

1. Read the following excerpt from the *Raleigh News and Observer* (2/3/94) and answer the question following:

Raleigh's Losing its Edge: TeamTennis Franchise Exits Despite Making Money, Fans. The Raleigh Edge is folding. Co-owner Duane Long said the league will officially withdraw the franchise today, two days after the City Council voted down a proposal for the city to take over the team. ... Long and Tim Wilkison, who co-owned and operated the team each of its four years announced at the end of last season they needed to devote more time to their private businesses and put the club on the market for \$250,000. "Tim and I don't have the time to do the marketing and operating because of our businesses ... It takes more time than some people might think." ... Long said the Edge was marginally profitable each of the past three years and has no outstanding debts."

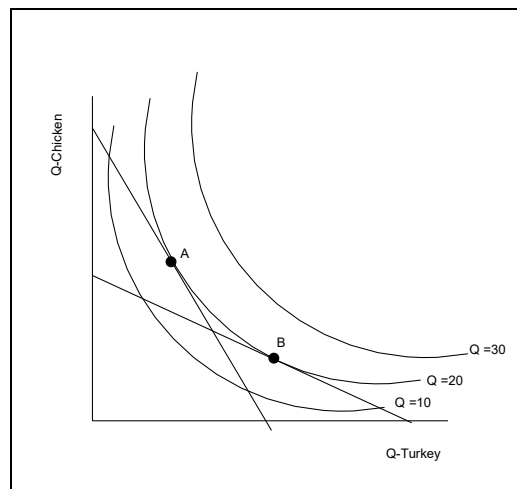
Write a short essay in which you explain, why, if the Edge was profitable, it is folding. Use economic reasoning and explain your answer.

Answer: The fact is, that the Edge was *not profitable*. The newspaper article wrongly fails to include the *opportunity cost of the owners' time* in their assessment of profits. In fact, the opportunity cost was apparently so high that they decided that they would rather quit without finding anyone to buy the team than to keep going longer until some sort of buyer could be found. Owners of small businesses often initially fail to count-in the opportunity cost of their time when assessing the feasibility of a business. They think that if they can pay their help and cover the bills, they are making a "profit", even if the net revenue available to them is below what they could be earning in another occupation.

Economics 10 (Turchi): Essay Question

21. (6 points) Boston Market, the restaurant chain, is famous for its chicken pot pie. It is a little known secret that this chicken pot pie may contain some amount of turkey in place of chicken. Write an essay (and draw a graph) in which you provide an economic analysis of the factors that determine what ratio of chicken to turkey Boston Market uses for a given quantity of pies. Demonstrate what would happen to the ratio of chicken to turkey needed to produce the *same amount* of pies if the price of chicken doubled.

This question asks the student to demonstrate understanding of the determination of cost-minimizing inputs of chicken and turkey. The student should draw a set of production isoquants, and show the *expenditure line* that would minimize the cost of producing a given quantity of chicken pies. Points of emphasis are that the slope of the expenditure line is determined by the ratio of prices of chicken and turkey and that the cost minimizing combination of chicken and turkey is determined by the tangency between the expenditure line and the appropriate isoquant.



This graph shows Boston Market producing 20 pies with the ratio of chicken to turkey as specified by point A. The student should note that the cost minimizing input combination occurs (for $Q=20$ in this case) where the isoquant and the expenditure line are tangent. When the price of chicken doubles, the firm substitutes away from chicken toward turkey. Producing the same amount of pies leads us to point B. How much turkey is substituted depends upon the shape of the isoquant. In this case there is considerable room for substitution.