Short Run and Long Run Costs

The table shows a firm's total and marginal costs.

What is the average fixed cost of producing 6 units?

A $50

B $60

C $180

D $300

Correct Answer is... A

- Total fixed costs are $300 since the marginal cost of the first unit = $40
- Average fixed cost = TFC/ Q
- = $300 / 6 = $50

output	total cost ($)	marginal cost ($)
1	340	40
2	375	35
3	400	25
4	435	35
5	475	40

A firm has total fixed costs of £3000 and can produce two units per hour. Its total variable costs are £2000 for one unit and £3000 for two units.
Which cost will fall by the least when the second unit is produced?

- **A** average fixed cost
- **B** average total cost
- **C** **average variable cost**
- **D** marginal cost

Correct Answer is... C

- Total cost of producing 1 unit = £5,000
- Total cost of producing 2 units = £6,000

AFC = TFC/Q:
AFC of 1 unit = £3,000
AFC of 2 units = £1,500
(Fall of £1,500)

AC = TC/Q
AC of 1 unit = £5,000
AC of 2 units = £3,000
(Fall of £2,000)

AVC = TVC/Q
AVC of 1 unit = £2,000
AVC of 2 units = £1,500
(A fall of £500)

Marginal cost falls £1,000 from 1st to 2nd unit

A small European airline currently produces at point X on its long-run average cost curve. It wants a bigger share of the European airline market and proposes to merge with another small European airline. The newly merged firm would produce at point Y on the long-run average cost curve, as shown. Why might the newly merged firm be able to produce at point Y?

A The new airline can negotiate discounts when buying fuel.

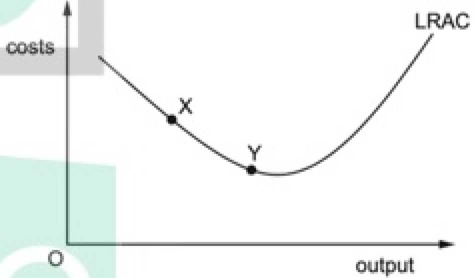
B The new airline has many layers of management.

C The new airline is unable to hire enough pilots.

D The workforce of the new airline lacks morale and is demotivated.

Correct Answer is... A

- An enlarged airline would have greater monopsony (buying) power when purchasing fuel – this lowers their long run average cost (an economy of scale)



The size of a firm increases. As a result, its long run average costs fall because the firm utilises its factory more efficiently and the advertising cost per item decreases. Therefore, the firm experiences

Correct Answer is…

A purchasing and marketing economies of scale.

B technical and marketing economies of scale.

C financial and purchasing economies of scale.

D financial and technical economies of scale.