

# Choosing Output in LR

## Long Run Competitive Equilibrium

- 3 conditions
  - All firms maximize profits
  - No firm has incentive to enter or exit
  - Price equates supply and demand

## Long Run Supply

- Cannot horizontally add because in LR, don't know which firms produce
- Shape of LR supply depends on whether changes in industry output affect input prices
- Case 1 – Constant Costs

- Case 2 –Increasing Costs
  - Price of some input(s) rise as output expands

- Case 3 –Decreasing Costs

# Analysis of Competitive Markets

- Study welfare effects of policy, using producer and consumer surplus
  - Demonstrate the efficiency of competitive markets
  - To evaluate a policy, as “what happens to producer and consumer surplus?”



## Price floor above $P^*$

### Two Possibilities

- 1) producers realize that buyers want only  $Q_1$
- 2) Producers make  $Q_2$  units



## Price Supports vs. Paying Not to Produce

### Consider government programs

- Buy  $Q_S$  for  $P_S$ .
- Pay farmers not to produce
- Both programs benefit farmers by  $2+3+4$ 
  - It may be cheaper to give this than to run program.