

Edexcel (A) Economics A-level
**Theme 3: Business Behaviour &
the Labour Market**


3.4 Market Structures

3.4.1 Efficiency


Notes

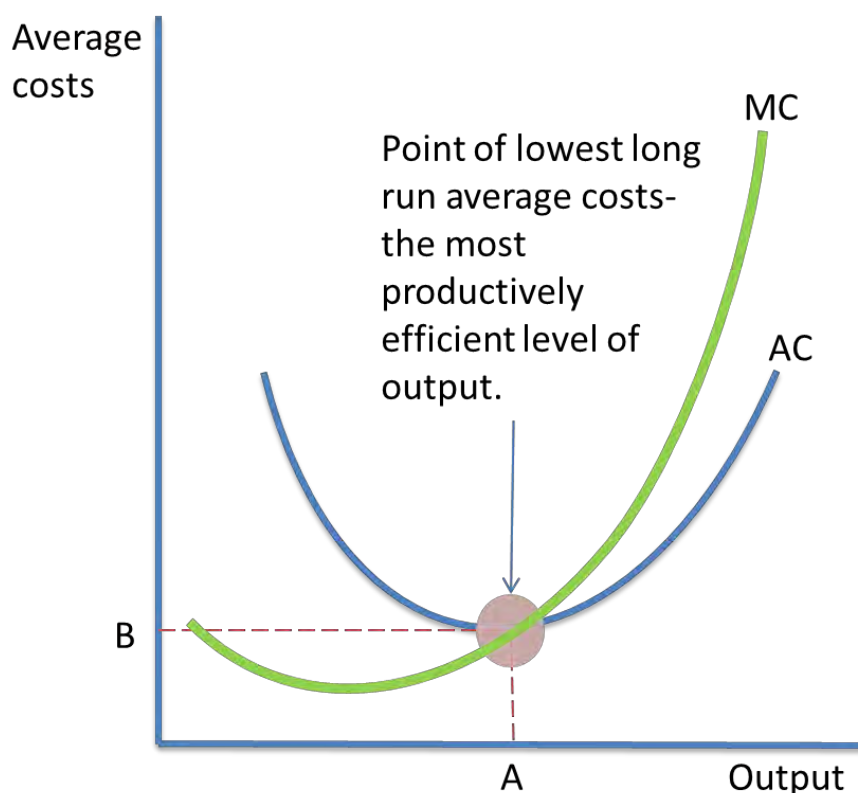


Allocative efficiency:


-  Allocative efficiency occurs when resources are distributed to the goods and services that consumers want. This maximises utility. It exists at $P = MC$, which means that consumers pay for the value of the marginal utility they derive from consuming the good or service. Free markets are considered to be allocatively efficient.

Productive efficiency:

-  This is when firms produce at the lowest point on the average cost curve. Since the MC curve cuts the AC curve at the lowest point, $MC = AC$ is a point of productive efficiency. All points on the PPF curve are productively efficient.






Dynamic efficiency:


-  This is when all resources are allocated efficiently over time, and the rate of innovation is at the optimum level, which leads to falling long run average costs. The

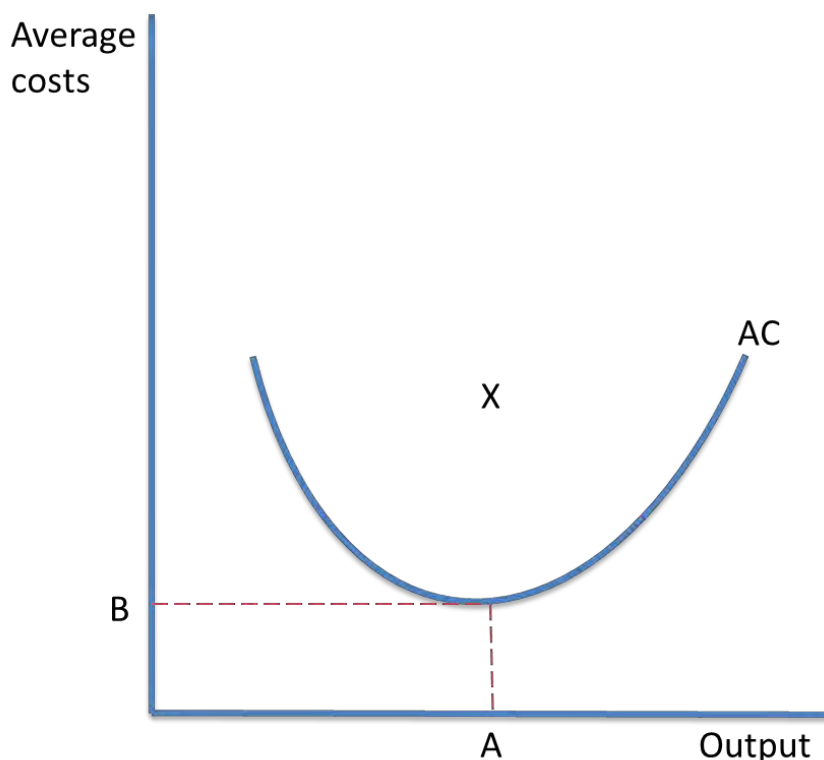



market is dynamically efficient if consumer needs and wants are met as time goes on. It is related to the rate of innovation, which might lead to lower costs of production in the future, or the creation of new products.

-  Dynamic efficiency is affected by short run factors such as demand, interest rates and past profitability.
-  Short run costs might be increased in order to cause long run costs to fall.
-  Dynamic efficiency can be evaluated by considering the long time lag between making an investment and having falling average costs and by considering how factors change in the long run. Moreover, some firms will face a trade-off between giving their shareholders dividends and making an investment.

X-inefficiency:

-  A firm is x-inefficient when it is producing within the AC boundary. Costs are higher than they would be with competition in the market. The point 'X' on the diagram shows x-inefficiency.



-  This could be due to organisational slack, a waste in the production process, poor management, or simply laziness. Monopolies tend to be x-inefficient, since they have little incentive to lower their average costs because of the lack of competition they face.

