

Student response

A business faces accounting costs and economic costs.

(a) Explain the difference between accounting costs and economic costs.

[illegible]

(b) Label the following costs *explicit* or *implicit*.

- | | | |
|--------|---|-------|
| (i) | Actual costs of production | _____ |
| (ii) | Economic costs | _____ |
| (iii) | Implied costs | _____ |
| (iv) | Accounting costs | _____ |
| (v) | Opportunity costs of interest foregone | _____ |
| (vi) | Wages for factory workers | _____ |
| (vii) | Rent lost for the building owned and used by the producer | _____ |
| (viii) | Interest on the bank overdraft | _____ |
| (ix) | Salary of the general manager | _____ |

eLearneconomics: Accounting and economic costs/profits (1a)



Solution

(a) Accounting costs are the actual (or explicit) costs involved in production – mortgage, rent, power, raw materials, wages, and so on.

Economic costs are the actual (explicit) or accounting costs as well as the opportunity costs (implied or implicit) of the resources used.

Economic costs would include the lost salary of a teacher who starts a lawn-mowing round. Rent lost by the owner of a factory whose firm currently uses the building is an economic cost. Economic costs include the lost interest that could have been earned by the owner(s) if they had the funds in a bank account rather than in a business.

Economic costs are always greater than accounting costs.

(b) (i)	Actual costs of production	explicit
(ii)	Economic costs	implicit
(iii)	Implied costs	implicit
(iv)	Accounting costs	explicit
(v)	Opportunity costs of interest foregone	implicit
(vi)	Wages for factory workers	explicit
(vii)	Rent lost for the building owned and used by the producer	implicit
(viii)	Interest on the bank overdraft	explicit
(ix)	Salary of the general manager	explicit



eLearneconomics: Accounting and economic costs/profits (2)

Student response _____

(a) Complete the table below assuming it represents a perfectly competitive firm and the current market price is \$10.

Output (Q)	Average cost (AC) (\$)	Total cost (TC) (\$)	Total revenue (TR) (\$)	Profit (or loss) (\$)
8 000	2.10			
10 000	2.50			
12 000	5.00			

(b) Why do economists use economic costs rather than accounting costs when determining the profit maximising level of output for a firm?

(c) Indicate whether the following statements are *correct* or *incorrect*.

Statement	Correct or incorrect?
(i) Economic profit is always greater than accounting profit.	
(ii) Accounting profit is always greater than economic profit.	
(iii) Economic profit is always smaller than accounting profit.	
(iv) The correct measure of economic cost includes explicit and implicit cost.	
(v) The correct measure of economic cost includes accounting costs and opportunity costs.	
(vi) Accounting profit is a firm's revenue minus explicit costs only.	
(vii) Economic profit is a firm's revenue minus explicit costs only.	
(viii) Actual costs are implicit costs of the opportunity costs in operating a business.	
(ix) Implicit costs are the actual costs of a firm.	
(x) Explicit costs are the actual costs of a firm.	
(xi) Total revenue equals sales (or quantity) times price.	

eLearneconomics: Accounting and economic costs/profits (2a)



Solution

(a) Complete the table below assuming it represents a perfectly competitive firm and the current market price is \$10.

Output (Q)	Average cost (AC) (\$)	Total cost (TC) (\$)	Total revenue (TR) (\$)	Profit (or loss) (\$)
8 000	2.10	16 800	80 000	63 200
10 000	2.50	25 000	100 000	75 000
12 000	5.00	60 000	120 000	60 000

(b) Why do economists use economic costs rather than accounting costs when determining the profit maximising level of output for a firm?

To calculate their profit and therefore their profit maximising level of output, firms must know their total costs. Economic costs provide a total cost that include all the costs of production including opportunity costs. Accounting costs do not cover opportunity costs such as the return for the risk taken by the entrepreneur and therefore do not cover all costs.

(c) Indicate whether the following statements are *correct* or *incorrect*.

Statement	Correct or incorrect?
(i) Economic profit is always greater than accounting profit.	incorrect
(ii) Accounting profit is always greater than economic profit.	correct
(iii) Economic profit is always smaller than accounting profit.	correct
(iv) The correct measure of economic cost includes explicit and implicit cost.	correct
(v) The correct measure of economic cost includes accounting costs and opportunity costs.	correct
(vi) Accounting profit is a firm's revenue minus explicit costs only.	correct
(vii) Economic profit is a firm's revenue minus explicit costs only.	incorrect
(viii) Actual costs are implicit costs of the opportunity costs in operating a business.	incorrect
(ix) Implicit costs are the actual costs of a firm.	incorrect
(x) Explicit costs are the actual costs of a firm.	correct
(xi) Total revenue equals sales (or quantity) times price.	correct