

Course– PRINCIPLES OF ECONOMICS

Lecture 25: COST OF PRODUCTION
SEPTEMBER, 2015



TOPICS TO BE DISCUSSED

1. Cost of Production

➤ Meaning

➤ Concepts of cost

- Total Cost, Marginal Cost, Average Cost
- Fixed Vs Variable Cost
- Explicit Vs Implicit Cost
- Opportunity Cost

“BUY LOW AND SELL HIGH”

➤ “BUY LOW”- ???

- Increasing competitive pressure
- Changing technology
- Customer demand
- Maximization of Profit without Increase in Price

➤ “Sell High”- ???

- Profit Maximization



“Buy Low”- deals with Cost, “Sell High”- deals with Price

COSTS AND PROFIT

- **Total Revenue**

- Amount a firm receives from the sale of its output

- **Total Cost**

- Market value of the inputs, a firm uses in production
- Expenditure made on the use of factors of production
- $C = f(O)$ Positive relationship

- **Profit**

- Total Revenue - Total Cost

TYPES OF COSTS

- **Explicit Costs/Outlay Costs/Absolute Costs**

- Input costs that require an outlay of money by the firm
- Cash payments made to outsiders for their goods & services
- Accounting Costs = Explicit Costs**

- **Implicit costs/Opportunity Cost**

- Input costs that do not require an outlay of money by the firm, Costs of an entrepreneur's own factors/resources
- Example:** use of own land, building, own capital for own business
- Economic Costs = Explicit + Implicit Costs**

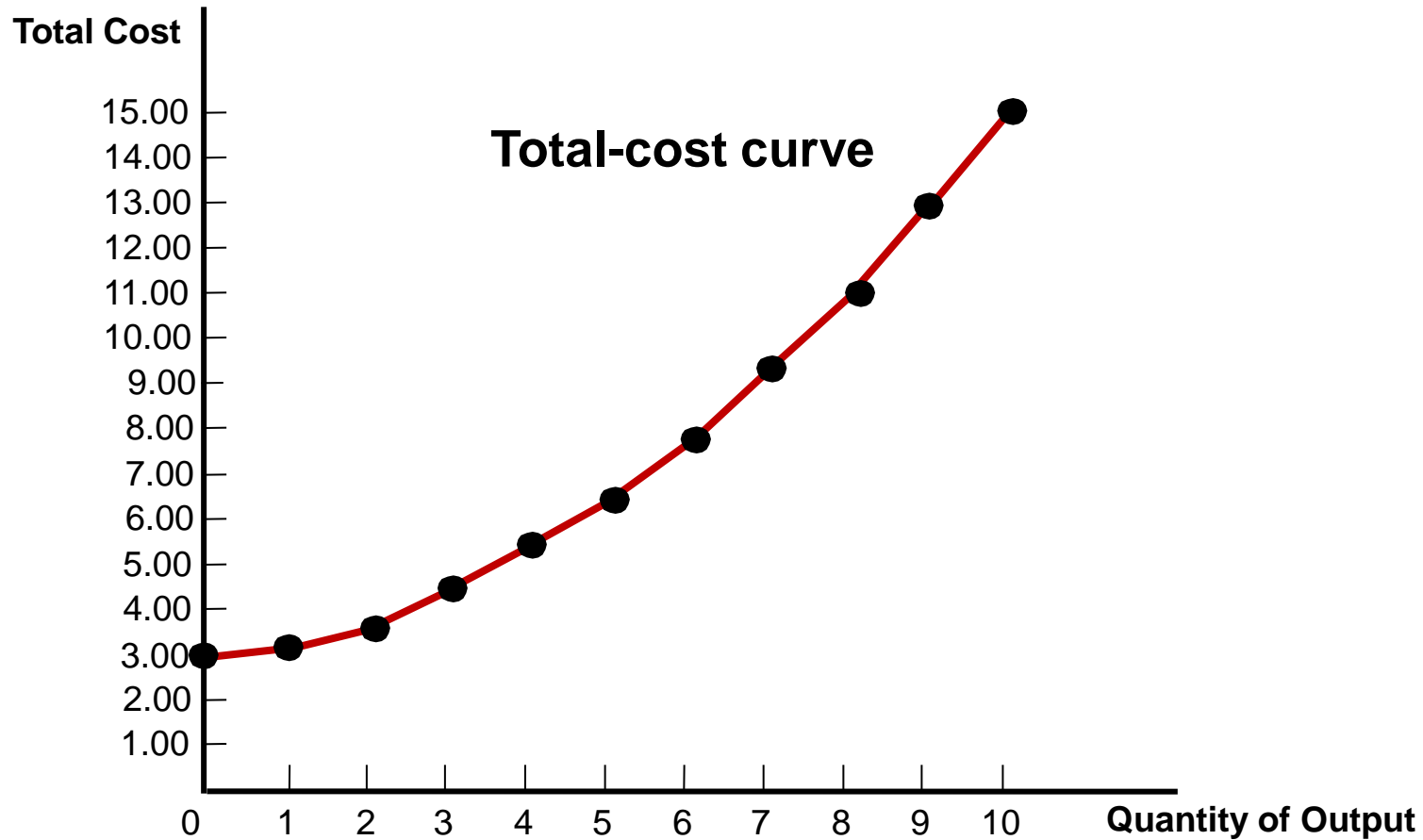
VARIOUS MEASURES OF COST

- **Opportunity Costs:** Forgoing the opportunity to produce alternative goods and services
- **Fixed costs**
 - Do not vary with the quantity of output produced
- **Variable costs**
 - Vary with the quantity of output produced
- **Average fixed cost (AFC)**
 - Fixed cost divided by the quantity of output
- **Average variable cost (AVC)**
 - Variable cost divided by the quantity of output

PRODUCTION AND COST

Input (Labour)	Total Production	Fixed Cost (FC)	Variable Cost (VC)	Total Cost (FC+VC)
0	0	3.00	0.00	3.00
1	1000	3.00	100	103
2	3000	3.00	200	203
3	6000	3.00	300	303
4	8000	3.00	400	403
5	9000	3.00	500	503
6	9500	3.00	600	603
7	9850	3.00	700	703
8	10000	3.00	800	803
9	9850	3.00	900	903
10	9500	3.00	1000	1003

TOTAL-COST CURVE



RECAP

Type	Meaning	Description
Explicit costs	Costs that require an outlay of money by the firm	
Implicit costs	Costs that do not require an outlay of money by the firm	
Fixed costs	Costs that do not vary with the quantity of output produced	FC
Variable costs	Costs that vary with the quantity of output produced	VC
Total cost	The market value of all the inputs that a firm uses in production	$TC = FC + VC$
Average fixed cost	Fixed cost divided by the quantity of output	$AFC = FC / Q$
Average variable cost	Variable cost divided by the quantity of output	$AVC = VC / Q$
Average total cost	Total cost divided by the quantity of output	$ATC = TC / Q$
Marginal cost	The increase in total cost that arises from an extra unit of production	$MC = \Delta TC / \Delta Q$

THANK YOU 😊