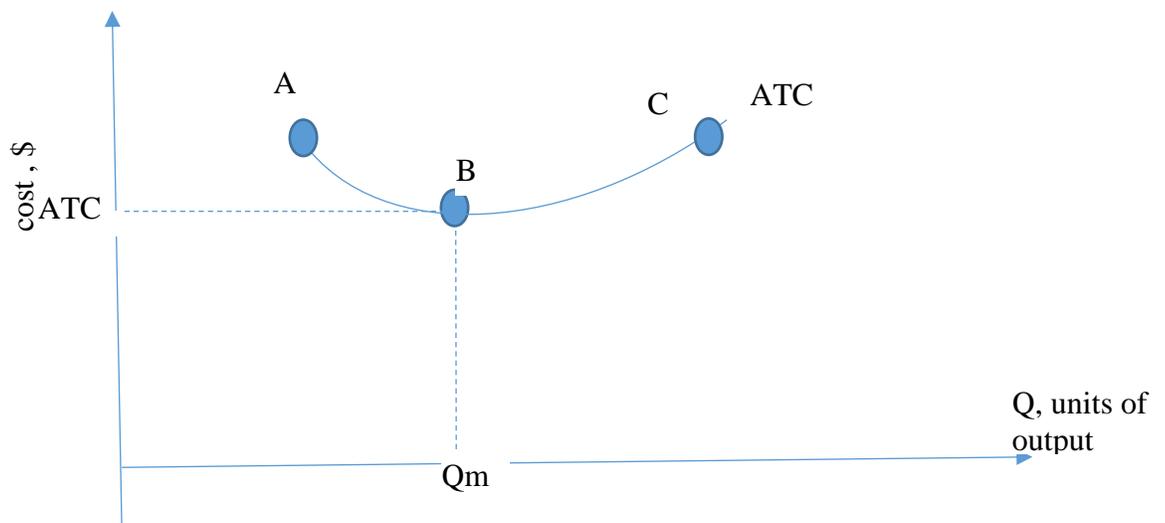


Answer on Question 81602-Economics - Microeconomics

Explain how the u-shaped average cost curve can be used by a firm in decision making

Answer

The U-shaped ATC curve can be used for choosing of optimal quantity of output. Total costs consist of fixed costs (that does not change in the short run) and variable costs (that increase with increasing of output). So, with growth of output fixed costs per unit gradually decrease. This explains the descending character of the curve in the section AB. For example, with an increase in the output of plastic packaging production, the cost of leasing of manufacturing space and equipment will decrease until production capacity is fully involved. In the figure, this corresponds to the point of minimum average costs - point B. At this point, all equipment and areas are fully used, employees work efficiently, the process control structure, marketing and administrative apparatus are optimal. With further attempts to increase output, a disproportionate growth of the administrative apparatus can occur, which makes management ineffective. Either ineffective sales, which do not keep pace with increasing volumes of production, fail, and this increases the cost of storing finished products. In the case of plastic containers, this is acceptable, but, for example, agricultural goods have a specific shelf life, and in this case there would be direct losses. All this is called negative scale effects, and they explain the ascending character of the curve in the BC area.



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