

Ok so we have been studying about supply function of a firm in the short run now we are going to talk about.

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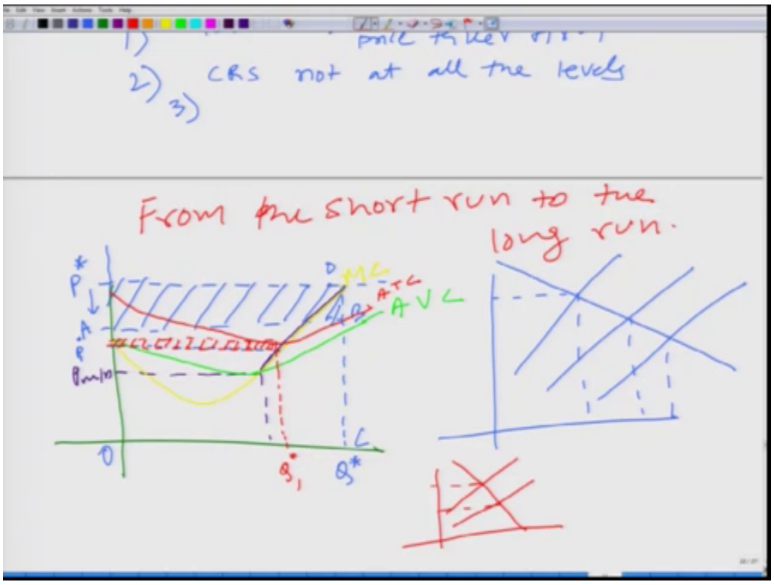

Let us say the adjustment from short run to long run. So, let me see the title is from us from the short run to the long run. And I have many times i have said it and i am going to say it again because this is very, very important that; supply function of a firm in the short run is nothing but the upward sloping part of the marginal cost curve which lies above the average variable cost curve.

So, let us draw this supply curve here is the marginal cost curve then let us draw average variable cost curve this is marginal cost curve and here we will have average total cost or average cost curve, and the marginal cost curve is clearly this particular part the upward sloping part of the marginal cost curve, but this we have done, what is new? That we are going to say what happens when the price is above this P min let me say this is P min, why this is P min? If the market price is lower than the P min then this firm would decide not to supply any of it is product in the market. So, let us say price is higher than P min

And let us say it is at this level this is P star let us say for a moment this is the market price, what happens that; at this market price this firm would produce Q star amount of output. Now what is happening if you pay attention that the total cost to produce Q star amount of output is given by given by let us say A origin B C. The rectangle A O B C gives the total cost, it means; the firm which is operating in this market will earn a tidy profit of this much amount ok. Let us name it let us put it D which is P star D B A.

What it would do, it would incentivize other entrepreneurs to enter the market because this firm is earning a profit which is more than normal profit, and normal profit is what? It is clear from the graph that this particular form is earning a positive profit ok. And which is the positive profit would induce several other entrepreneurs to enter in the market. And as the, enter in the market they would supply the products in the market and we already know that the market supply is given by the horizontal sum of all the supply curve of all the firms present in the market. So, as more and more firms would enter in the market, what would happen to the supply curve? The supply curve would shift rightward and as supply curve would shift rightward what would happen to the market price.

Let us say the market price will come down. So, market price comes down it means there is a movement in this direction the P star is the market price and it will decrease. And the new entrepreneurs will keep on entering the market as long as firms are making positive profit in this market let us look at related, but slightly different case what happens there that here market price happens to be let us say, P star 1 ok. Let us let us use slightly different color, and in this case the form would like to supply Q star 1.

In this case what is happening this particular form will be making a loss, loss equal to this area ok. So, it will induce these firms and of course, in short run the firm will keep on operating because the firm is able to recover it is variable cost, but this situation persists in the long run this firm would like to exit the market because it would keep on incurring a loss. So, it may start if all the firms are experiencing the same phenomena the many firms would exit the market, and what is going to happen? When firms exit the market the market supply goes down, when market supply goes down the supply curve shifts upward and, in this case, what will happen the market price will increase.

So, two things we saw when a firm earns a positive profit it induces other entrepreneurs to enter in the market in expectation of making some profit. And if firms are earning loss then it induces these firms to leave the market which again in turn bring the price to a label when where the firms are not able to make any profit. Let me repeat this once again two things we have talked about one entry and another exit.

Entry is when forms are earning profit then it will induce other entrepreneurs to enter in the market in expectation of making profit. So, that would create a downward pressure on the market, when similar thing happens when a firms are making loss in this market. It induces the firms present in the market to leave the firm hence decreasing the supply and decrease in the supply means increase in the market price. So, here price would have an upward pressure.

Thank you.