



COSTS

Short Run and Long Run Costs



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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

$$AFC = TFC/Q$$

$$AFC \text{ of 1 unit} = £3,000$$

$$AFC \text{ of 2 units} = £1,500$$

(Fall of £1,500)

$$AC = TC/Q$$

$$AC \text{ of 1 unit} = £5,000$$

$$AC \text{ of 2 units} = £3,000$$

(Fall of £2,000)

$$AVC = TVC/Q$$

$$AVC \text{ of 1 unit} = £2,000$$

$$AVC \text{ of 2 units} = £1,500$$

(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.

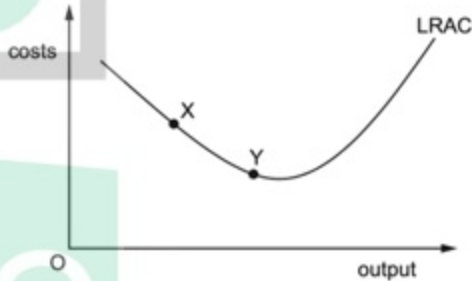
D

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.



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