

CHAPTER - 12: COST DETERMINED PRICING

(From this chapter one SAQ (1X1) question will come)

1. What is mark-up system?

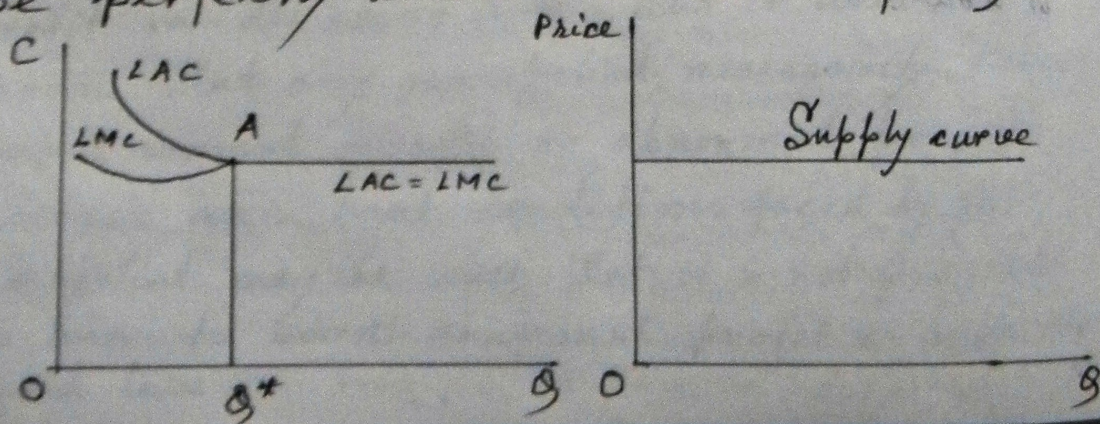
Firms may like to get a planned profit that can be measured as profit per unit of output or can be measured as a percentage of total cost. In both the cases the firm has to first determine the average cost of production. Then the planned profit is added with this average cost, i.e.,

$$\text{Price} = \text{Average cost} + \text{Planned profit per unit.}$$

The system of determining the price of a product by adding something with average cost is called the mark-up system.

2. What is the shape of long-run industry supply curve for industrial products?

Long-run industry supply curve is ~~horizontal~~ horizontal under cost-determined pricing system. In this case supply is said to be perfectly elastic. The reason of why the



industry supply curve for an industrial product is horizontal, modern economists took the help of L-shaped average cost curve. From the figure it is seen that upto OB^* units of output the LAC curve is negatively sloped and the corresponding LMC curve lies below the LAC curve. OB^* amount of output is called minimum optimum ~~output~~ scale. Beyond OB^* , LAC remains constant and hence $LAC = LMC$. Due to the existance of excess capacity, the firm always produces at any point of the horizontal portion of the LAC curve. If we assume that all firms have identical cost conditions then industry supply curve will be horizontal.

3. What is the shape of LAC curve explained by the modern economists.

- The answer of this question is given in the the answer of question 2 above.

4. How the price of product is determined under cost determined pricing?

- The price of the industrial product is determined by the position of the supply curve. There is no role of demand curve in determining the product price.

5. On which factor the quantity of product produced by an industry depends in cost determined pricing?

- Quantity of product depends on the demand for that product. The price is cost-determined and production is demand determined in case of industrial or manufactured products.