Questions in the economics 2010 course

Literature, Russian Literature

2. Look at the graph below:

a) Is there an externality situation in the antibiotics market? Explain.

b) Mark and label the areas and or lines identifying “ Social Cost”; the market “ equilibrium quantity consumed and price”; “ external cost of antibiotic use”; “ deadweight loss”; “ efficient equilibrium” if one exists; and “ private value”.

When resources are allocated ineffectively then the deadweight loss is created since supply and demand will not be in equilibrium.

c) What does each of the items to be identified and marked in the graph above mean?

3. Earlier in the Economics 2010 course, we learned that a tax on an ordinary good increases deadweight loss. Does the same impact result with the imposition of a tax on a good with an external cost? Explain. Yes; a tax would cause a change in the equilibrium price and quantity resulting in an inefficient market.

The theorem states that in case there is a conflict of property rights the parties involved may negotiate on terms that seem to be more beneficial to them than the assigned rights of the property. The theorem will breakdown when there are huge costs associated with bargaining.

5. Explain and/or graph with explaining the difference between controlling and regulating a negative externality by use of a “ Corrective Tax”; a “ Pollution permit system and market”, or a “ Command and control” regulation. Explain the pros and cons of these 3 types of resolution of the

negative externality problem.

Command and control regulation on emissions

Control regulations usually generate more abatement costs than necessary.

6. Define the following:

Total Revenue:

It is the summation of all the sales that a company makes together with other additional sources of income for a given period of time during the production process for a given product. It is usually given as Total revenue = price × quantity + other incomes

Marginal Revenue:

Change in Total Revenue is given by the production of a single extra unit in the production process.

Explicit cost & Implicit cost:

Explicit cost: It is the cost that the business entity incurs in a direct manner so as to do an activity for example Salaries and wages.

Implicit cost: It is the intangible cost that is hard to account for and can be thought of as opportunity cost. Examples are depreciation and interest rate fluctuations.

Opportunity Cost:

Opportunity cost is the cost that somebody suffers for choosing the alternative decision over the other and it is always considered that the best

choice is made between the options; the lesser privileged choice is foregone to pursue the other for more benefits to be yielded. The cost of the neglected choice is considered less than the gain to be obtained from the preferred choice.

Total Cost, Fixed Cost, Variable Cost, and Average Cost:

Total Cost: this is the sum of all the costs incurred over the production process for a given good or product at a certain period of time.

Fixed Cost: It is the cost that is constant and is not influenced by any factor of production. Its value does not change over time.

Variable Cost: It’s the cost that keeps on varying depending on certain factors of production, its value changes with time and can either increase or decrease.

Average Cost: It is the cost of a given single unit produced which is obtained by dividing the total cost by the number of units produced. It affects the supply and demand curves.

Economic Profit relative to accounting profit:

Economists use the economic profit to gauge effectiveness as an indicator. Companies obtain economic profit when the price of the goods sold is higher than the opportunity cost which is not an effective strategy while accounting profit is defined as the totals earning of the company which includes even inflation and interest rates.

Why is profit equal to (price – average cost) X quantity sold? Explain or

otherwise break down profit from total revenue minus total cost.

This is due to the fact that the price of the product sold is higher than the average cost which the production cost for the single products. The difference between the price and the average cost gives profit per a single unit and multiplying it with the number of products sold gives the total profit obtained.

7. If a firm operates in a perfectly competitive market, what is the point where profit is maximized? Derive or explain.

Perfect Competitive market is where there are no population blocks that are large enough to determine the buying pattern of a market. These markets are strict and rare to find if they exist at all. An entry of a block of consumers into the market who consumes the product will make the market to have more sales hence more profits which maximize the profits ((Bercovitz and Will, 66).

8. Graph the perfectly competitive market including supply equal demand equilibrium and the firm which faces the market equilibrium price and increasing costs. Point out, given the demand (or price) and cost conditions, the profit maximization position and level of output that the competitive firm faces (or, in other words, derives given the competitive market and the increasing cost conditions).

The graphs portray the market and firm’s situation in case of a perfect market

In this case, the marginal revenue is the price (MR= P). Therefore, for-profit

maximization in a competitive firm marginal cost would be marginal revenue which will equal the price MC= MR= P

9. What does an entrepreneur have to do to minimize the total costs of production across two different firms? Explain.

The entrepreneur can decide to let one company specialize with the product its effective in producing while the other specializes in the other products which are produced at a lower cost hence the total cost of both firms will be low due to specialization and effective utilization of resources.

10. Explain what is meant by “ Creative Destruction” and the “ Elimination Principle”.

In 1942 Joseph Schumpeter coined the name which states that evolution of the economic structure comes from within and destroys the existing one older one and creates a newer one. It relates the Capitalism, Socialism and Democracy economy structures. The folder structure is done away with a newer one, for example, modern computers eliminated the old huge mainframes (Bercovitz and Will, 63).