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Sws

THE COSTS OF PRODUCTION. INCOME FROM FACTORS OF PRODUCTION

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Content

Economic Costs

- The payment that must be made to obtain and retain the services of a resource
- Explicit Costs
  - Monetary payments
- Implicit Costs
  - Value of next best use
  - Self-owned resources
  - Includes normal profit

Accounting Profit and Normal Profit

- Accounting profit

  = Revenue – Explicit Costs

- Economic profit

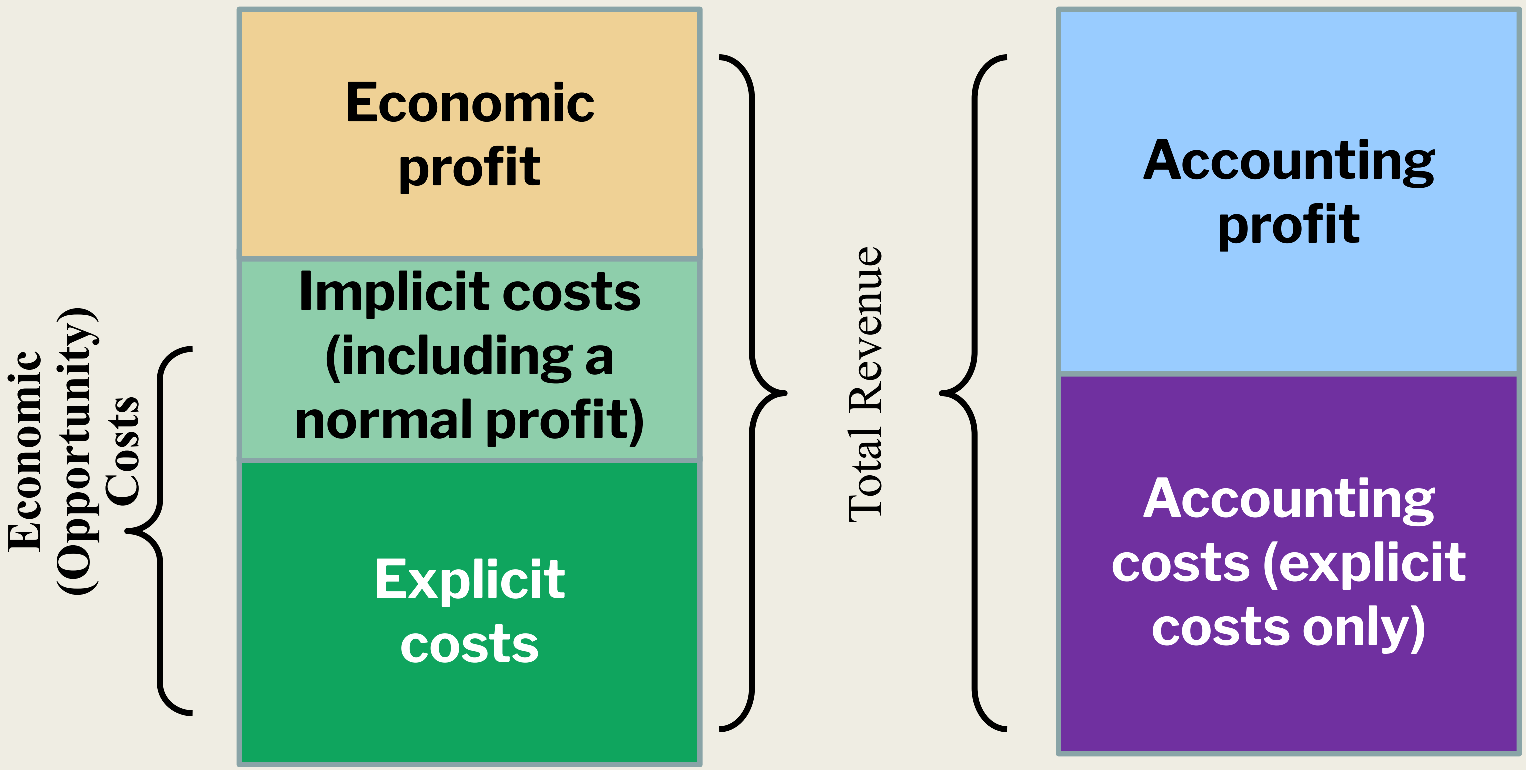
  = Accounting Profit – Implicit Costs

- Economic profit (to summarize)

  =Total Revenue – Economic Costs

  =Total Revenue – Explicit Costs – Implicit Costs

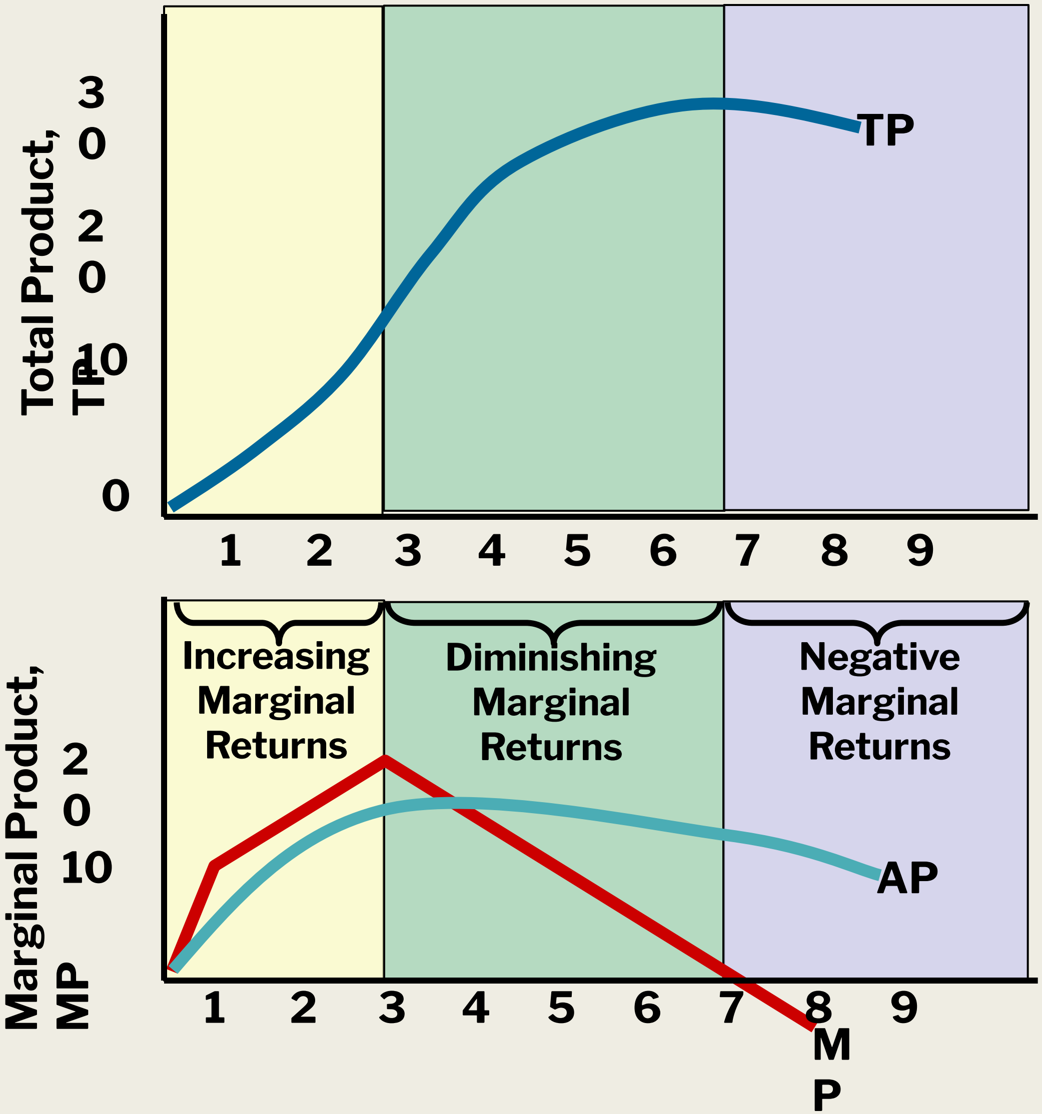
Economic Profit



Short Run and Long Run

- Short Run
  - *Some variable inputs*
  - *Fixed plant*
- Long Run
  - *All inputs are variable*
  - *Variable plant*
  - *Firms enter and exit*

The Law of Diminishing Returns



Short-Run Production Relationships

- Total Product (TP)
- Marginal Product (MP)

$$\text{Marginal Product} = \frac{\text{Change in Total Product}}{\text{Change in Labor Input}}$$

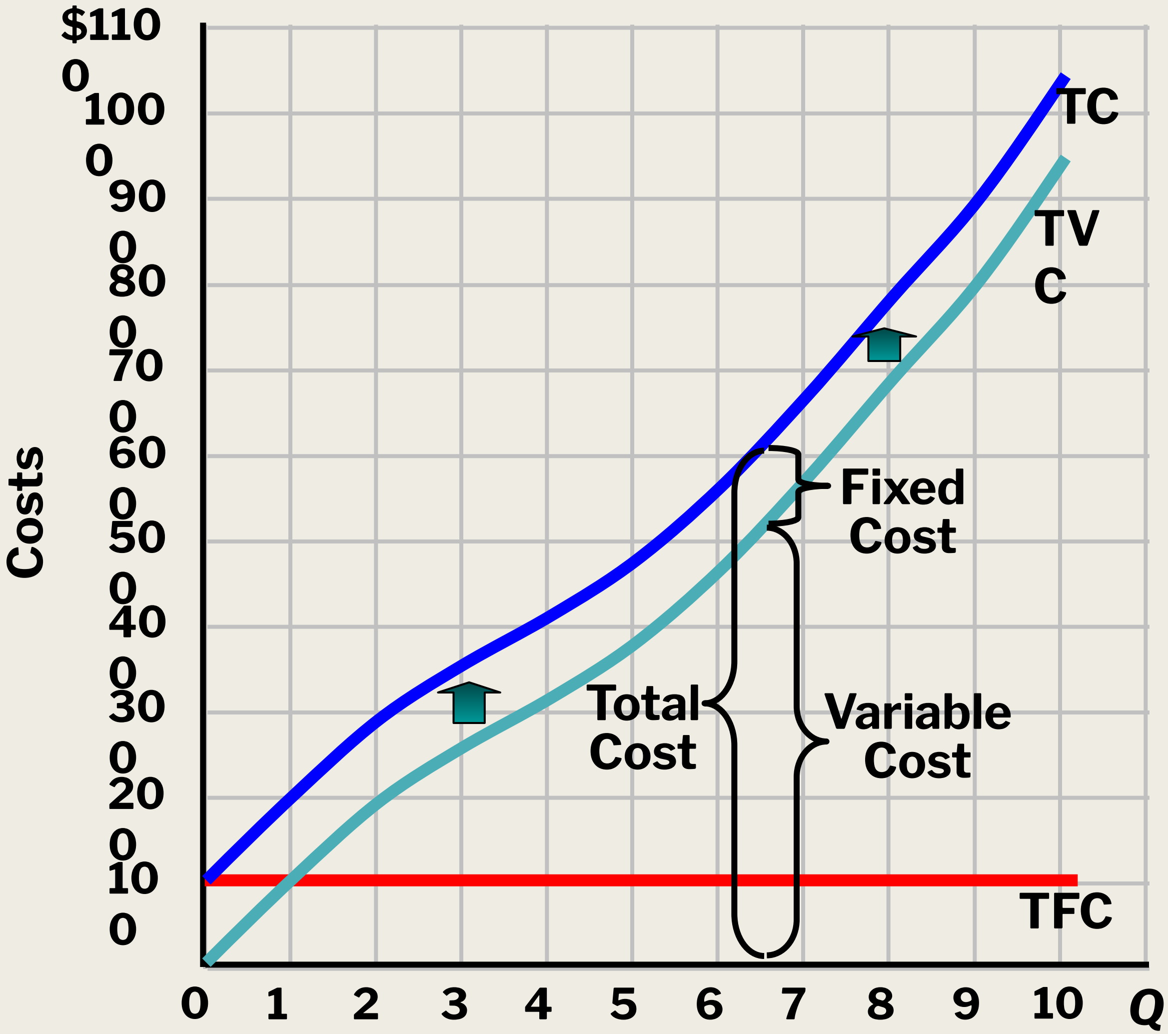
- Average Product (AP)

$$\text{Average Product} = \frac{\text{Total Product}}{\text{Units of Labor}}$$

Short-Run Production Costs

- Fixed Costs (TFC)
  - *Costs do not vary with output*
- Variable Costs (TVC)
  - *Costs vary with output*
- Total Costs (TC)
  - *Sum of TFC and TVC*
  - *TC = TFC + TVC*

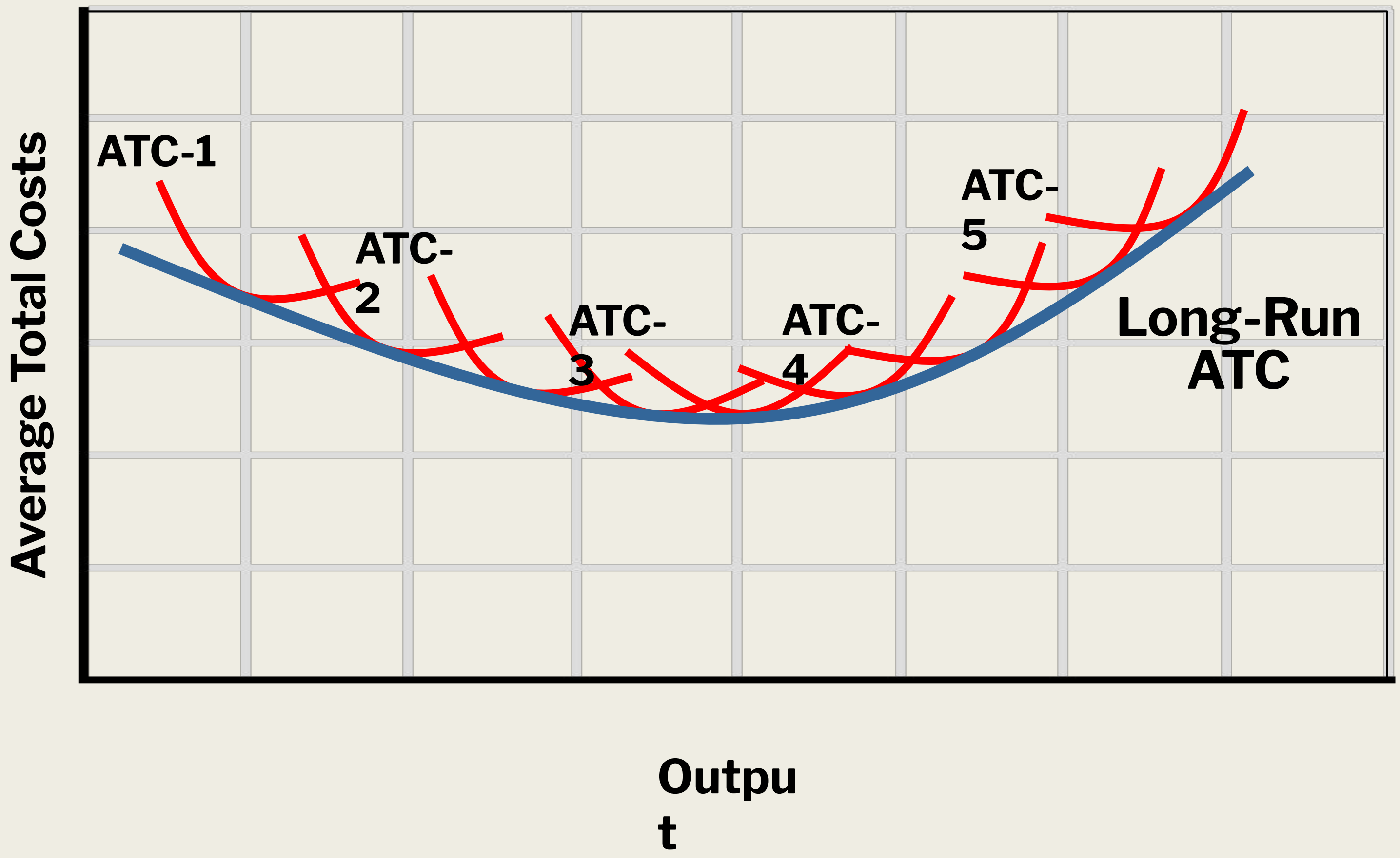
Short-Run Production Costs



Long-Run Production Costs

- The firm can change all input amounts, including plant size.
- All costs are variable in the long run.
- Long run ATC
  - *Different short run ATCs*

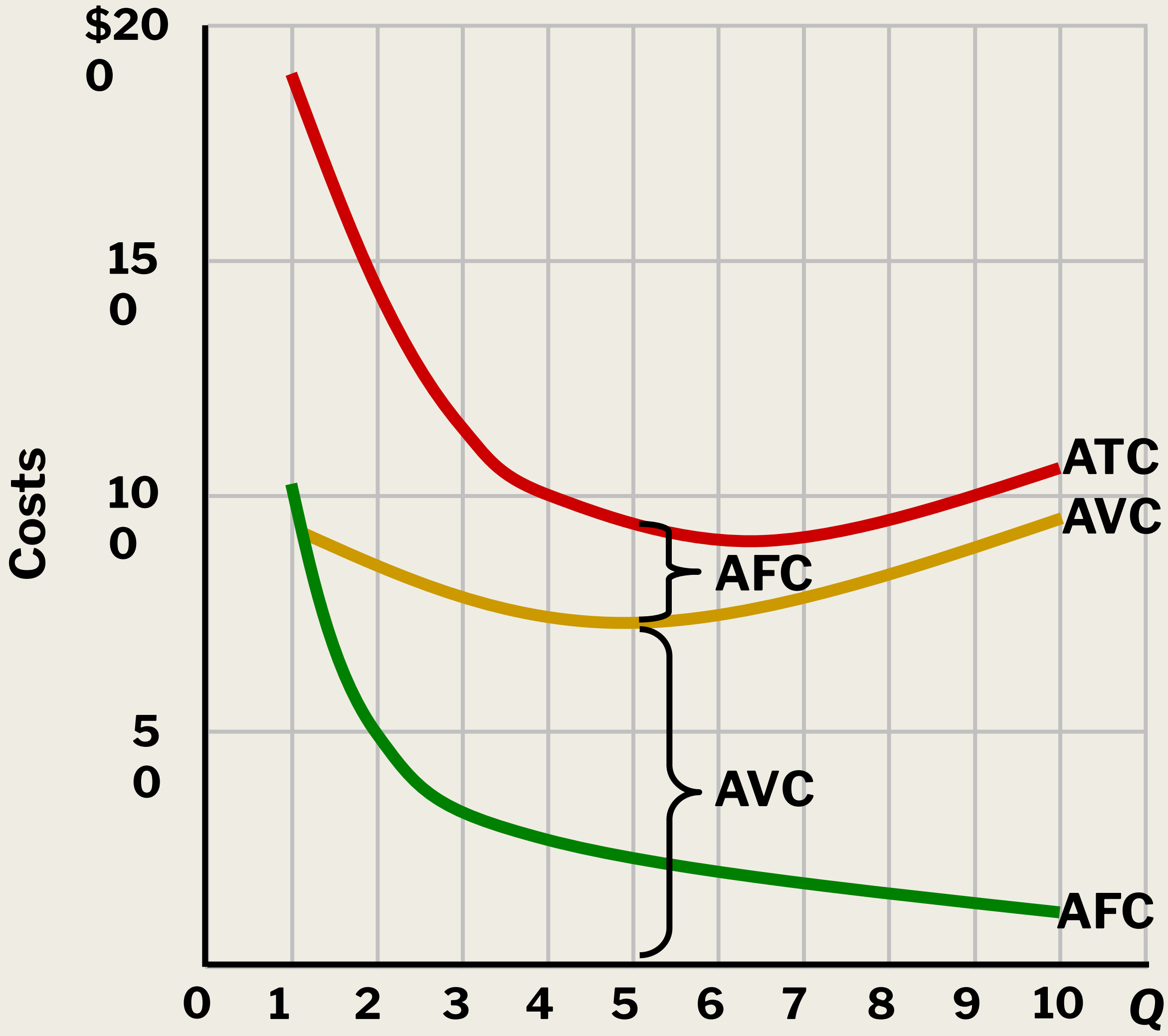
The Long-Run Cost Curve



Per-Unit, or Average, Costs

- Average Fixed Costs $AFC = TFC/Q$
- Average Variable Costs $AVC = TVC/Q$
- Average Total Costs $ATC = TC/Q$
- Marginal Costs $MC = \Delta TC/\Delta Q$

Per-Unit, or Average, Costs



Economies and Diseconomies of Scale

- Economies of scale
  - *Labor specialization*
  - *Managerial specialization*
  - *Efficient capital*
  - *Other factors*
- Constant returns to scale

Economies and Diseconomies of Scale

- Diseconomies of scale
  - *Control and coordination problems*
  - *Communication problems*
  - *Worker alienation*
  - *Shirking*

Conclusion

The costs related to making or acquiring goods and services that directly generates revenue for a firm. It comprises of direct costs and indirect costs. Direct costs are those that are traceable to the creation of a product and include costs for materials and labor whereas indirect costs refer to those costs that cannot be traced to the product such as overhead.

Reference

- Donald F. Gordon, "What was the Labor Theory of Value"
- The basis of economic theory
- Arthur V. Kozneyev, "The book for economic leader"