

3.4.1 Efficiency

- A measure of how well resources are used. Output relative to some other factor.

Allocative Efficiency

- When price equals MC ($AR=MC$)
- People are paying the exact amount it costs to produce the last unit
- A way to consider this is approaching Allocative Efficiency. If people are prepared to pay more than it costs to produce last unit then it would satisfy more consumers to produce more units. If consumer satisfaction from last unit is less than cost then production should be cut back as consumers don't appreciate cost
- Maximises social welfare, takes into account P and C surplus

Productive Efficiency

- This is when a firm operates at the output where its average cost is lowest. (Lowest point on AC)
- $MC=AC$
- Any point on PPF curve
- Lowest price consumer can enjoy, optimum output for consumer surplus and productivity
- Very little producer incentive to operate here

In perfectly competitive market, Productive efficiency and Allocative efficiency are equal in long run. Productive efficiency kicks in at lower output since demand curves are downwards sloping

Dynamic Efficiency

- Arises when firm uses resources more effectively and productively over time
- Opposed to the two above which focus on one point in time (they are both static efficiencies)
- This is related to tech advances and innovation
- It can be achieved through innovation, tech advances, investment in capital, investment in human capital and labour relations etc

X-Inefficiency

- Occurs when costs rise due to lack of competitive pressure in market
- Can occur for monopolies or public sector firms, since there is little incentive to minimise costs. Workers may also not work as hard due to wages and employments not

being based on revenue.

- Results in upwards shift of AC curve
- Internal diseconomy of scale

Efficiency/Inefficiency in different market structures

Market structure	Productively efficient in the short run?	Productively efficient in the long run?	Allocatively efficient in the short run?	Allocatively efficient in the long run?
Perfect competition	No	Yes	Yes	Yes
Monopolistic competition	No	No	No	No
Oligopoly	No	No	No	No
Monopoly	No	No	No	No

- No structure has productive efficiency in SR
- Only perfect competition has productive efficiency in LR
- Only perfect competition has allocative efficiency in SR
- Only perfect competition has allocative efficiency in LR
- Basically, its only Perfect comp that is Productively efficient in the SR and Allocatively efficient in both the LR and SR