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output op



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The LAC curve helps a firm to decide the size of the plant to be adopted for producing the given output. For outputs less than the low cost combination at the optimum scale, i. e. when the firm is working subject to increasing returns to scale, it is more economical to underuse a slightly large plant operating at less than its minimum cost output than to overuse a smaller plant. Conversely, at outputs beyond the optimum level that is when the firm experiences decreasing returns to scale, it is more economical to overuse a slightly smaller plant than to underuse a slightly larger one.

An example may make it simple to understand why a firm may choose to operate plants at other than their minimum cost output (optimum capacity) levels. Assume a firm has a choice to use any of the four plants A, B, C, D, arranged in order of increasing size. The average cost curves for the plants are AA1, BB1, CC1,, and DD1, respectively. The firm's long-run average cost curve will be the scalloped curve ARSTD1,. This curve consists of the lowest segments of all the short run average cost curves. As will be clear that the output OP can be derived from plant C at the lowest cost. Still if the firm desires an output of OP, i.

e., an amount less than the minimum unit cost output OP1, it can have either plant A or plant B, but it will find it cheaper to have plant B and undersize it rather than to have plant A. If the firm desires an output OP2 i. e.

an output more than the minimum unit cost output OP, it will have either plant C or plant D but it will find it more economical to have plant C and overuse it rather than to have plant D. In this way, in managerial decision-making usefulness of the long run cost curve lies in its ability to keep the

management in the determination of the best size of the plant to be constructed or when a new one is being built or an old one is being expanded. As the long-run cost curve can help the enterprise to plant the best scale of plant or the best size of the firm for his purposes; for this reason it is also known as the planning curve. At the planning stage, management is faced with the problem of choosing one of the several possible sizes of plant.