Chapter 16 Short-Run Costs

Cost = the least cost of producing a given output Q. The cost is determined by the use of inputs (labor L and capital K),

- with fixed input prices (wage w and interest r)
- in the most efficient way (no unnecessary wastes)
- with the available best technology
- in the specified time frame (Short-Run/Long-Run)

Thus, the cost function is a function of quantity.

Short-Run Costs: the least cost of producing a given output Q where at least one input is fixed.

- K is assumed to be the fixed input at $K = K_0$, at price r/unit of capital

$$\Longrightarrow r \cdot K_0 = Total\ Fixed\ Cost$$
$$= TFC(Q)$$

—a constant that does not vary with Q.

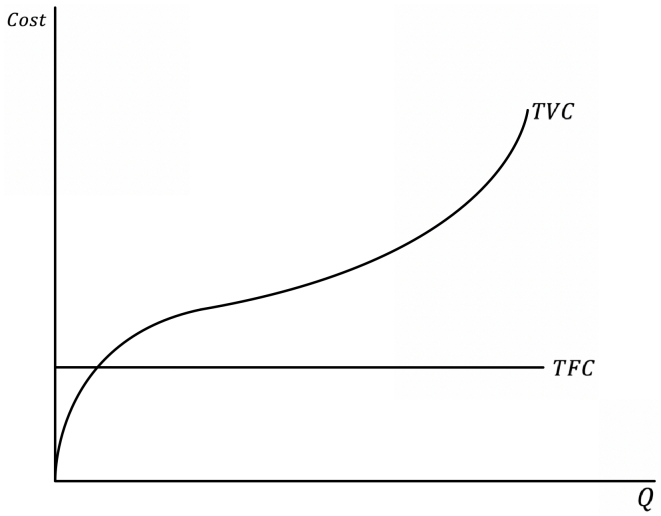
- L is variable at price w/unit of labor

$$\Longrightarrow w \cdot L = Total\ Variable\ Cost$$
$$= TVC(Q)$$

—Note that $TVC(Q)$ varies with the quantity Q, thus the name variable cost.

$$Total\ Cost = Total\ Fixed\ Cost + Total\ Variable\ Cost$$
$$TC(Q) = TFC(Q) + TVC(Q$$

Relation of Total, Fixed and Variable Costs:



Relationships of Total, Average, and Marginal of Total, Fixed and Variable Costs
—each of Total costs has its Average and Marginal

Average Costs:

$$AC(Q) = \frac{TC(Q)}{Q}$$
$$AVC(Q) = \frac{TVC(Q)}{Q}$$
$$AFC(Q) = \frac{TFC(Q)}{Q}$$

- Since $TC(Q) = TFC(Q) + TVC(Q)$, we have

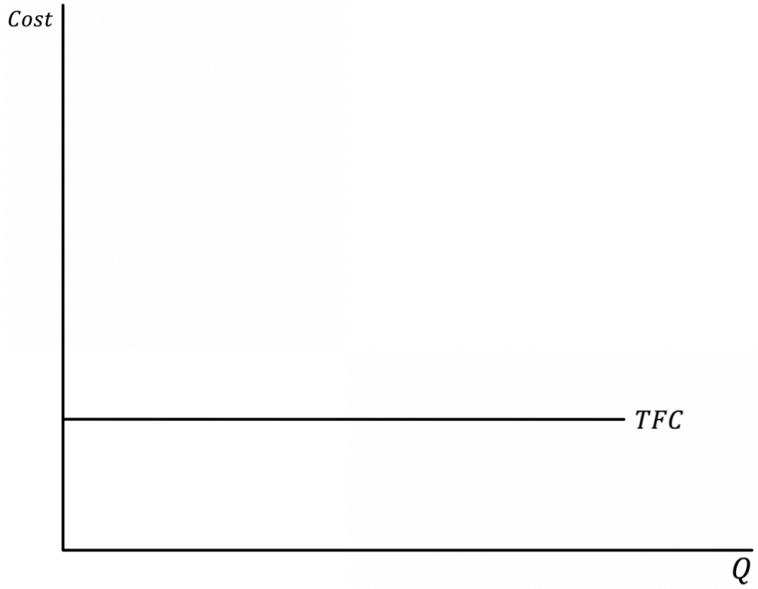
$$\frac{TC(Q)}{Q} = \frac{TFC(Q)}{Q} + \frac{TFC(Q)}{Q}$$
$$AC(Q) = AFC(Q) + AVC(Q)$$

Marginal Cost:

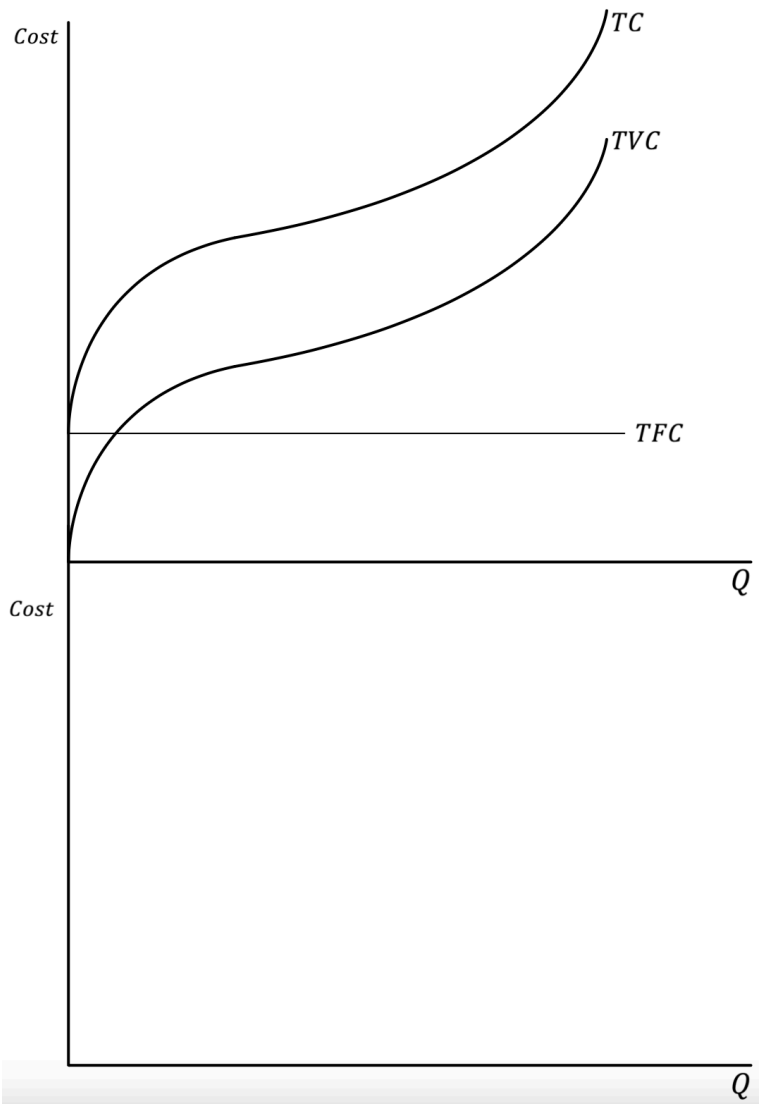
$$MC(Q) = \frac{d}{dQ}TC(Q)$$
$$= \frac{d}{dQ}(TFC(Q) + TVC(Q))$$
$$= \frac{d}{dQ}TVC(Q)$$

- Marginal Cost is the slope of Total Cost, which is the same as the slope of Total Variable Cost

Graph of $AFC(Q) = \frac{TFC(Q)}{Q}$



- We can demonstrate the relationships of these Totals, Averages, and Marginals by the following diagrams.



Total	Average	Marginal

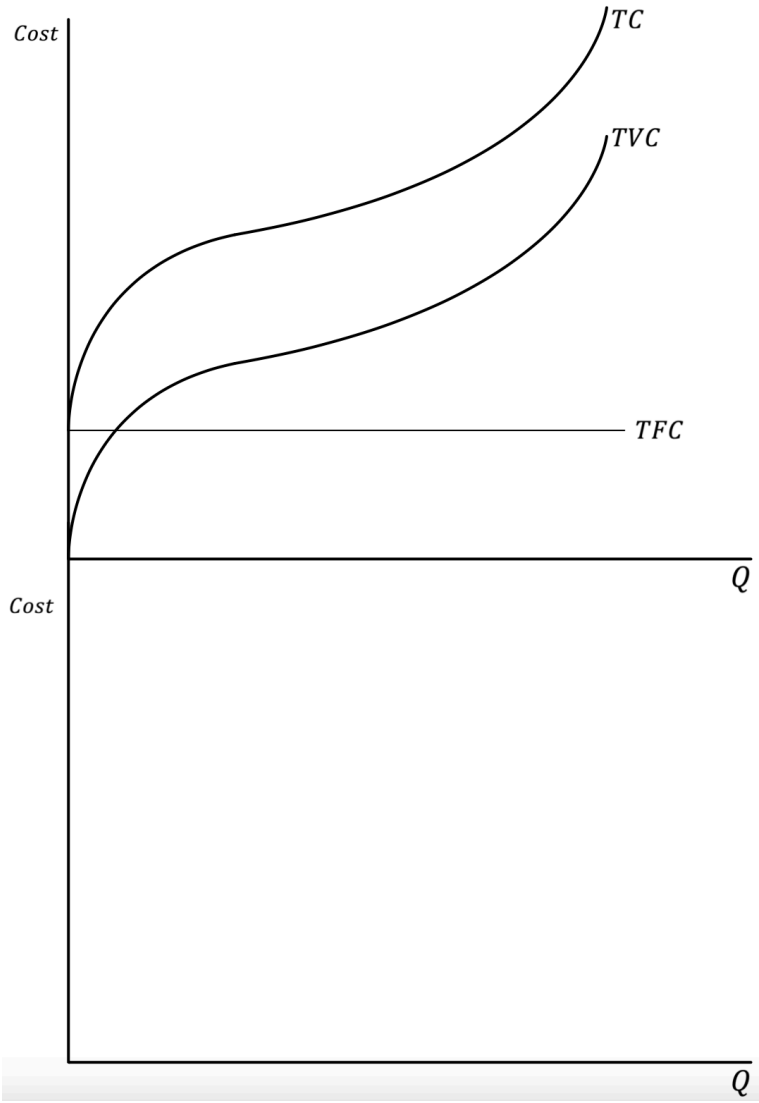
- The relationship between Average and Marginal can also be verified by calculus. By definition,

$$TC(Q) = AC(Q) \cdot Q$$

Changes of Cost Curves

1. Change in TFC—higher rent or higher price of fixed factor

$$TC(Q) = TFC(Q) + TVC(Q)$$
$$TC'(Q) = TFC'(Q) + TVC(Q)$$



2. Change in TVC The government imposes tax of 10 Bahts/unit on the producer.

$$TC(Q) = TFC(Q) + TVC(Q)$$
$$TC'(Q) = TFC(Q) + TVC'(Q)$$

Change in Average Costs,

$$TVC'(Q) = TVC(Q) + 10Q$$

$$AVC'(Q) = AVC(Q) + 10$$

$$\frac{TC'(Q)}{Q} = \frac{TFC(Q)}{Q} + \frac{TVC(Q)}{Q} + \frac{10Q}{Q}$$
$$AC'(Q) = AFC(Q) + AVC(Q) + 10 = AC(Q) + 10$$

Change in Marginal Cost,

$$TVC'(Q) = TVC(Q) + 10Q$$

$$MC'(Q) = MC(Q) + 10$$