

Answer on Question #44491 – Economics – Microeconomics

Task

Carefully detail the three main types of long run average cost curves. Then indicate how each of those cost structures might affect and industries market structure.

Solution

The long-run average cost curve is the envelope of an infinite number of short-run average total cost curves, with each short-run average total cost curve tangent to, or just touching, the long-run average cost curve at a single point corresponding to a single output quantity. The key to the derivation of the long-run average cost curve is that each short-run average total cost curve is based on a given amount of the fixed input, usually capital. As such, when the quantity of the fixed input changes, the short-run average total cost curve shifts to a new location.

The long-run average cost curve can be derived by identifying the factory size (or quantity of capital) that can produce each quantity of output at the lowest short-run average total cost. For example, The Wacky Willy Company has one short-run average total cost curve corresponding to a 10,000 square foot factory, another short-run average total cost curve corresponding to a 10,001 square foot factory, another for a 10,002 square foot factory, etc. Each of these short-run average total cost curves incurs the lowest average total cost for the production of a given quantity of output. The long-run average cost curve is then the combination of all minimum short-run average total cost values.