Micro Final Study Guide

❖ =Review

Chapter 1

- Scarce→demand exceeds supply
- Economics: 1) How people make decisions?
  2) How people interact with one another?
- Efficiency (size of economic pie)
- Equality (how pie is divided into individual slices)
- Rational decision maker→ marginal benefits>marginal costs
- Trade can make people better off (specialization)
- Markets are a good way to organize economy
- Government involvement (property rights, promote efficiency and equality)

Chapter 2

- Role of assumptions→can simplify complex world
- Economic models (diagrams and equations)

-Circular-flow diagram (visual model of economy)

>dollars flow from markets, households and firms

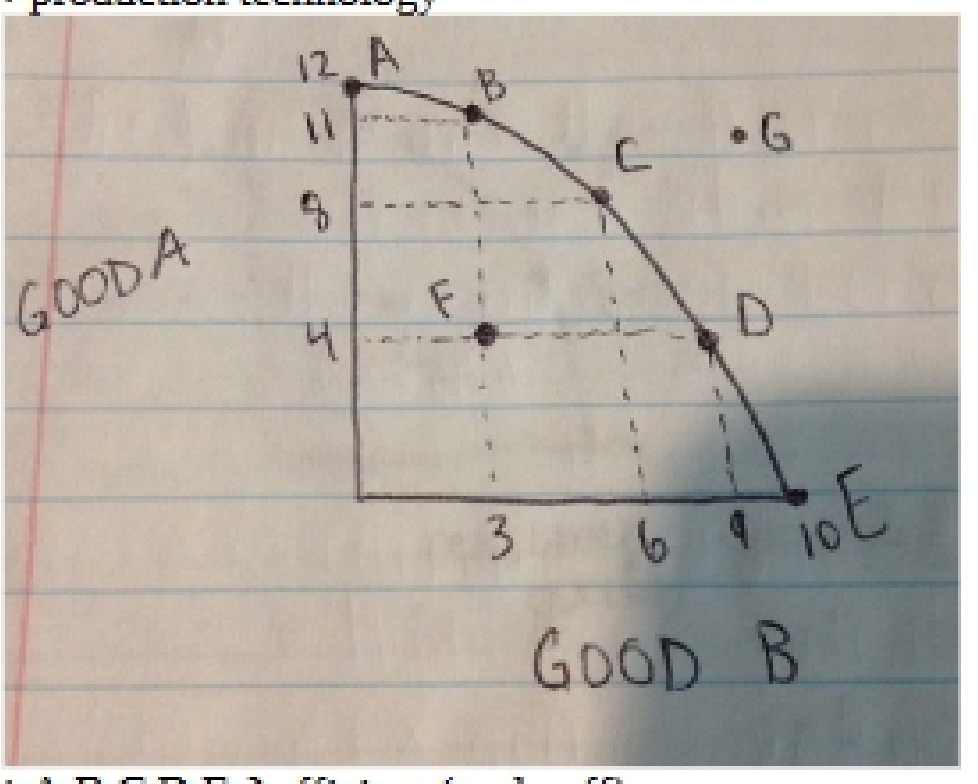
>decision makers →firms and households

>markets→goods and services

-Production Possibilities Frontier (graph, combo of output that economy can produce)

>factors of production→fixed

>production technology



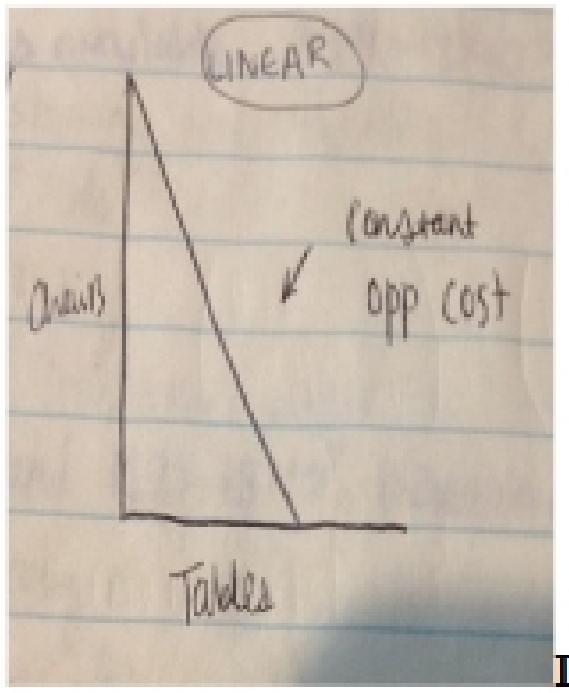
>A,B,C,D,E→efficient (trade-off)

>G→not possible

>F→inefficient

>Ex) What is the opportunity cost of moving production from…

- B → C (gave up 3 units of Good A)
- D → C (gave up 3 units of Good B)
- A → D (gave up 8 units of Good A)
- F → B (gave up 0 units)- going from inefficient use of resources to efficient resources (perhaps you opened up a factory)



Linear→resources are perfectly adaptable /interchangeable to either product

>oppurntunity cost of producing an extra unit always remains constant

>shift→technological change (resource specialization)

- Positive v Normative Analysis

-Positive-attempt to describe world as it is, descriptive ("what is")

>confirm/refute by examining evidence

-Normative-attempt to describe how the world should be ("what ought to be")

>prescriptive, based on individual preferences

Chapter 3

- Parable for modern economy:

-2 goods: meat and potatoes

-2 people: rancher and farmer

-rancher produces only meat, farmer only potatoes

>both gain from trade

-farmer will specialize in potatoes (more time growing, less time cattle)

-rancher will specialize in cattle (more time in cattle)

-farmer stop producing meat, specialize in potatoes if farmer gives rancher 15 oz potatoes, then rancher gives farmer 5 0z of meat

- Imports: produced abroad and sold domestically
- Exports: produced domestically and sold abroad
- Absolute advantage: produce a good using fewer inputs than another producer
- Opportunity cost: measures trade-off between 2 goods that each producer faces
- Comparative advantage→lower opportunity cost

-produce at this (economic pie bigger)

-people focus production on goods they can produce at lower opportunity cost (CA) than other person and sell (export) their goods→total output increases

-only one good, interdependence, gains from trade

- Price of trade→lie between 2 opportunity costs
- Deal: 5M=15p F buy M, sell P

1M=3p R buy P, sell M

Farmer→highest price he'll pay for meat is 4 potatoes (opportunity cost)

2P<_1M<_4P 1M=4P

Chapter 4

- Market: group of buyers and sellers
- Competitive market: many buyers and sellers→each negligible impact on market price
- Quantity demanded: amount of a good that buyers are willing and able to purchase
- Law of demand: when price of good rises, QD good falls
  -other things equal (ceteris paribus)
- Demand schedule→quantity demanded at each price
  -slope downward→varies with price
  -Qd=f(p)→run/rise→change QD/change price
- Slopes-y=f(x)→y=dependent variable, x=explanatory variable
- Slope: change in y/change in x=change in dep. variable/change in exp. variable=rise/run
- Flatter curve →greater slope (more elastic)
- Bubble→price inflate (self-fulfilling phenomenon)
- Market demand: sum of the individual demand curves
- Increase in demand→any change that increases QD at every price
  -shifts right (left for decrease)
  -income (normal/inferior), prices of related goods (complements/subs), tastes, expectations about future, number of buyers
    >normal good: increase in income leads to an increase in demand
    >inferior good: increase in income leads to a decrease in demand
    >substitutes: increase in price of one leads to increase in demand for other
    >complements: increase in price of one leads to decrease in demand for other
- Supply: amount of a good
  -quantity supplied: amount of a good sellers are willing and able to sell
  -law of supply: price of good rises, QS good rises (other things equal)
  -shift→input prices, technology, expectations about future, number of sellers
- Equilibrium→various forces are in balance
  -market→quantity supplied=quantity demanded
  -supply and demand intersect
  -price→market-clearing price
  -quantity→QS and QD at equilibrium price
  -QS>QD (surplus) QD>QS (shortage)
- Law of supply and demand: price of any good adjusts
  -respond to supply and demand
  -prices allocate resources
- Most markets→surpluses and shortages temporary
- Shift in curve→change movement along fixed curve→change in quantity
- Prices→signals that guide allocation of resources, mechanism for rationing resources, determine who produces each good and how much is produced
- Non-price allocation mechanism→lines, black markets, tie-in sales, discrimination

Chapter 5

- Elasticity: measure of responsiveness of QD or QS
- Elastic demand: QD responds substantially to changes in price
- Inelastic demand: QD responds only slightly to changes in price
- Price elasticity of demand determinants→availability of close subs (goods-more elastic demand), necessities (inelastic) v luxuries(elastic), definition of the market (narrowly defined→more elastic), time horizon (demand more elastic over longer time horizons)