

# Economies of Scale

**SYLLABUS REFERENCE 2.3 <sup>1</sup>: Theory of the firm: Must know information and how to draw accurate diagrams.**

- Need to know checklist:
1. Draw profit max output level for all 4 models
  2. SRAC- U shaped Why? (webnote 216)
  3. LRAC- U shaped Why? (webnote 216)
  4. Productive efficiency
  5. Economic efficiency see webnote 218
  6. Profit maximising o/p
  7. Abnormal profit
  8. Break even point of a firm in PC see (webnote 221)

**Green Circle**

Main 2.3 Focus – Must know for each of the 4 Models

Exam Q's will focus on:

1. Profit maximising output where  $MR=MC$  (see item 1,2 and 3 in table 1 below) or alternatives see web 242
2. Normal or supernormal profits
3. efficiency in terms average unit cost
4. high or low level of output
5. importance of economies of scale



**Table1: Summary of the 4 competitive models in the Long Run**

<u>Main concepts</u>	<u>PC</u>	<u>M-istic</u>	<u>O</u>	<u>M</u>
<b>1. Max Profit</b> <b>MR=MC</b>	<b>MR=MC</b>	<b>MR=MC</b>	<b>MR=MC</b>	<b>MR=MC</b>
<b>2. Allocatively efficient</b> <b>MC=AR</b>	Yes	No	No	No
<b>3. Productively efficient</b> <b>MC=AC</b>	Yes	No	No	No
<b>S/N Profit</b>	<b>SR only</b>	<b>SR only</b>	<b>SR+LR</b>	<b>SR+LR</b>
<b>Efficiency/price taker or maker</b>	<b>Lowest point of AC. Price taker. Efficient. Competitive Industry.</b>	<b>Not at Lowest point of AC. Price taker or maker. Low price power. Non Price</b>	<b>Not at Lowest point of AC. Often a Price maker. Can have high price</b>	<b>Not at Lowest point of AC. Often a Price maker. Can have high price</b>

<sup>1</sup> 1 of 1

		competition.	power. Non Price competition.	power. Non Price competition.
Output level/market share	Low	Low	High	High
Econ. Of scale	No	Unlikely	Likely	Likely

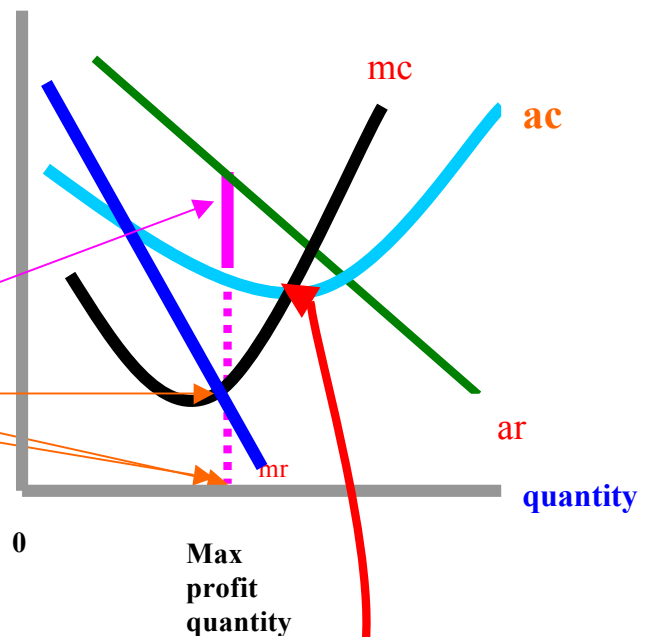
**The Diagrams: How to draw them accurately?**

**Note to diagrams:**

Look for the following points in order to analyse/evaluate each of the 4 types of competition:

1. S/N exists where  $AR > AC$
2. Max profit at  $MC = MR$
3. Efficiency at lowest point of AC

Price /cost



**5** Tips...

1. Draw AR and AC
2. Select a max profit quantity
3. from this point highlight S/N profit where  $AR > AC$  (or normal profit)
4. Add in MC cutting AC (at lowest point or not?)
5. Add in MR. It must be where you have marked the profit maximising level of output

Note: remember for PC:  $AC=AR$  (ar is drawn horizontal)