Economics

Literature, Russian Literature

Wheat supply1 P1 C1 Supply of Wheat 2 PE C2 P2 Q1 QE Q2

Wheat Demand Curve

1a) the quantity demand is labeled QE and corresponding price is PE in the graph.

1b) after the price increase, the corresponding quantity demand and quantity supplied are Q1 and Q2 as shown in graph respectively at price P1.

1c) the triangle C1 in the graph indicates the cost that the government will incur by implementing the first policy.

1d) CI is excess surplus that the government will purchase in order to maintain the price p1 and is equal to the cost of government. Meanwhile, C2 show the cost that the government will incur by implementing the second policy.

1e) if the government decides to maintain price at p1 by purchasing excess supply, there will be a problem in case there will be a rise in supply due to better than predictable yields of wheat at harvest time. This will cause the supply of wheat to shift out to Supply of wheat 2 as shown in graph putting down ward pressure on the free market equilibrium price. The policy will become costly because the government will be forced to implement the same policy of buying up the surplus of wheat to prevent price from falling. Moreover, the policy 2 is costly than the policy 1 when the government faces a problem in dealing with the excess wheat it bought. The policy is costly because if government opts to purchase the wheat, but it sells it to developing countries at a rock bottom prices. The government can also sell the surplus to farmers by feeding animals or offering it at a reduced price prices to those in need of it, in other countries. However, the policy of paying

the farmers the supply price is costly than that of buying the surplus because the price paid to farmers in inevitably higher than the price received from the sale of surplus.

1f) both Policies will produce equal net economic benefit because the cost associated with both policies affect the society directly, and are subtracted from the producer and consumer surplus. From the graph, the net economic benefit is shown by the triangle Q1P1QE.

QUESTION 2

a) In the real world environments, firms are not identical because technology changes continually and diverse firms have different histories. The change in technology will cause the firm to reduce the cost of production, and in turn causes downshift of in each firm's marginal cost curve. Meanwhile, the short run supply curve that is the total of the firm's marginal cost curves will shifts downwards. According to Lipsey and Chrystal (2007, 146), the firm's produces economic profits and output at which price equals marginal cost. In the perfect competition, the marginal cost curve is greater and stiffer than average cost curve. Meanwhile, there will be no new entrants attracted to the industry because the average cost minimizing output is greater. In the short run, the entry of new firms shifts the supply curve to the right. Each firm old and new will cover its total cost by producing at a minimum point on its average total cost curve.

b) The long run equilibrium of a competitive firm occurs when firms are earning zero profits. The price increases because the firms start experiencing lower cost of production as a result of change in technology. In the long run, profit will not persists in an industry with freedom of entry. There will be a

possibility that new firms will enter the industry that will increase output and reduce the price until all profit is eliminated. Lipsey and Chrystal (2007, 142) indicate that all benefits of lower costs in the perfectly competitive firms will be transferred to customers in a higher output and lower prices in a long run. Thus, these will cause firms to leave the industry until those remaining can handle all their costs.

Works Cited

Lipsey, Richard and Chrystal, Alec. Economics. New York: Oxford University Press, 2007. Print.