Short Run and Long Run Costs. Relationships between them.

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Long Run Costs.

In economics, "short run" and "long run" are not broadly defined as a rest of time. Rather, they are unique to each firm.

Long Run Costs

Long run costs are accumulated when firms change production levels over time in response to expected economic profits or losses. In the long run there are no fixed factors of production. The land, labor, capital goods, and entrepreneurship all vary to reach the long run cost of producing a good or service. The long run is a planning and implementation stage for producers. They analyze the current and projected state of the market in order to make production decisions. Efficient long run costs are sustained when the combination of outputs that a firm produces results in the desired quantity of the goods at the lowest possible cost.

Example of long run decision

Examples of long run decisions that impact a firm's costs include changing the quantity of production, decreasing or expanding a company, and entering or leaving a market. Examples also include the rental costs of buildings; the costs of leasing or purchasing capital equipment; the annual business rate charged by local authorities; the costs of employing full-time contracted salaried staff; the costs of meeting interest payments on loans; the depreciation of fixed capital (due solely to age) and also the costs of business insurance.

Short Run Costs

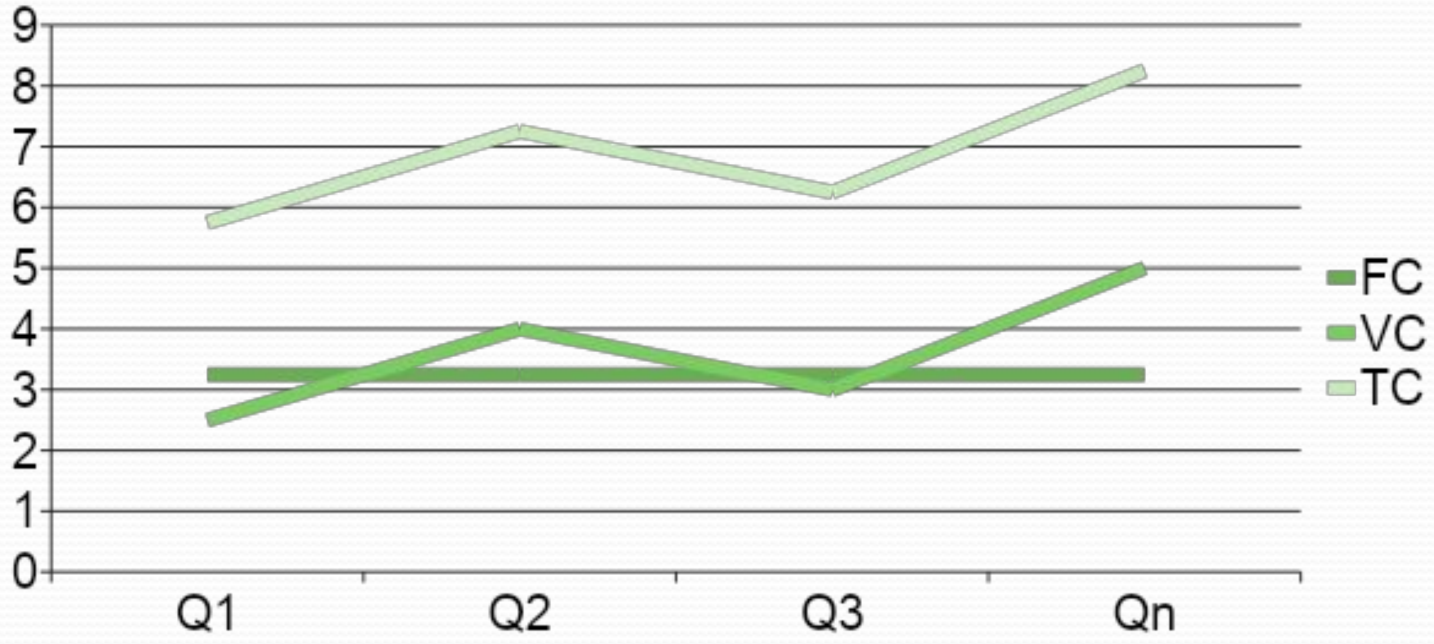
Short run costs are accumulated in real time throughout the production process. Fixed costs have no impact of short run costs, only variable costs and revenues affect the short run production. Variable costs change with the output. Examples of variable costs include employee wages and costs of raw materials. The short run costs increase or decrease based on variable cost as well as the rate of production.

Consequence of using only short run decisions.

If a firm manages its short run costs well over time, it will be more likely to succeed in reaching the desired long run costs and goals.

Relationships

This curve shows relationships between them. Total cost is determined by the sum of FC and VC. Fixed cost for a some period did not change, but it does not mean that it can not be changed for another economic period. Variable cost is increasing as number of products increases too.



Differences

The main difference between long run and short run costs is that there are no fixed factors in the long run; there are both fixed and variable factors in the short run . In the long run the general price level, contractual wages, and expectations adjust fully to the state of the economy. In the short run these variables do not always adjust due to the condensed time period. In order to be successful a firm must set realistic long run cost expectations. How the short run costs are handled determines whether the firm will meet its future production and financial goals.