# Basic concepts of economics

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Intermed Micro Exam 1 Chapter 1 (Powerpoint Slides) Economics- Unlimited wants and limited resources Microeconomics- Branch of economics that deals with the behavior of individual economic units. Units such as, consumers, firms, workers, and investors, as well as the markets that these units comprise. Macroeconomics- Branch of economics that deals with aggregate economic variables. Such as the level and growth rate of national output, interest rates, unemployment, and inflation. Micro Economics is a story of trade-offs that consumers, workers & firms face and shows how these trade-offs are best made.

Key Players – Consumers, Workers, Firms Trade offs for Consumers: Limited Incomes – To save or to spend. If save then for HOW LONG and of-course HOW MUCH If spend then on WHAT and HOW MUCH This gives birth to the CONSUMER THEORY, which talks about the preferences, choices, utility etc. Trade offs for Workers: Time: Leisure Vs. Labor Whether and when to enter the work force…. Pay scale is dependent oneducationChoice of employment: Risky but high paying VS safe but lessmoneyTrade offs for Firms: What to produce? How much to produce? Example: Any company in the world would love to produce everything and reap profits but can’t do it.

Central planned economy- Prices are set by the gov’t In a market economy- Prices are determined by the interactions of consumers, workers, and firms. These interactions occur in markets—collections of buyers and sellers that together determine the price of a good. In economics, EXPLANATION and PREDICTION are based on theories and models. Theories- are developed to explain observed phenomena in terms of a set of basic rules and

assumptions. Model – is a mathematical representation, based on economic theory, of a firm, a market, and some other entity.

Positive Analysis - describing relationships of cause and effect. Normative Analysis – Analysis examining questions of what ought to be. Competitive Market – market with MANY buyers and sellers trading identical products so that each buyer and seller is a price taker. Non-Competitive Market – Seller or buyer can influence the prices Market Boundary – GEOGRAPHICAL and RANGE of products Why is boundary important? To get to know about actual and potential competitors and its helpful in making Public plicies. Example: Pain Killers REAL Vs. NOMINAL prices

Nominal price - Absolute price of a good, UNADJUSTED for inflation Real Price - Price of a good relative to an aggregate measure of prices; price ADJUSTED for inflation Consumer Price Index – Measure of the aggregate price level. Producer Price Index – Measure of the aggregate price level for INTERMEDIATE products and WHOLESALE goods. REAL vs. NOMINAL pricing The real price of eggs in 1970 dollars is calculated as follows: The real price of eggs in 1970 dollars is calculated as follows: The real price of eggs in 1990 dollars is calculated as follows: Public Policy - * Great impact on Economics * Can change course of the market

Chapter 2 (Powerpoint Slides) Supply Curve - Relationship between the quantity of a good that producers are willing to sell and the price of the good The Supply curve is upward slopping: The higher the price, the more firms are able and willing to produce and sell. If production costs fall, firms can produce the same quantity at a lower price of a larger quantity at the same price. The supply curve then shifts to the right. Insert Graph by hand: The

Supply Curve – is thus a relationship between the quantity supplied and the price. We can write this relation as an equation: QS = QS(P) Other Variable That Affect Supply are:

Production costs, including wages, interest charges, and the costs of raw materials. When production costs decrease, output increases no matter what the market price happens to be. The entire supply curve thus shifts to the right. Change in supply or Shifts in the supply curve Vs Change in the quantity supplied or Movements along the supply curve. The Demand Curve – Relationship between the quantity of a good that consumers are willing to buy and the price of the good. Equation can be written: QD = QD(P) Insert Graph by hand: A higher demand curve shifts the demand curve to the right. Downward Sloping) Shifting the Demand Curve - If the market price were held constant at P1, we would expect to see an increase in the quantity demanded—say from Q1 to Q2, as a result of consumers' higher incomes. Because this increase would occur no matter what the market price, the result would be a shift to the right of the entire demand curve. Insert Graph by hand: Shifting the Demand Curve Substitutes – Two goods for which an increase in the price of one leads to an increase in the quantity demanded of the other. Complements - Two goods for which an increase in the price of one leads to a decrease in the quantity demanded of the other.

THE MARKET MECHANISM The market clears at price P0 and quantity Q0. At the higher price P1, a surplus develops, so price falls. At the lower price P2, there is a shortage, so price is bid up. Insert Graph by hand: Equilibrium (aka market clearing) price – Price that equates the quantity supplied to the quantity demanded. Market Mechanism- Tendency in a free market for price

to change until the market clears. Surplus - Situation in which the quantity supplied exceeds the quantity demanded. Shortage – Situation in which the quantity demanded exceeds the quantity supplied. CHANGES IN MARKET EQUILIBRIUM

New Equilibrium following Shift in Supply When the supply curve shifts to the right, the market clears at a lower price P3 and a larger quantity Q3. Insert Graph by hand: New Equilibrium following Shift in Demand When the demand curve shifts to the right, the market clears at a higher price P3 and a larger quantity Q3. Insert Graph by hand: New Equilibrium following Shifts in Supply and Demand Supply and demand curves shift over time as market conditions change. In this example, rightward shifts of the supply and demand curves lead to a slightly higher price and a much larger quantity.

In general, changes in price and quantity depend on the amount by which each curve shifts and the shape of each curve. Insert Graph by hand: From 1970 to 2007, the real (constant-dollar) price of eggs fell by 49 percent, while the real price of a college education rose by 105 percent. What are the possible reasons for such a sharp change : The mechanization of poultry farms sharply reduced the cost of producing eggs coupled with sharp decline in demand for eggs shifted byhealth-conscious population who tended to avoid eggs.

As for college, increases in the costs of equipping and maintaining modern classrooms, laboratories, and libraries, along with increases in faculty salaries, pushed the supply curve up. Demand for college increased as a larger percentage of a growing number of high school graduates decided that a college education was essential & paying. Market for Eggs The supply

curve for eggs shifted downward as production costs fell; the demand curve shifted to the left as consumer preferences changed. As a result, the real price of eggs fell sharply and egg consumption rose. Insert Graph by hand: Market for College Education

The supply curve for a college education shifted up as the costs of equipment, maintenance, and staffing rose. The demand curve shifted to the right as a growing number of high school graduates desired a college education. As a result, both price and enrollments rose sharply. Insert Graph by hand: Supply and Demand for New York City Office Space Following 9/11 the supply curve shifted to the left, but the demand curve also shifted to the left, so that the average rental price fell. Insert Graph by hand: Elasticity – Percentage change in one variable resulting from a 1% increase in another.

Price Elasticity of Demand – Percentage change in quantity demanded of a good resulting from a 1% increase in its price. Linear Demand Curve – Demand curve that is a STRAIGHT LINE. Linear Demand Curve The price elasticity of demand depends not only on the slope of the demand curve but also on the price and quantity. The elasticity, therefore, varies along the curve as price and quantity change. Slope is constant for this linear demand curve. Near the top, because price is high and quantity is small, the elasticity is large in magnitude. The elasticity becomes smaller as we move down the curve.

Insert Graph by hand: Infinitely Elastic Demand – Principle that consumers will buy as much of a good as they can get at a single price, but for any higher price the quantity demanded drops to zero, while for any lower price the quantity demanded increases without limit. a. ) For a horizontal demand

curve, ? Q/? P is infinite. Because a tiny change in price leads to an enormous change in demand, the elasticity of demand is infinite. Insert Graph by hand: Completely Inelastic Demand – Principle that consumers will buy a fixed quantity of a good regardless of its price. b. For a vertical demand curve, ? Q/? P is zero. Because the quantity demanded is the same no matter what the price, the elasticity of demand is zero. Insert Graph by hand: Other Demand Elasticities Income Elasticity of Demand – Percentage change in the quantity demanded resulting from a 1% increase in income. Cross-Price Elasticity of Demand - Percentage change in the quantity demanded of one good resulting from a 1% increase in the price of another. Elasticities of Supply Price Elasticity of Supply – Percentage change in quantity supplied resulting from a 1% increase in price.

SHORT-RUN vs LONG-RUN ELASTICITIES Demand Gasoline: Short-Run and Long-Run Demand Curves a. ) In the short run, an increase in price has only a small effect on the quantity of gasoline demanded. Motorists may drive less, but they will not change the kinds of cars they are driving overnight. In the longer run, however, because they will shift to smaller and more fuel-efficient cars, the effect of the price increase will be larger. Demand, therefore, is more elastic in the long run than in the short run. Insert Graph by hand: