3 Profit and perfect competition – Part 2

Name: _____ Class: _____ Date: _____

Vocabulary

Write each word three times.

English	**Write it 3 times** (English)		
marginal revenue			
Economic profit			
Perfect competition			

Recall

In Part A you met a firm's costs. Now how much it should make, and what "profit" really means:

- A firm wants to make the most profit it can.
- Profit is what is left after paying costs.
- But economists count the cost of missed opportunities too.

Each idea has a worked example before the Practice.

New ideas

■ 1 Profit maximization

Every firm makes the most profit at the quantity where **marginal revenue** (the extra revenue from one more unit) equals **marginal cost**:

$$MR = MC.$$

Make each unit whose revenue beats its cost; stop where they are equal.

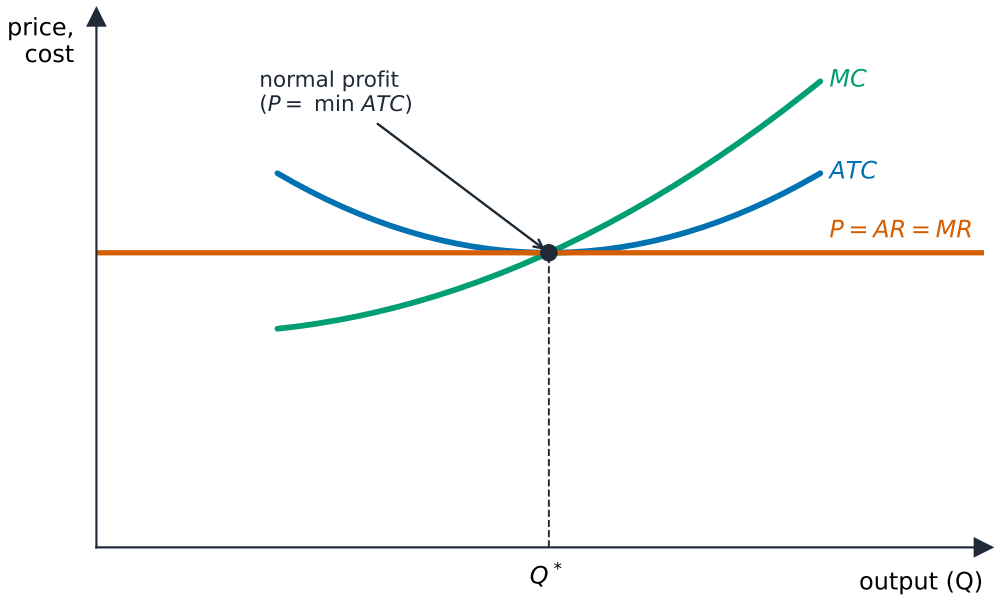
2 Two kinds of profit

- **Accounting profit** = revenue − the money costs you pay.
- **Economic profit** = revenue − money costs − the opportunity costs of your own resources.

Worked example. A shop earns \$200,000 and pays \$120,000 in costs, so accounting profit is \$80,000. But the owner gave up a \$70,000 salary elsewhere, so economic profit is 80,000 − 70,000 = \$10,000.

3 Perfect competition

Perfect competition has many small firms selling an identical product, with free entry. Each firm is a **price taker** – too small to change the market price.



4 The long run

In perfect competition, profits attract new firms (entry) until economic profit falls to **zero** – firms just cover all their costs, including opportunity costs.

Watch out: zero **economic** profit is not the disaster it sounds – it means the owner is earning exactly what their resources could earn elsewhere. It is a perfectly acceptable, "normal" outcome.

Practice

Try these in order. The methods are all above.

2.1 State the rule for the profit-maximizing quantity. [1]

2.2 State the difference between accounting profit and economic profit. [2]

2.3 A business earns $150,000 and pays $90,000 in costs. Find the accounting profit. [2]

2.4 The owner gave up a $50,000 salary. Find the economic profit. [2]

2.5 Explain why firms in perfect competition earn zero economic profit in the long run. [2]