CHAPTER 5 : Cost

Key terms

1. Average cost : the average cost of production per uni, calculated by dividing total cost by the quantity produced.
2. Average fixed cost : total fixed cost divided by the number of unit produced
3. Average product : the quantity of output per unit of factor input. It is total product divided by the level of output
4. Average variable cost : total variable cost divided by number of unit produced
5. Economic cost : the opportunity cost of input to the production process
6. Factors of production : inputs to the production process : land , labour, capital and enterprise
7. Fixed cost : cost that not vary by the level of production
8. Law of diminishing return : if increasing quantities of variable input are combined with a fixed input, eventually the marginal product and then the average product of that variable input will decline.
9. Marginal cost : the cost of producing an extra unit of output
10. Marginal product : the addition to output produced by an extra unit of input. It is the change in total output divided by the change in the level of inputs
11. Short run : the period of time when at least one factor input to the production process cannot be varied
12. Total cost : fixed cost + variable cost
13. Variable cost : cost which vary directly in proportion to the level of output of a firm

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1. **Fixed cost** : cost that do not vary by the output eg. Rental / Machine / Salary

2. **Variable cost** : cost that do vary by the output eg. Wage / raw material

3. **Total cost** : Fixed cost + Variable cost

4. **Average cost**

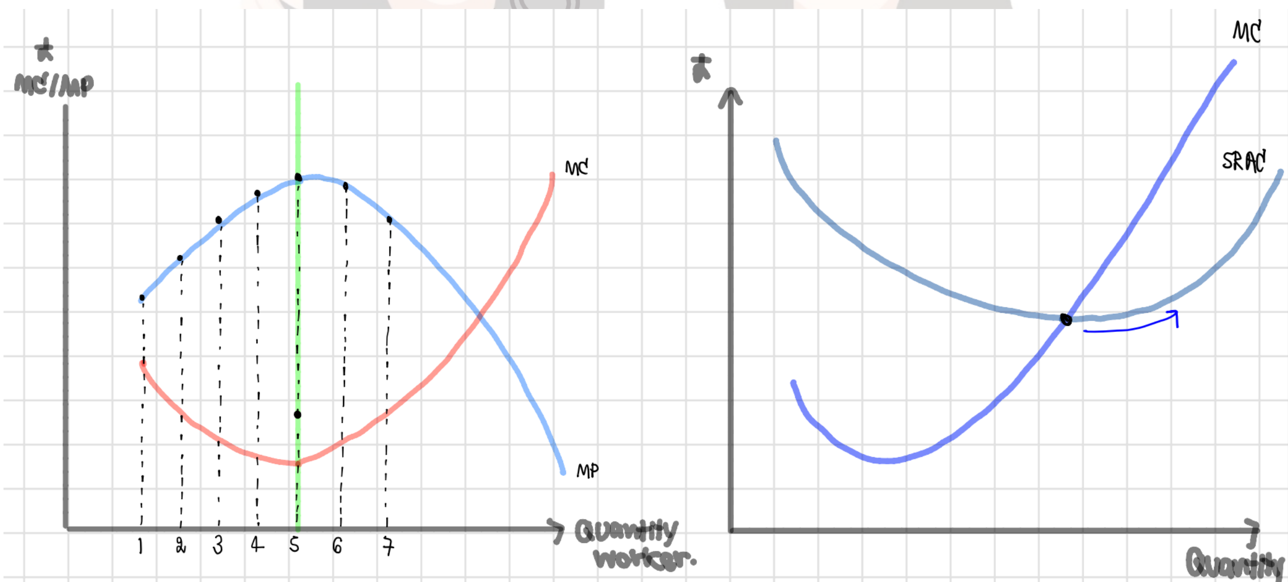
- Average total cost (ATC) = Total cost / Quantity
- Average total variable cost (AVC) = Total variable cost / Quantity
- Average total fixed cost (AFC) = Total fixed cost / Quantity

5. **Marginal cost** : additional cost from one more unit produced

6. Short run cost

Assumption : can change only variable cost but cannot change capital

Diagram



: In short run cost : using the concept diminishing returns occurs in the short run, where one factor is fixed

: If the variable factor of production (labour) is increased, there comes a pint where it will become less productive

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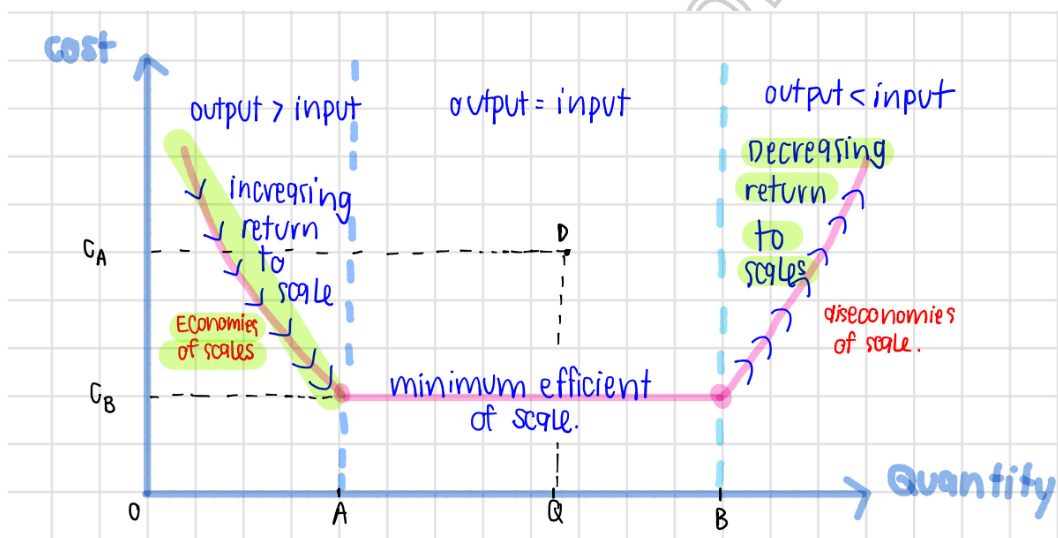
: This is because if capital unchanged, extra workers will eventually get one each other's way as they attempt to increase production

7**. Long run cost**

Assumption : can change all fixed and variable of factors of production

Diagram



- From 0 to A : Economies of scale, average cost will be lower
- From A to B : Minimum efficient scales : constant return to scales
- From B to infinity : Diseconomies of scale, average cost will be higher

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