Finding Economic and Accounting Profit

**Key Concepts:**

- Economic and accounting profits differ from each other in the way that each defines costs: accounting uses only explicit costs, but economics calculates opportunity costs.

- Sunk costs are unrecoverable costs that should not effect current decisions.

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**Economic and Accounting Profit**

**Economic Profit**

- If total revenue is greater than the sum of the opportunity costs of the resources, the resources will stay at the firm.

**Accounting Profit**

- Accounting costs are only those costs that the firm explicitly pays for. They are costs that the firm must write checks for. To calculate accounting profit, the firm finds its total revenue and subtracts its explicit costs. Accounting does not account for the opportunity costs of the resources.

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**Calculating Economic Profit**

**Accounting Profit**

- Accounting costs are only explicit costs, or costs that the firm has to write checks to pay.

**Economic Profit**

- Best alternative: the stock market $50 x 20% = $10
- Investors must earn at least $10 on each TV.
- The manager’s opportunity cost is what he could earn in his next best job.
- The remaining economic profits will be divided among the resources in the form of rent.

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Economists and accountants look at costs very differently. Accountants account for only explicit costs, or those costs for which a monetary payment must be made. Economics account for opportunity costs as well as explicit costs. Because of the two ways of examining costs, accounting and economic profit are different. Recall that total revenue minus total costs equals profit.

\[ TR - TC = \text{profit} \]
Sunk costs are unrecoverable costs that a firm expends on a project. Economists argue that sunk costs should never enter into current decisions.