Exercise walk-through

Types of Profit ▪ 3.4

eXercise

You must be able to

- distinguish **explicit costs 显性成本** from **implicit costs 隐性成本**
- calculate **accounting profit 会计利润** (TR − explicit costs)
- calculate **economic profit 经济利润** (TR − explicit − implicit costs)
- define **normal profit 正常利润** (economic profit $= 0$)

Method — Two kinds of profit

- **Accounting profit** = total revenue − **explicit** costs.
- **Economic profit** = total revenue − explicit − **implicit** costs.

Implicit costs include the opportunity cost of the owner's own resources.

Method — Normal profit

The level of profit where **economic profit** $= 0$ — the owner is doing exactly as well as in the next-best alternative. Economic profit is the correct signal for firms to **enter** or **exit** a market.

Practice 2.1 ▪ 2 marks

State the difference between accounting and economic profit.

Solution 2.1

Method: Two kinds of profit

Worked steps

accounting profit subtracts only explicit costs; economic profit subtracts both explicit and implicit costs **B1** **B1**.

Practice 2.2 ▪ 2 marks

A firm has TR $= \$200$k, explicit costs $= \$120$k, and implicit costs $= \$50$k. Find its economic profit.

Solution 2.2

Method: Two kinds of profit

Worked steps

$200 - 120 - 50 = \$30\text{k}$ **M1** **A1**.

Practice 2.3 ▪ 1 mark

Define normal profit.

Solution 2.3

Method: Normal profit

Worked steps

the profit earned when economic profit is exactly zero **B1**.

Exam-style 3.1 ▪ 1 mark

Economic profit equals total revenue minus

A explicit costs only

B implicit costs only

C both explicit and implicit costs

D taxes only

Solution 3.1

Method: Two kinds of profit

A explicit costs only

B implicit costs only

C both explicit and implicit costs ✓

D taxes only

Worked steps

C.

Exam-style 3.2 ▪ 1 mark

Normal profit occurs when economic profit is

A positive

B zero

C negative

D at its maximum

Solution 3.2

Method: Normal profit

A positive

B zero ✓

C negative

D at its maximum

Worked steps

B.

Exam-style 3.3 ▪ 1 mark

A firm earns TR $= \$150$k with explicit costs $\$90$k and implicit costs $\$60$k.
(a) Find the accounting profit.
(b) Find the economic profit.
(c) State whether the owner should stay in this business.

Solution 3.3

Method: Two kinds of profit

Worked steps

(a) $150 - 90 = \$60$k B1. (b) $150 - 90 - 60 = \$0$ B1. (c) yes — it earns normal profit, matching the next-best alternative B1.