

# ECO111 Notes — Unit 7

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## 1 Firms

- When doubling all the inputs causes the output to increase by more than double we say, the production process exhibit economies of scale or **increasing returns to scale**.
- When doubling all the inputs causes the output to also double, the production process exhibit **constant returns to scale**.
- When doubling all the inputs causes the output to increase by less than two times the earlier ouput, the production process exhibits **decreasing returns to scale**.

### 1.1 Curves

- Demand curve is the curve that gives the quantity the consumers will pay at each possible prices.
- **LAW OF DEMAND:** is the inverse relationship between the price of a good and the demand for the good. The demand curve generally slopes downward.
- Isoprofit curve is the price-quantity curve on which all points yield the same amount of profit.
- The isoprofit curve can be thought of as the producer’s indifference curve.
- The average cost curve is also the curve where profit = 0, as shown in the figure.
- For Profit Max, slope of the demand curve (MRT for the producer) = slope of the isoprofit curve (MRS for the producer, i.e., how price is tranformed for quantity)

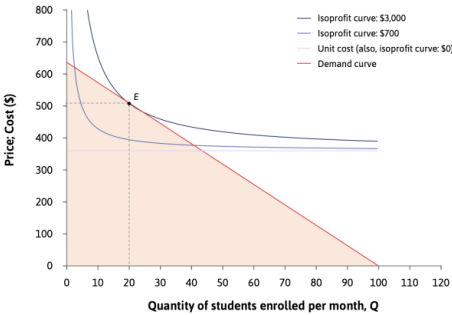


Figure 1: Profit Maximization

## 1.2 Some Terminologies

- Economic rent is a payment or benefit received above and beyond what the individual would have received in their next best option / reservation option
- Gains from exchange are the benefits that each party gains from a transaction compared to how they would have fared without the exchange.
- Total surplus are the gains received by all parties in the trade. It is measured as the sum of the consumer surplus and producer surplus.
- A consumer whose WTP is higher than the price at which the good is offered, gains from the trade or receives surplus from trade.
- The producer whose unit cost is less than the price receives a surplus from trade too.