1.30 Productive, Allocative, Dynamic and X-Efficiency: Test Pack

Total Marks

AQA 7136 · Calculators not allowed · about 15 minutes

Name: _____ Date: ____ / ____ / _____

Answer all questions. Write full sentences for questions worth 4 marks or more and for the final 15-mark essay. Time guidance: 15 minutes total.

1 Multiple choice, context: efficiency concepts in the theory of the firm. Which of the following best describes allocative efficiency?

- ☐ A: Producing at the lowest point on the average cost curve.
- ☐ B: Producing the output level where price equals marginal cost.
- ☐ C: Continual innovation that lowers long run average costs over time.
- ☐ D: Operating with excess managerial slack so costs exceed the minimum possible.

(Total for Question 1 is 1 mark)

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2 State and explain one policy a regulator could use to reduce X-inefficiency in a monopolistic firm that faces little competitive pressure.

(Total for Question 2 is 4 marks)

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3 Define productive efficiency in the context of a firm's cost curves and state its usual graphical criterion.

(Total for Question 3 is 2 marks)

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4 Explain why a natural monopoly that benefits from large economies of scale might be productively efficient but not allocatively efficient when it sets price under average cost pricing.

(Total for Question 4 is 3 marks)

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Mark scheme · 1.30 Productive, Allocative, Dynamic and X-Efficiency: Test Pack

Question 1

correct option B selected, allocative efficiency is where price equals marginal cost **B1**

Answer: B

Question 2

states a plausible policy, e.g. introduce stronger competition via breaking up the firm, facilitate entry, price cap regulation that links price to efficient costs, or incentive-based regulation **B1**

explains mechanism: e.g. a price cap forces the firm to cut avoidable costs to maintain margin or entry increases threat of losing market share, restoring incentives to be cost efficient **M1**

developed explanation: price cap tied to efficient cost benchmarks rewards cost reduction while protecting consumers from monopoly pricing **A1**

mentions possible drawback, e.g. risk the cap is set too tight reducing investment or regulation being costly to implement **A1**

Answer: Example: use a price cap set on efficient costs; this forces a monopolist to remove slack and reduce avoidable costs to keep margins, reducing X-inefficiency. However if set too tightly it may deter necessary investment.

Question 3

productively efficient means producing at the lowest possible average cost for given technology and input prices **B1**

graphically, the criterion is producing at the minimum point of the long run average cost curve or short run average cost curve appropriate to the plant **B1**

Answer: Productive efficiency is producing at the lowest average cost; graphically it is at the minimum point of the relevant average cost curve.

Question 4

a natural monopoly may be productively efficient if average costs are minimised at the large scale of output the firm supplies, since LRAC falls over the relevant range **M1**

under average cost pricing the firm sets price equal to average cost, which may be above marginal cost **A1**

since allocative efficiency requires P = MC, pricing at AC > MC means allocative inefficiency persists even though productive efficiency may hold **A1**

Answer: A natural monopoly can be productively efficient by operating at large scale lowering AC, yet set P = AC which exceeds MC, so allocative efficiency (P = MC) is not achieved.

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