chapter 6 COST.

Q1. What do you mean by cost?

Cost means sum total of all expences incurred on production of certain units of a product using given factors of production during a given period of time. In economics cost is the sum total of explicit cost and implicit cost.

Economic Cost

Explicit Cost

It is the actual expenditure on inputs or payment made to outsiders for hiring their factor services. Eg: Wages paid to employees, Rent for building etc. Also known as paid out cost.

Implicit cost

It is the estimated value or cost of own resources which is not paid to any outsider, therefore, it is also known as paid in cost.
Eg: Int. on own ~~building~~ capital, rent of own building etc.
This is also called as Imputed cost.

Q2. Differentiate b/w explicit & implicit cost.

Basis	Explicit	Implicit
Meaning	It is the payment made to outsider for hiring factor services.	It is the cost of self owned factor services.
Money Payment	It involves actual payment on hiring services.	It does not involve any actual payment of money.

Eg: wages, rent, insurance, etc. Int. on capital, rent of own building, normal profit, etc.

Q3. What is cost function?

Cost function is a functional relationship b/w cost & output as the cost depends on quantity of output. More is the quantity produced more will be cost incurred. Symbolically it is written as $\boxed{C = f(q)}$

$C \downarrow$ cost, $q \downarrow$ quantity of output.

Q4. What do you mean by opportunity cost?

It is the cost of next best alternative foregone to explain when a firm decides to produce a particular commodity. It always considers the value of alternative commodity which is not produced. The value of commodity not produced is the opportunity cost of commodity produced.

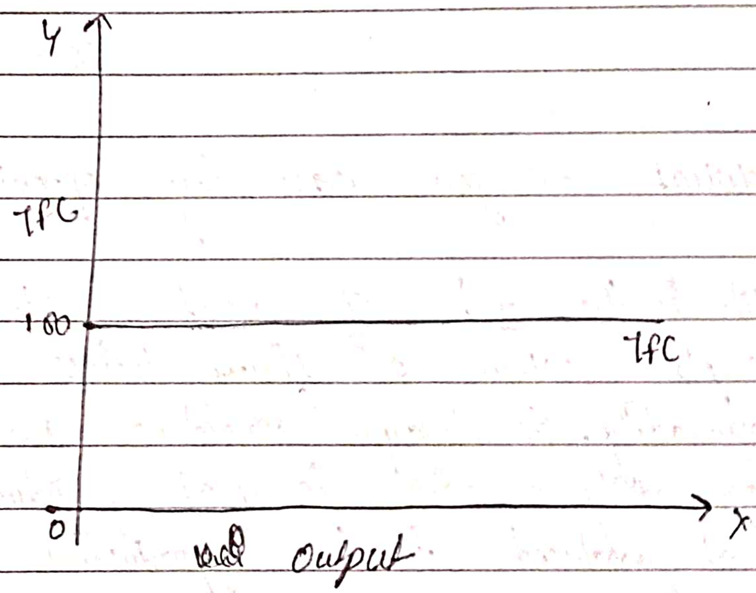
Eg: A firm decides to produce plastic bottles worth Rs 5 lakh & does not produce the plastic glasses worth Rs 4 lakh, so 4 lakh worth glasses is the opportunity cost of producing bottles.

Q5. What are the different short run cost?

In short run factors of production are divided into fixed & variable. Similarly the costs are divided into 2 categories fixed & variable cost.

TFC) **Total fixed cost:** It refers to that cost which does not change directly with the change in level of output. So, whatever is the level of output this cost remains same.
Eg: Rent of building, Salary of permanent staff, Insurance premium.
Its alternative names are supplementary cost, indirect cost, general cost, un-avoidable cost. This can further be explained with the help of following schedule & diagram.

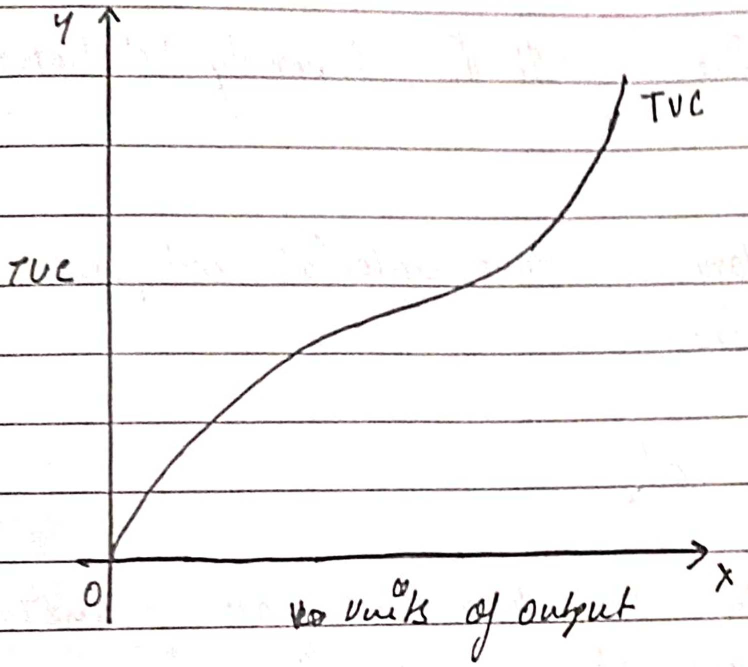
Units of o/t	TFC
0	100
1	100
2	100
3	100
4	100
5	100
6	100



In this diagram units of o/t is shown on (x,o) axis and cost on (o,y) axis. TFC represents Total fixed cost curve which is a straight line parallel to x axis that shows TFC remains same at all levels of output.

Total Variable cost

It refers to that cost which changes directly with change in output. It remains 0 at 0 level of output. It is further explained with the help of following schedule and diagram.



Units of o/td	TVC
0	0
1	8
2	18
3	30
4	44
5	60

In this diagram units of output are shown on (x, 0) axis ~~avg~~ and variable cost of (0, y) axis. TVC represents the ~~$~~ total variable cost curve which start from 0 & it is an inverse 'S' shaped curve.

Q6. Differentiate b/w TVC & TFC.

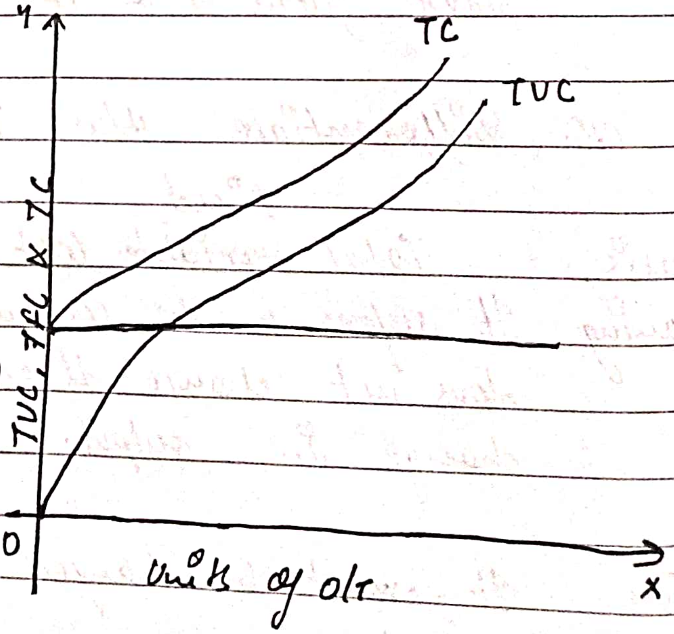
Basis	Total ~~variable~~ fixed Cost	Total ~~fixed~~ variable Cost.
Meaning	It refers to the cost which does not change directly with change in output.	It refers to the cost which changes directly with change in output.
Time Period	It cannot be changed in short run.	It can be changed in short-run.

cost at 0 level of o/t	It can never be 0 at 0 level of o/t	It is 0 at 0 level of output.
factors of Production	It is incurred of factors like building, m/c, etc.	It is incurred on factors like labour, material etc.
Shape of the curve	It is a straightline parallel to x axis.	It is inversely 's' shaped curve.
Eg:	Rent of building, Salary of permanent staff, etc.	Raw material cost, wages, electricity, etc.

Q7. What is total cost?

Total cost is the sum total of all expenditures incurred in production of certain units of a product using given factors of production. It is the sum total of VC & FC. So TC is equal to TVC + TFC. This can further be explained through following schedule and diagram.

Units of o/t	TVC	TFC	TC
0	0	30	30
1	8	30	38
2	18	30	48
3	30	30	60
4	44	30	74
5	60	30	90



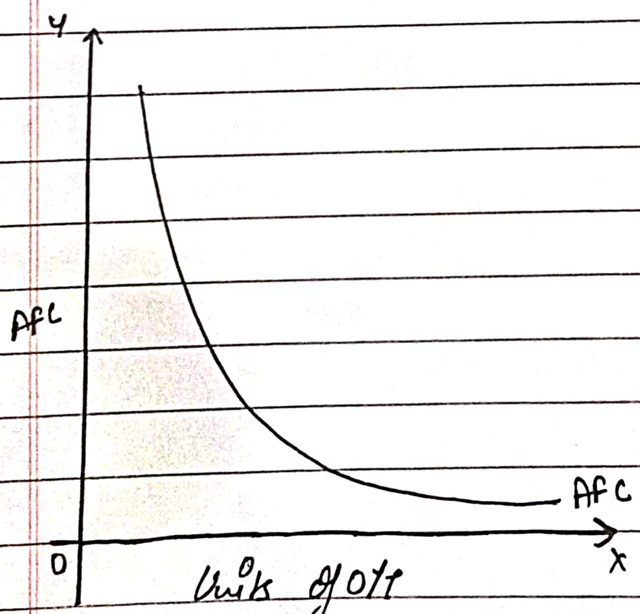
$\boxed{TC = TVC + TFC}$

In this diagram units of output are show on (x, o) axis and cost on (o, y) axis. TVC represent total variable cost curve, TFC represents total fixed cost curve and TC represents total cost curve.
TC changes due to change in TVC as TFC anyway remains constant. Therefore the shape of TC is similar to that of TVC.

Q8. What do you mean by Average fixed cost?

It is the per unit ~~variable~~ fixed cost of production. In other words fixed cost incurred in producing 1 unit of a product on an average, It is calculated by dividing TFC ~~by~~ No. of units of o/t so $\boxed{AFC = \frac{TFC}{N}}$

It can further be explained with the help of following schedule and diagram.



units of o/t	TFC	AFC (TFC/N)
0	30	-
1	30	30
2	30	15
3	30	10
4	30	7.5
5	30	6