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Topic: Diseconomies of scale

Introduction

Diseconomies of scale are increases in per-unit production costs caused by an increase in the volume produced.

The opposite of diseconomies of scale is supposed to happen: Businesses grow when they can produce more units of a product using the same level of investment in resources.

Thus, diseconomies of scale increased production costs caused by increased production volume are the opposite of economies of scale.

- Diseconomies of scale occur when the expansion of output comes with increasing average unit costs.
- Diseconomies of scale can involve factors internal to an operation or external conditions beyond a firm's control.
- Diseconomies of scale may be caused by technical issues in a production process, organizational issues, resource constraints, or inefficient use of resources.

The word diseconomies refer to all those losses which accrue to the firms in the industry due to the expansion of their output to a certain limit. These diseconomies arise due to the use of unskilled labourers, outdated methods of production etc.

Like economies, diseconomies are also of two types.

1. Internal Diseconomies
2. External Diseconomies

1. Internal Diseconomies:

Internal diseconomies implies to all those factors which raise the cost of production of a particular firm when its output increases beyond the certain limit. These factors may be of the following two types:

(a) Inefficient Management:

The main cause of the internal diseconomies is the lack of efficient or skilled management. When a firm expands beyond a certain limit, it becomes difficult for the manager to manage it efficiently or to co-ordinate the process of production. Moreover, it becomes very difficult to supervise the work spread all over, which adversely affects the operational efficiency.

(b) Technical Difficulties:

Another major reason for the onset of internal diseconomies is the emergence of technical difficulties. In every firm, there is an optimum point of technical economies. If a firm operates beyond these limits technical diseconomies will emerge out. For instance, if an electricity generating plant has the optimum capacity of 1 million Kilowatts of power; it will have lowest cost per unit when it produces 1 million Kilowatts. Beyond, this optimum point, technical economies will stop and technical diseconomies will result.

(c) Production Diseconomies:

The diseconomies of production manifest themselves when the expansion of a firm's production leads to rise in the cost per unit of output. It may be due to the use of inferior or less efficient factors as the efficient factors are in scarcity. It happens when the size of the firm surpasses the optimum size.

(d) Marketing Diseconomies:

After an optimum scale, the further rise in the scale of production is accompanied by selling diseconomies. It is due to many reasons. Firstly, the advertisement expenditure is bound to increase more than proportionately with scale. Secondly, the overheads of marketing increase more than proportionately with the scale.

(e) Financial Diseconomies:

If the scale of production increases beyond the optimum scale, the cost of financial capital rises. It may be due to relatively more dependence on external finances. To conclude, diseconomies emerge beyond an optimum scale. The internal diseconomies lead to rise in the average cost of production in contrast to the internal economies which lower the average cost of production.

2. External Diseconomies:

External diseconomies are not suffered by a single firm but by the firms operating in a given industry. These diseconomies arise due to much concentration and localization of industries beyond a certain stage. Localization leads to increased demand for transport and, therefore, transport costs rise. Similarly, as the industry expands, there is competition among firms for the factors of production and the raw-materials. This raises the prices of raw-materials and other factors of production. As a result of all these factors, external diseconomies become more powerful.

Some of the external diseconomies are as under:

(a) Diseconomies of Pollution:

The localization of an industry in a particular place or region pollutes the environment. The polluted environment acts as health hazard for the labourers. Thus, the social cost of production rises.

(b) Diseconomies of Strains on Infrastructure:

The localisation of an industry puts excessive pressure on transportation facilities in the region. As a result of this, the transportation of raw materials and finished goods gets delayed. The communication system in the region is also overtaxed. As a result of the strains on infrastructure, monetary as well as the real costs of production rise.

(c) Diseconomies of High Factor Prices:

The excessive concentration of an industry in a particular industrial area leads to keener competition among the firms for the factors of production. As a result of this, the prices of the factors of production go up. Hence, the expansion and growth of an industry would lead to rise in costs of production.