

Economic Profit

Is the UNC Ticket Distribution System
Efficient? Fair? Educationally Appropriate?
Who Bears the Burden of an Excise Tax?
The Economic Definition of Profit Is
Different from the Accounting Definition.
Profit is the Motivator; competition, is the
regulator.
Economic Rent Is Different from Economic
Profit.

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UNC Ticket Distribution

Students enter a lottery.
Winners receive two general admission tickets
marked with a time of entry.
Students may enter the Dean Dome at any time
after their time of entry.
Admission to the risers also requires a bracelet
handed out to first 400 students who request one.
Lottery registration begins on 22nd of the month
before the month of the games for which tickets
are being allocated (e.g. Oct 22 for Nov games).

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Use Your Clickers To Answer
The Following Questions

Send A for True
Send B for False

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What is your view?

The UNC sports ticket distribution
system efficient is efficient.

That is, it would not be possible to
make one student better off without
making another student worse off.

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What is your view?

The UNC sports ticket distribution system is fair.

That is, it provides all students with equal opportunities.

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What is your view?

The UNC sports ticket distribution system creates incentives that are compatible with UNC's educational mission.

What incentives does the ticket distribution create?

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Who bears the burden of a tax levied on a good or service?

Taxing a good will generally change the market price of the good.

Who bears the burden depends on how large the price change.

The fact that the tax is collected from suppliers does not mean that suppliers bear the burden of the tax.

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The size of the price change depends on the elasticity of demand and supply.

When demand is less elastic buyers tend to bear a larger burden from the tax.

When supply is less elastic, suppliers tend to bear a larger burden from the tax.

Use Your Clickers To Answer
The Following
Graded Question.

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The proponents of a tax on sugary beverages must believe that the young-person demand for sugary beverages is price _____ because then the tax will _____ of sugary beverages by a large amount.

- A. Elastic, raise the price
- B. Elastic, lower the quantity
- C. Inelastic, raise the price
- D. Inelastic, lower the quantity

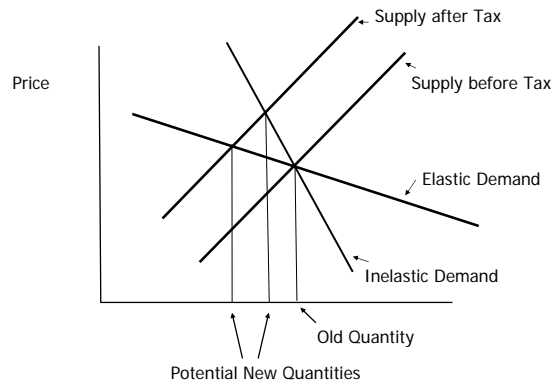
Will A Tax on Sugary Beverages Have the Intended Effect?

The Intended Effect is a Large Decrease in
Consumption of Sugary Beverages by the Young.

The Size of the Quantity Response to a Tax
Depends on the Elasticity of Demand.

Proponents of the Tax Must Believe that the
Demand Schedule of the Young for Sugary
Beverages is Highly Elastic.

Will a Tax Substantially Lower Consumption of Sugary Beverages?



Economist Use a Different Definition of Profit Than Accountants

Accounting Profit =
Total Revenue – Total Explicit Costs

Economic Profit =
Total Revenue – Total Explicit Costs
– Normal Profit

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What is Normal Profit?

Normal Profit is the opportunity cost of resources supplied by the owners of the firm including the opportunity cost of their time.

Normal Profit is the level of profit just sufficient to keep the owners operating the business in question.

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Example: John Jones owns and manages a café in Chapel Hill. His weekly costs and revenues are given in the table.

How much is John's accounting profit?

Item	
Revenue	\$5,000.
Labor	\$2,000.
Food and Drink	\$1,500.
Electricity	\$ 100.
Vehicle Lease	\$ 150.
Rent	\$ 500.
Interest on Equipment Loan	\$ 50.

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Accounting Profit =
Total Revenue – Total Explicit Costs

Explicit Costs = \$4300 =
2,000 + 1500 + 100 +
150 + 500 + 50

Acct Profit = \$700
= 5000 - 4300

Item	
Revenue	\$5,000.
Labor	\$2,000.
Food and Drink	\$1,500.
Electricity	\$ 100.
Vehicle Lease	\$ 150.
Rent	\$ 500.
Interest on Equipment Loan	\$ 50.

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Suppose John could earn \$300 per week as a shift manager at Fosters. What is his economic profit from operating the Chapel Hill café?

Econ Profit =
 Acct Profit – Normal Profit
 Econ Profit = \$400
 = 700 - 300

Item	
Revenue	\$5,000.
Labor	\$2,000.
Food and Drink	\$1,500.
Electricity	\$ 100.
Vehicle Lease	\$ 150.
Rent	\$ 500.
Interest on Equipment Loan	\$ 50.

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Use Your Clicker
 To Answer The Following
 Non-Graded Question.

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John uses a gift from his Uncle to pay off his equipment loan. The interest rate he pays on the equipment loan is the same as the rate he can earn on his savings. John's accounting profit _____ and his economic profit _____.

- A. Rises, Stays the same.
- B. Rises, Rises.
- C. Stays the same, Rises.
- D. Stays the same, Stays the same.

Item	
Revenue	\$5,000.
Labor	\$2,000.
Food and Drink	\$1,500.
Electricity	\$ 100.
Vehicle Lease	\$ 150.
Rent	\$ 500.
Interest on Equipment Loan	\$ 50.

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John uses a gift from his Uncle to pay off his equipment loan. John's accounting profit **rises** and his economic profit **stays the same**.

Explicit Costs fall by \$50
 Acct. Profit rises by \$50

Normal profit rises by \$50.00.
 Econ Profit does not change.

Item	
Revenue	\$5,000.
Labor	\$2,000.
Food and Drink	\$1,500.
Electricity	\$ 100.
Vehicle Lease	\$ 150.
Rent	\$ 500.
Interest on Equipment Loan	\$ 50.

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Why does John's normal profit rise by \$50.00

John's uncle gives him a gift of cash. The cash is a resource belonging to John.

If John uses any resource in his business, the opportunity cost of that resource is part of his normal profit.

If the interest rate on John's loan is higher than the interest rate John could get by saving, then John's economic profit would rise if he used the gift to pay off his loan.

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Use Your Clicker
To Answer The Following
Graded Question.

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Before, John's best alternative was working as a shift manager at Foster's for \$300 per week and he was making an economic profit of \$400. Suppose Sarah Foster now offers John \$1000 per week to be store manager. Is John still making an economic profit?

- A. Yes, because Foster's offer is irrelevant to John's profit calculation.
- B. Yes, because explicit costs have not changed.
- C. No, because John's normal profit is now larger than his accounting profit.
- D. No, because John's explicit costs have risen.

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John is now making an economic loss rather than an economic profit.

Revenues	=	\$5,000
Total Explicit Costs	=	\$4,300
Accounting Profit	=	\$ 700
Original Normal Profit	=	\$ 300
Original Economic Profit	=	\$ 400
New Normal Profit	=	\$1,000
New Economic Profit	=	(\$ 300)

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Profit is a Motivator.

"It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard of their own interest. We address ourselves not to their humanity, but to their self-love, and never talk to them of our necessities, but of their advantage."
(Smith, *Wealth of Nations*, Chapter II)

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Profit is the Motivator.

Profit motivates individuals to provide goods and services that members of society would like to consume and use.

Profit creates an incentive for entrepreneurs to produce goods and services that society values.

In that sense, profit serves an important social function.

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Competition is the Regulator.

Competition among entrepreneurs tends, over the long run, to reduce profits to normal levels.

Competition works best in markets where entry by entrepreneurs is free.

Owners of profitable firms have strong incentives to block entry.

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How does competition regulate John's profit as a café owner?

In our original scenario, when John's opportunity cost was \$300 per week, John's economic profit was \$400 per week.

John's economic profit is an incentive for others, perhaps shift managers at Fosters, to open cafés in Chapel Hill.

Once others enter the café market, John's profits are likely to fall. He may lose customers, lower prices, or both.

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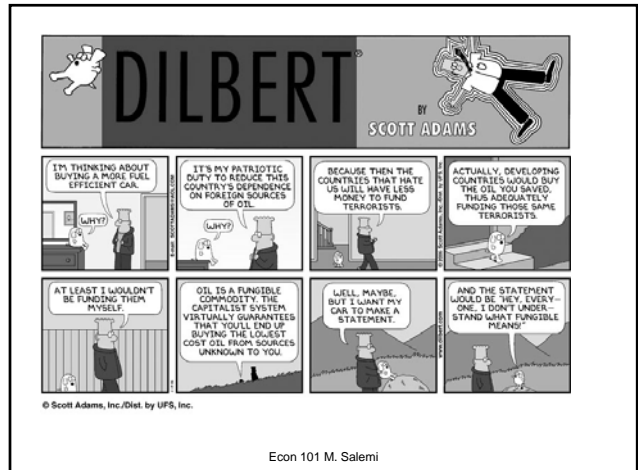
Economic Rent Is Different from Economic Profit.

Economic Rent is that part of the payment for a factor of production that exceeds the factor owner's reservation price.

Economic profit is driven to zero by competition.

In contrast, economic rent may persist when important production factors cannot be easily duplicated.

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Use Your Clicker
To Answer The Following
Graded Question.

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Scott Adams loves to draw and has created a well-liked cartoon called Dilbert. When he first started out, Scott earned \$3,000 per month drawing Dilbert for subscribing newspapers. Dilbert became popular and now Scott earns \$10,000.00 per month drawing Dilbert.

Is Scott Adams receiving economic rent or profit?

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Is Scott Adams receiving economic rent or profit?

- A. Economic Profit because his current wage is greater than his opportunity cost.
- B. Economic Profit because there is great competition in the cartoon industry.
- C. Economic Rent because he is in business for himself.
- D. Economic Rent because no other cartoonist is permitted to draw Dilbert.

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Scott Adams is earning rent on his unique ability to draw Dilbert.

Copyright laws prohibit others from selling Dilbert images.

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A Puzzle

Mario leases 25 acres of vineyard from Gianpiero in Tuscany. With the grapes he grows, Mario makes a "single estate" Brunello wine.

At first, Mario and his wine were little known and Mario made just enough profit to be willing to keep making wine.

Then, wine critic Robert Parker gave Mario's Brunello a very high rating.

The price of the Brunello went from \$25 to \$60 per bottle.

Will Mario or Gianpiero benefit from the price increase?

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Who Will Benefit?

The owner of the vineyard will benefit provided that the grapes are what accounts for the quality of the wine.

This is an example of economic rent which comes in the form of a lease price for the vineyard higher than the opportunity cost of the land on which the vineyard is located.

If the land has special properties that result in exceptional grapes, the lease price may be relatively high for a long time.

We have learned

To apply the economic concept of efficiency to the BBall ticket distribution system.

That economic profit subtracts the opportunity cost of the entrepreneur's time and property from accounting profit.

That profit motivate entrepreneurs while competition keeps their profits at normal levels.

That economic rent is payment to a special factor of production.

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