Competitive Diversity

• How can cost functions differ?

Economic and Accounting Profits

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Taxing a Competitive Industry

Different Cost Functions

• We have looked at two cases:

• How can cost functions differ?
• Economic and Accounting Profits
• Taxing a Competitive Industry
• Consumer and Producer Surplus
Different Cost Functions

• We have looked at two cases:
  – Firms with identical cost functions
  – Firms with different cost functions.

Different Cost Functions

• We have looked at two cases:
  • To most, it seems obvious that firms have different cost functions.

Sources of Differences

• Different Endowments
  – Suppose farmer Jones has rich flat bottomland, while Smith has hilly rocky land.
  – Then different production functions and hence different AC and MC functions.

Sources of Differences

• Different Endowments
• Learning Curve
  – Suppose Smith is just starting out, while Jones is an old hand at this business.
Sources of Differences

• Different Endowments
• Learning Curve
• Aging Plants
  – Smith has a new plant; Jones has a clunker.

Sources of Differences

• Different Endowments
• Learning Curve
• Aging Plants
• Patents and other know how.

Economic and Accounting Profits

• We are told that firms are in business to make a profit.

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  – When firms are identical and industry is in equilibrium \( P = AC \), meaning zero profit.

Economic and Accounting Profits

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  – When firms are identical and industry is in equilibrium \( P = AC \), meaning zero profit.

  – Accountants and the IRS take a different view.

Economic and Accounting Profits

• We are told that firms are in business to make a profit.

• The difference is Economic Profits vs. Accounting Profits.
Economic and Accounting Profits

- Joe Smith Widget Works sold $1,000,000 last year.
  - Paid workers $700,000
  - Accountants and the IRS would record profits of $300,000

Economic and Accounting Profits

- The difference is opportunity cost

Economic and Accounting Profits

- The difference is opportunity cost
- Joe could have earned $150,000 working for Baker Widgets
- Joe had $1,500,000 in business, could have earned 10% elsewhere.

Economic and Accounting Profits

- The difference is opportunity cost
- Then economic profits are zero; the $300,000 represents opportunity cost.

Taxing a Competitive Industry
Upward Sloping Supply Curve

How Much Gets Passed

\[
\text{Percent to Consumer} = \frac{\eta_s}{\eta_t - \eta_d}
\]

Consumer and Producer Surplus
Consumer and Producer Surplus

End

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