Cost of Production

= Costs are the amount which are incurred in order to produce a commodity. Suppose in order to produce a pen ₹10 is incurred. ₹10 is called the cost of production.

= The most widely accepted concept of cost is the money cost of production. It means the aggregate money expenditure incurred by a firm on the various items entering into the production of a commodity. Example:- Payment for raw materials, expenditure on power and light, insurance, Transportation, advertisement, Purchase of machinery etc.

Real Cost of Production:

The real cost of production of a commodity is expressed not in money but in efforts (of workers) and sacrifices (of capitalists) undergone in the making of a commodity.

Opportunity cost:

A person cannot satisfy all his wants since the money at his disposal is scarce/limited. He has to choose between one thing and another.

= The forgone opportunity of using a productive resource somewhere else rather than in the present use is termed as opportunity costs.

Exam: A driver can drive Taxi, auto rikshaw, car, tractor or truck. but he cannot drive all these things. His employment as a taxi driver means the loss of an opportunity of employing him as a truck driver.

In modern Economics Three Kinds of Costs are'.

Total costs
Average costs
Marginal Costs

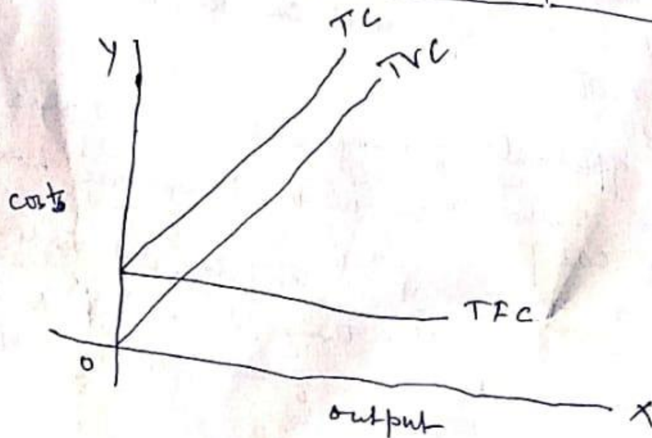
Total cost:- refers to the Sum of all costs incurred in producing a quantity of output. The total costs rises with the level of output.

Fixed cost (Supplementary cost)

They are Those costs which donot vary directly with the level of output of the firm. The expenditure on machine, depreciation of capital, rent administrative expenses. They are borne even if output is zero.

variable cost (Prime cost)

These costs vary directly with the change in the production. They rise as more output is produced and fall as production is reduced. They are known as Prime Cost. Wages of Labour, Cost of power, raw materials are variable cost.



Average cost

Average Fixed Cost

Average Fixed Cost (AFC) is obtained by dividing the total fixed cost of the firm with its output.

$$AFC = \frac{TFC}{Q\ (\text{output})}$$

Average variable cost

Average variable cost (AVC) is obtained by dividing the total variable cost by the output of the firm

$$AVC = \frac{TVC}{Q\ (\text{output})}$$

Marginal Cost

Marginal cost (MC) is the addition to total cost (TC) resulting from increasing the rate of production by one unit.

= Marginal cost is the change in the total cost associated with a change in output.

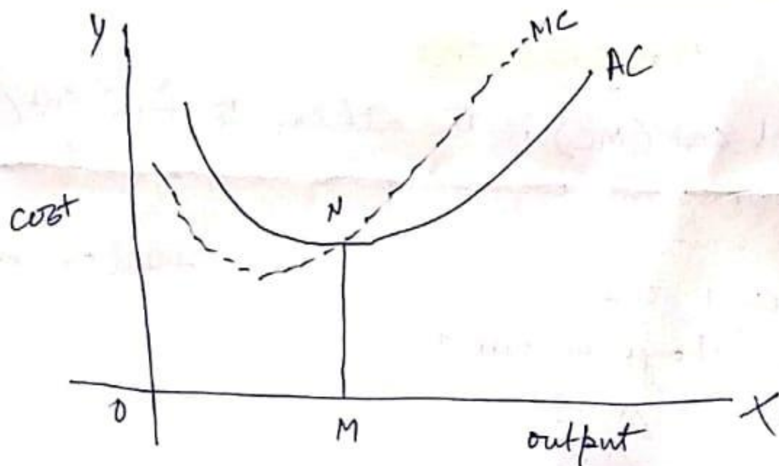
$$MC = \frac{\Delta TC}{\Delta Q}$$

If the addition of another unit of a commodity increases the total cost from ₹190 to ₹220, Then MC is ₹30 (220-190).

Relation between MC and AC

It can be explained with a table and diagram.

Unit of output	Total Cost ₹	Average Cost	Marginal Cost
1	150	150.0	—
2	190	95.0	40
3	220	73.3	30
4	236	59.0	16
5	270	54.0	34
6	324	54.0	54
7	415	59.3	91
8	580	72.5	165



This diagram shows the relation between AC and MC.

1. When AC is falling MC is always lower than the AC. A common view is that when AC falls MC falls faster
2. When AC is rising MC lies above the AC and rises faster than AC.
3. The MC curve must cut the AC curve at AC's minimum point.

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