# Research paper on principles of economics

Health & Medicine, Alcoholism

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# Question 1

An economist will approach the problem of abuse of alcohol as a cost and attach a monetary value to it. Alcohol abuse is a negative externality of consumption. The social benefits of consuming alcohol are less than the private benefits. Abuse of alcohol causes harm to; an individual, their friends, family and the society as a whole. External costs associated with abuse of alcohol include; injuries to third parties, alcohol related crime, partner assault, excess over consumption of health services, absenteeism at workplace, reduced productivity at the work place and alcohol related accidents. Economist will attempt to quantify these external costs and include them as part of the costs of alcohol consumption which are not normally borne by the consumer.

The first possible solutions to these problems are increasing the cost of alcohol through taxes. This will in effect lower the demand for alcohol to socially optimal level. These kinds of taxes are referred to as pigouvian taxes, and their effect on consumption is referred to as pigouvian effect in economics. The second solution to the problem of alcohol abuse is lowering the amount produced to what is socially optimal. This can be done by negotiations between the society and producers without government intervention. This is possible only if, property rights can be secured and negotiation costs are not very high. This is known as coarse theorem in economics.

## Question 2

The influence of prescription drugs on the demand of other goods and services depends on the nature of the goods and the relationship between the goods and services with prescription drugs. The goods and services may either be compliments or substitutes. The compliments of a commodity are those goods and services used or consumed with it. The compliments of prescription drugs are; physician services, medical laboratory test and nursing. An increase in the demand for prescription drugs will result in an increase for these services. The substitutes of a commodity are those that can be used or consumed in the place of the commodity. The compliments of prescription drugs are; herbal remedies, traditional healers and medical supplements. An increase in the demand for prescription drugs will result in a decrease in demand for these services and products.

The influence of prescription drugs on supply of other goods and services depend on the price of prescription drugs relative to other goods. Producers will allocate resources to production of goods that will maximize their profits.

Therefore, an increase in the price of prescription drugs relative to other goods will result in a decrease in the supply of other goods and services.

## Question 3

Elasticity of demand is an important element when analyzing a shift in supply by producers because it determines the extent to which producers can shift the incidence of tax. The lower the elasticity of demand, the more producers can shift the tax burden of a newly imposed tax. This is because when the elasticity of demand is low the responsiveness of quantity demand to price changes is little. Therefore, producers can easily pass new taxes through price increases without significant reduction in quantity demanded and hence aggregate revenues will not be affected. When the elasticity of demand is high, producers will not be able shift the tax burden of a newly imposed tax. This is because when the elasticity of demand is high the responsiveness of quantity demand to price changes is high. Therefore, producers cannot easily pass new taxes through price increases significant reduction in quantity demanded and hence a loss aggregate revenue.

## Question 4

An increasing cost industry is an industry which the cost curve shifts upwards as the aggregate industry output increases. The supply curve of the industry is, therefore, positively sloped. It occurs in industries whose structure closely resembles that of perfectly competition. This is because such industries have free entry. As new firms enter the industry prices of factors of production tend to rise due to competition for scarce resources. Therefore, production costs and the price of resources increase as the industry expands. This results in an upward sloping curve as output increases. Examples of increasing cost industries are; manufacturing industry and agricultural industry.

## Question 5

In the long-run firms in perfect competition earn normal profits. The characteristic of perfect competition whereby there is freedom of entry and exist to and from an industry implies that the entry of new firms bids away any supernormal. The entry of new firms leaves the equilibrium price until only normal profits are earned. Firms in perfect competition are price takers and they adopt the price determined at the level of the industry. Therefore, only efficient firms will produce and make only normal profits. The long run equilibrium position in perfect competition can be illustrated in the following diagram:

## Price Revenue
## LMC LAC

and

D

S cost

The figure above shows the long run equilibrium position in perfect competition. Since AC = AR the firm is only earning normal profits. The firm takes the price P as determined by the industry. Normal profits represent the minimum level of return necessary for the firm to continue in operation. In the long run firms in perfect competition produce at the lowest point of the long run average cost curve when the average cost is at a minimum.

# References

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