Answer on Question #38575 – Economics - Other

Marginal analysis shows clearly why decision makers should ignore average costs, fixed costs, and sunk costs when making decisions about the optimal level of activities. Since it is marginal cost that must equal marginal benefit to reach the optimal level of activity, any other cost is irrelevant for making decisions about how much of an activity to undertake.

In many cases, managers face limitations on the range of values that the choice of variables can take. For example, budgets may limit the amount of labor and capital managers may purchase. Time constraints may limit the number of hours managers can allocate to certain activities. Such constraints are common and require modifying the solution to optimization problems. To maximize or minimize an objective function subject to a constraint, the ratios of the marginal benefit to price must be equal for all activities, and the values of the choice variables must meet the constraint.