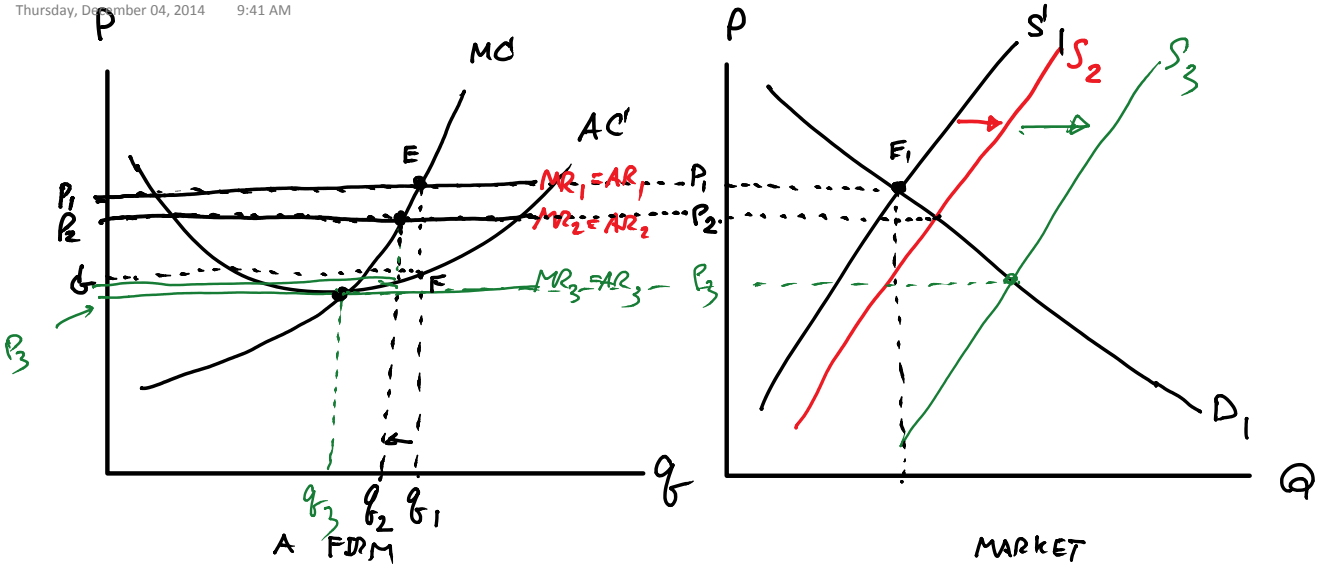


AT $P = P_1$, FIRM PRODUCES A q_1 WHERE $MR_1 = MC$. IT OBTAINS THE POSITIVE PROFIT = AREA E F G P_1. THE POSITIVE PROFITS WILL ATTRACT THE NEW FIRMS TO ENTER THE MARKET. AS A RESULT, THE MARKET SUPPLY CURVE SHIFTS TO THE RIGHT FROM S_1 TO S_2.

AT THE PRICE P_2, FIRM WOULD PRODUCE AT q_2 WHERE $MR_2 = P_2 = MC$. IT STILL OBTAINS POSITIVE PROFIT. THE SUPPLY CURVE CONTINUOUSLY SHIFTS TO THE RIGHT UNTIL THERE IS NO PROSPECT OF PROFITS ($\Rightarrow$ NEW FIRMS STOP TO ENTER).

ALL FIRMS IN THE MARKET NOW RECEIVE ONLY "ZERO ECONOMIC PROFITS"

EX: AT q_3 : TR = TC. SO $\boxed{\pi = 0}$

Q: WHY DOES A FIRM STILL PRODUCE WHEN $\pi^{EC} = 0$?

TO ANSWER THIS QUESTION, YOU MUST KNOW THE DIFFERENCE BETWEEN ACCOUNTING PROFITS (π^{AC}) AND ECONOMIC PROFITS (π^{EC}).

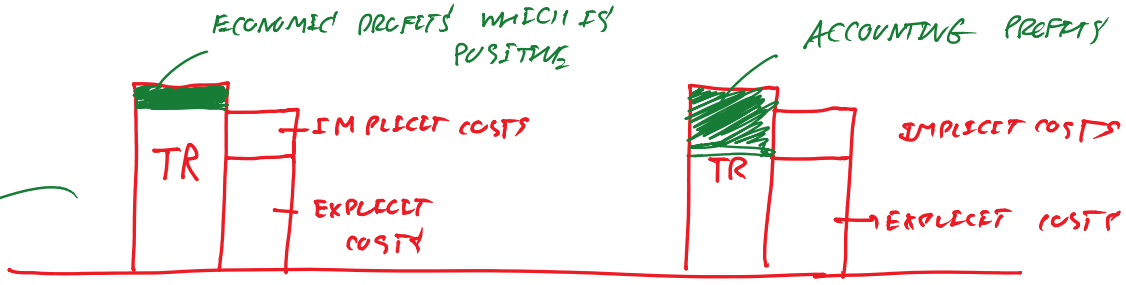
π^{AC} = TOTAL REVENUE (TR) − EXPLICIT COSTS

π^{EC} = TOTAL REVENUE (TR) − EXPLICIT COSTS − IMPLICIT COSTS (= HIDDEN COSTS)

TYPICALLY, $\pi^{AC} > \pi^{EC}$.

(= HIDDEN COSTS)

TYPICALLY, $\pi^{AC} > \pi^{EC}$.

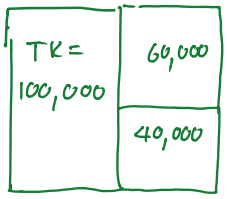


ECONOMIST'S POINT OF VIEW

ACCOUNTANT'S POINT OF VIEW.

ECONOMIC π = 100,000 − 40,000 − 60,000 = 0

$\pi^{EC} = 0$



IMPLICIT COSTS (EX: MY FORGONE SALARY)

EXPLICIT COSTS

SALARY = 60,000

MY BUSINESS!

SALARY MAN

THE FIRM SHOULD CONTINUE TO PRODUCE BECAUSE TR GENERATED IS ENOUGH TO COVER "ALL ECONOMIC COSTS" WHICH INCLUDE BOTH EXPLICIT AND IMPLICIT COSTS!