Syllabus Reference: 2. 3 + 2.1: Economic efficiency + Productive efficiency

1. Productive Efficiency

- Occurs within the firm. Efficiency is measured at any point in the Average cost curve (AC= TC/q)
- Why be efficient? Increases profits, particularly where firms are in a competitive industry. Consider TR- TC. Lowering costs increases profits.

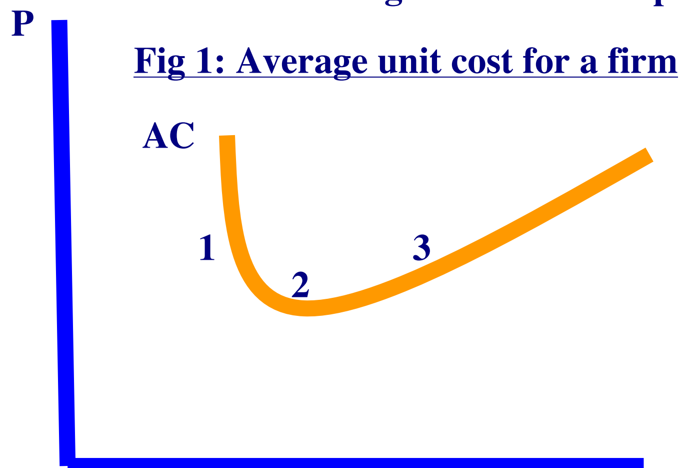

Fig 1: Average unit cost for a firm

Q

Economies of scale (size) can play a major role in productive efficiency if they cause LRAC / unit cost to fall i.e. if the big firm has lower unit costs than a smaller firm in the same industry. See webnote 209 for economies of scale.

- Economies of scale may be particularly relevant for firms in Monopoly / Oligopoly market structure. Note carefully that economies of scale is a long run concept only! LRAC= long run average cost

2 Economic Efficiency (Allocative efficiency) see fig. 2

- Occurs outside the firm (macro concept)
- Occurs when society is producing G + S most valued by society (see point on ppf)
- Producing within PPF may well be a good representation of ‘economic inefficiency’. (See point inside PPF.)

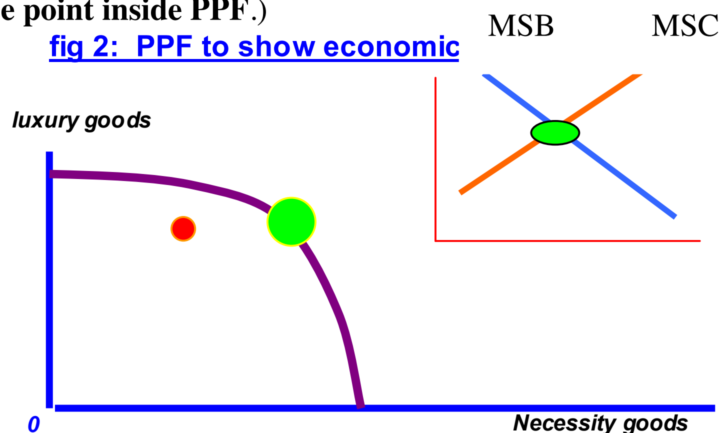

fig 2: PPF to show economic

Note on efficiency: **3** output levels face the firm:

1. **productive efficiency quantity** occurs at lowest point of ac curve: **mc=ac**
2. **allocative efficiency quantity** occurs at **mc=ar** (price). Also measured in terms of equilibrium in a market where supply = demand. This is also allocative efficiency.
3. **maximum profit quantity** occurs at **mr=mc** (profit max output) see webnote 242 for profit

note for HL: Perfect competition = 1+2+3 see webnote 214 for this!

see also webnote 242 for “profit”