ECONOMICS REVIEW QUESTIONS

-take calculator!

1. **What is the difference between change in demand (supply) and change in quantity demanded (supplied)?**
   - A change in any of the non-price determinants that shift the curve of demand (supply).
   - A movement along the same curve, the only determinant changing is price.
   - Increase in demand: curve shifts to the right
     a. Income up(normal good), Income down (inferior good)
     b. Price of substitute up, price complement down
     c. Change in tastes
   - Decrease in demand: curve shifts to the left
   - Increase in quantity supply: movement along the curve
   - Increase in supply : curve shifts
     a. Technology improves
     b. Input prices down
     c. Number producers increases
     d. Change in expectations
   - Decrease in supply: shifts left
2. **What are the three questions you should ask yourself whenever you encounter a comparative statics question?**
   a. Which curve shifts?
   b. Which directions does it shift?
   c. What happens to equilibrium price and quantity?
3. **What is the result of a "binding" price ceiling? A "binding" price floor?**
   - A binding price ceiling is set below the equilibrium price→ it causes shortage.
   - A binding price floor is set above the equilibrium price. → it causes surplus.
4. **What is elasticity and how is it calculated?**
   - Price elasticity of demand=how sensitive quantity demanded is to changes in price.
   - Percentage change in quantity demanded over percentage change in price.
   - Inelastic demand curve: steeper curve
   - Elastic demand curve: flatter curve
   - Perfectly inelastic: vertical
   - Perfectly elastic : horizontal
   - Midpoint formula
   - e>1→Elastic, e<1→Inelastic, e=1→Unit elastic (1% change in price we have 1 % change in quantity demanded)
   - ex: e=0.5 → A 1% change in price gives .5 % change in quantity demanded
   - elasticity is not constant along a linear demand curve (slope is constant). Inelastic is below the unit elasticity point. How do we talk about elastic and inelastic curve? Elastic curves have longer elastic segment and vice versa.
   - Rules of thumb for Price elasticity of demand
   - Cross-price elasticity of demand-measures the response of demand for one good to changes in the price of another good.

- For substitutes: cross-price elasticity >0; complements: cross-price elasticity <0
- Income elasticity of demand-response of change in quantity demanded to a change in consumer income.
- For normal good: income elasticity>0, inferior good: income elasticity <0
- Price elasticity of supply: the response of quantity supplied a good to changes in the good's price.

5. **Principles of Indifference Curves and Budget Constraints**

-how much can I afford? (BC)
-Tastes and preferences (IC)
-Indifference curve principles?
a. Higher IC represent higher utility
b. IC never cross
c. IC usually slope downward
d. IC are usually convex-bowed inward toward the origin (concave up)
- Why do they have the convex-bowed inward shape? → Diminishing marginal rate of substitution.
-Marginal rate of substitution: the amount of good on Y axis that you are willing to give up to get one more unit of the good on X axis.
-Diminishing MRS- the more X I have, the less Y I am willing to give up to get another unit.
-MRS=MUx/MUy

6. What are the conditions for a consumer optimum?

a. At the optimum point Slope IC=Slope BC

b. Slope BC=-Px/Py

c. Slope IC=-MRS→ -MUx/MU=-Px/Py→ **MUx/Px=MUy/Py**

➔ **Meaning: The marginal utility <u>per dollar spent</u> is the same for both goods.**

6. How does the optimum changes when
7. Income and substitution effects?
8. Why does the demand curve slope down?

-Good is normal>> SE and IE work in the same direction
-Good is inferior>>SE outweighs the IE to get a downward sloping demand curve