

Quiz 2 & Answers ☺

EE211 Section 1

Name _____ Last 4 digits ID _____

1. How and why does a firm's average-total-cost curve in the short run differ from its average-total-cost curve in the long run?

Hint: SR cost v.s LR cost

LRAC shows the lowest possible cost of producing each level of output when all inputs can be varied.

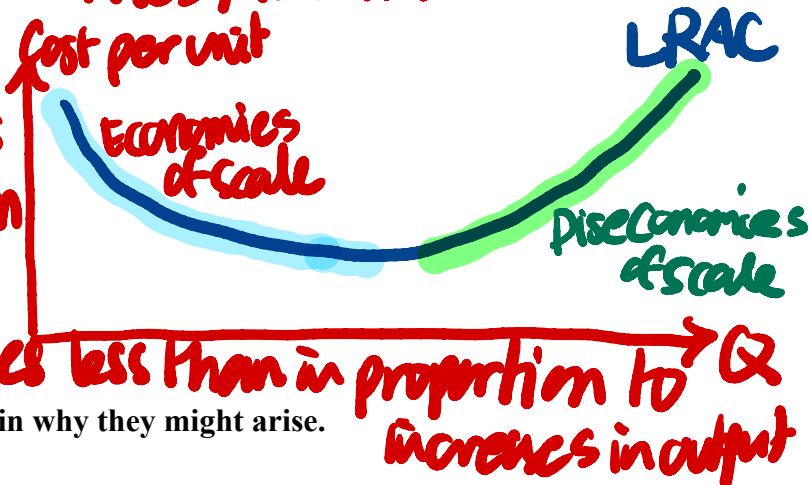
→ continue on P.3

2. Define economies of scale and explain why they might arise.

Hint: LR cost

→ When LRAC falls as output rises, the firm is said to have economies of scale.

→ The case of increasing returns to scale—output grows more than in proportion to the increase in inputs. In consequence, LRAC rises less than in proportion to



3. Define diseconomies of scale and explain why they might arise.

Hint: LR cost

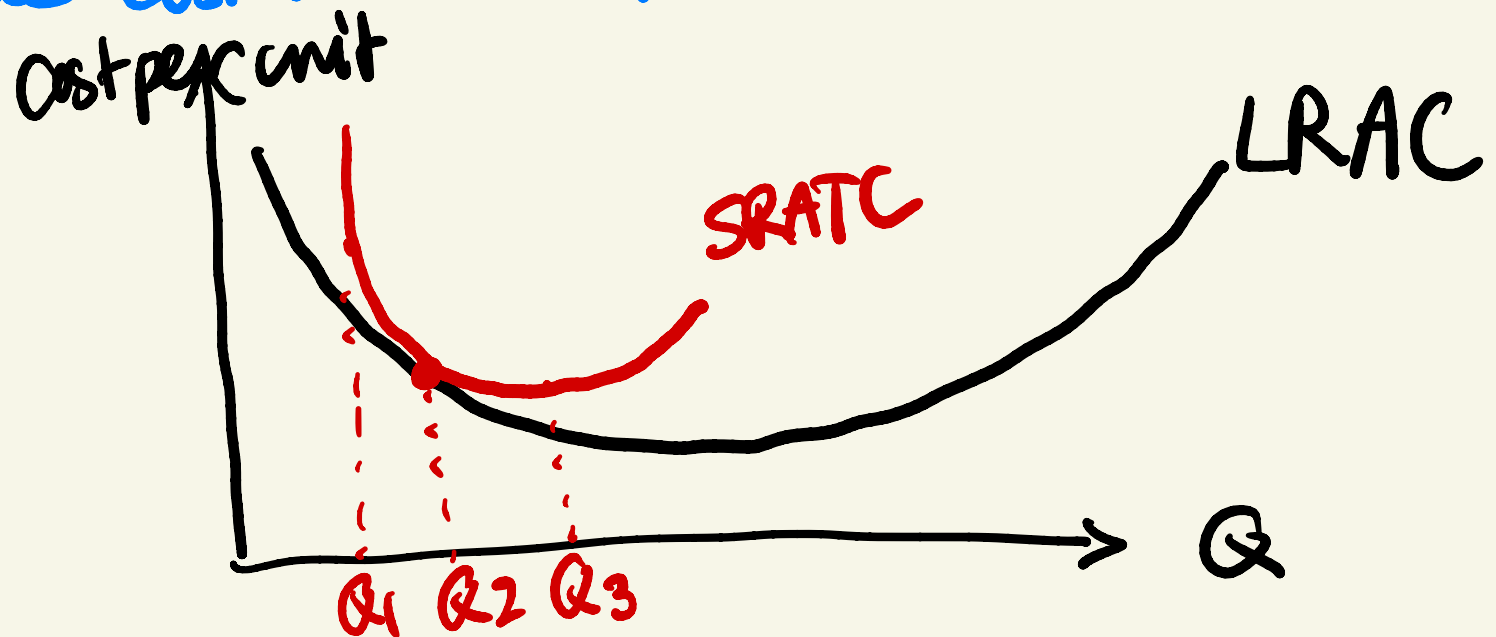
→ When LRAC curve is rising, a long-run expansion in production is accompanied by a rise in average costs.

→ If factor prices are constant, the firm's output must be increasing less than in proportion to the increase in inputs and the increasing cost firm is said to encounter LR decreasing returns →

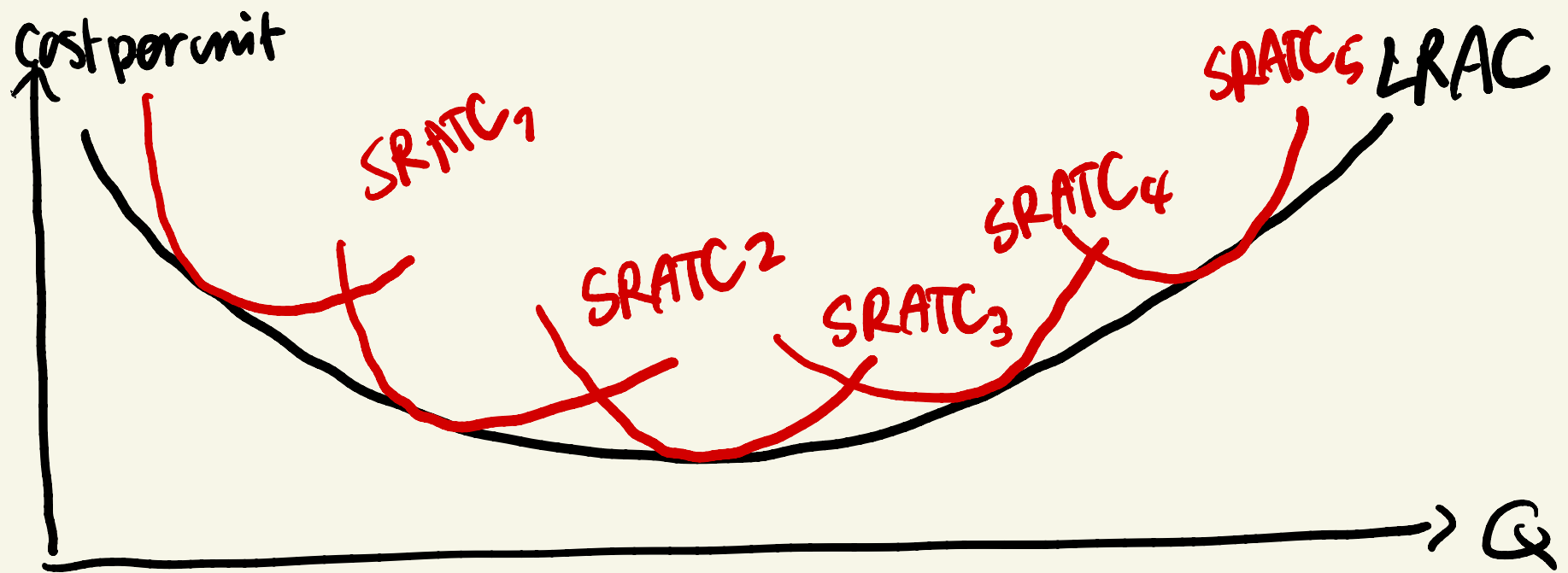
Decreasing returns imply that the firm suffers
some diseconomies of scale.

Each SRATC (Short-Run Average Total Cost) curve shows the lowest cost of producing any output when one or more factors are fixed.

* No SR cost curve fall below the LR cost curve because the LR AC curve represents the lowest attainable cost for each possible output.



Each SRATC curve is tangent to the LRAC curve at the level of output for which the quantity of the fixed factor is optimal.



To every point on the LRAC curve, there is an associated SRATC curve tangent at that point.

Each short-run curve is drawn for a given plant size, shows how costs vary if output varies (holding constant the size of plant).

The level of output at the tangency between such SRATC curve and the LRAC curve shows the level of output for which the plant size is optimal.