CHAPTER 5 – HOW OUTPUT AND PROFITS ARE DETERMINED

Also- chapter 3 and 7

1) **COSTS = Expenses involved in doing business.**

   a) **FIXED COSTS = Costs that are the same regardless of the level of production (a.k.a. overhead costs).**
   Examples: Rent, insurance, property taxes.

   b) **VARIABLE COSTS = Costs that rise with increased production and decline with decreased production.**
   Examples: Raw materials, labor, electricity to operate machines, etc.

   c) **TOTAL COST = Fixed costs + Variable costs.**

   d) **MARGINAL COST = The additional cost incurred in the production of one additional unit.**

   e) **AVERAGE TOTAL COST = Total cost divided by number of total number of units produced.**

2) **REVENUE = Money earned for the sale of a good or service.**

   a) **TOTAL REVENUE = Selling price x number of units sold (assuming price of all units sold is the same).**

   b) **MARGINAL REVENUE = The increase in total revenue generated by the sale of an additional unit.**
   Marginal Revenue = the price of the last unit sold.

3) **PROFIT = Total Revenue – Total Cost**

4) **PROFIT MAXIMIZING LEVEL OF OUTPUT =**
   A firm should keep producing additional units as long as:

   Marginal Revenue (MR) > Marginal Cost (MC).

   Or in other words, as long as the cost of producing an additional unit is lower the revenue generated by selling it. When MC > MR, profit is declining and it makes no sense to continue expanding production.