Presentation 10
costs

Costs

a/Cost theory

Producing commodities involves costs including:

Implicit costs

- Transactions costs implicit in economic transactions.
- Opportunity costs for having taken one decision rather than another.
- Social or external costs which are passed on to third parties as a consequence of economic activity.

Explicit costs

- Accounting costs as the expenditure over a fiscal year.
- Decision-making costs as the cost of information used for making decisions.
- Sunk costs that do not vary with different decisions.
- Incremental costs varying as per the decisions taken.

b/Transactions costs

Costs with no monetary value, yet are often perceived to be important determinants in decision making. Such costs include:

- Search costs: cost for identifying and obtaining relevant information before obtaining factors of production. For instance, looking into what job offers have been made to establish whether there are any suitable candidates.
- Bargaining costs: costs involved in negotiations such as those over wages and salaries.

- Contracting costs: costs involved with setting up contracts such as employment contracts.
- Hidden information costs: costs associated with information that is not known but which are inherent in contracts. For instance, spending more on commuting to a new job.
- Hidden action costs: costs associated with ensuring that contracts are performed such as spending time to control that the employee does the work assigned to

c/Accountant’s costs

Company accounts show the total expenditure or Total Costs (TC) for producing commodities often distinguished between:

- Fixed costs (FC) that do not vary with the output.
- Variable costs (VC) that vary with the output.

Documents:

- Income statement: TC/TR
- Balance sheet – assets/liabilities

However, these do not help take production decisions

d/Decision-making costs

Decision-making costs are information that helps businesses take decisions over production. These include:

- Marginal Costs (MC) which show the change in total costs to the change in output: $MC = \Delta C / \Delta Q$; they are compared against the Marginal Revenue to establish profit maximization in the long run.
- Marginal Factor Costs (MFC) which show the additional cost for an additional factor of production; they are compared against the Marginal Revenue Product to establish profit maximization in the short run.

Average (total) Costs (AC) show the total costs per output: $AC = TC/Q$; knowledge of average costs helps determine the minimum price to sell a unit of a commodity in the market which corresponds to the minimum efficient scale: $P\ min = AC\ min$;

Since $AC = AFC + AVC$ by extension Average Fixed Costs (AFC) show the total fixed costs per output, thus $AFC = FC/Q$, and the Average Variable Costs (AVC) show the total variable costs per output, thus $AVC = VC/Q$.