Exam 1 outline: Chapters 1-7
Powerpoints greetings & prep → The International Secto

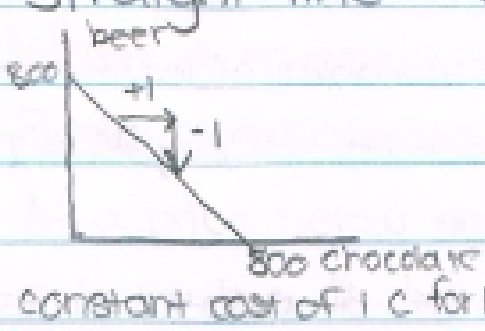
-Preliminary Material

•Opportunity Costs

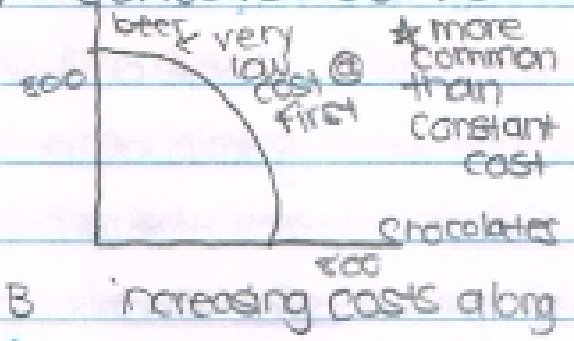
- The opportunity cost of any activity is the highest-valued alternative that must be given up to engage in that activity
- What you would have done instead, have to choice because of scarcity
- Costs can be monetary or nonmonetary
- Illustrated by the slope in a PPF, straight line means constant costs, Concave curve means increasing costs

•Underlies notion of PPF

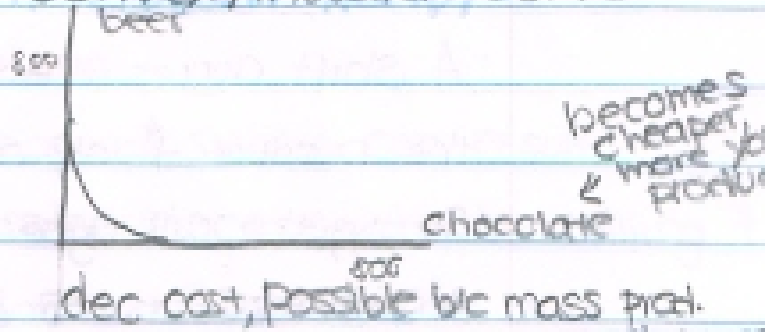
- PPFs show what production is possible. What a person, firm, or economy can do. Combination of 2 goods produced with available resources.
- Straight line v Concave Curve v Convex/inward curve



constant cost of 1 C for 1B



increasing costs along curve



dec cost, possible b/c mass prod. techniques

•Comparative Advantage

- Everyone has a comparative advantage, which is comp disadvantage to another
- The ability of an individual, a firm, or a country to produce a good or service at a lower opportunity cost than competitors
- Absolute advantage is the ability to produce more given the same resources but even at a disadvantage for every good, everyone has a comp. advantage
- Can be used to move outside PPF through trade, countries export goods they can produce more efficiently, & import goods they produce less efficiently
- Tells an individual, firm, or country what to specialize in
- Comparative advantage = lower opportunity cost
- The basis for trade,
- Specialize by calculating opportunity cost for each country, & whoever has lower opportunity cost should specialize in producing that good, and trading with the other country for the other good
- Being best is not necessarily good enough

· Supply and Demand

·Demand is the quantity of a good or service that consumers are willing & able to buy at a given set of prices over a given period of time

·Supply is the quantity of a good or service that producers are willing and able to sell at a given set of prices over a given period of time

·Why do the curves look the way they do?

-Demand curves slope down, price is a cost. Suppose price of scones falls; income effect, you can now buy more of everything, substitution effect, you buy more scones & fewer doughnuts.

-Supply curve slopes up, price is a reward. If the price of scones rises; current producers make more, new producers attracted.

·What makes the curves move?

-A shift occurs if there is a change in one of the variables, other than the price of the product that affects the willingness of consumers to buy the product or for supply, the willingness of suppliers to sell the product.

-Variables for change in demand include income, prices of related goods, tastes, population & demographics, and expected future prices.

-Variables that shift supply include prices of inputs, technological change, prices of substitutes in production, number of firms in the market, & expected future prices

-How do they move?

• For demand, if consumer income increases, or if another factor changes that makes consumers want more of the product at every price, the demand curve will shift to the right.

• An increase in... income (and the good is normal) shifts curve right; income (and good is inferior) shifts curve left; price of a substitute shifts curve right, price of a complementary good shifts curve left; taste for the good shifts curve right; population shifts curve right; the expected price of the good in the future shifts curve right.

• For supply, if the price of an input decreases or another factor changes that causes sellers to supply more of the product at every price, the supply curve will shift right.

• An increase in ... the price of an input shifts curve left; productivity shifts curve right; price of a substitute in production shifts curve left; number of firms in the market shifts curve right; the expected future price of product shifts curve left.

- What happens when they move?
  - A shift to the right is an increase in demand, to the left decrease in demand.
  - A shift to the right is an increase in supply, to the left is decrease in supply.

Equilibrium

- Equilibrium price has two basic qualities; "everyone" is happy, & no tendency to change
- Market equilibrium is a situation in which quantity demanded equals quantity supplied.
- Competitive market equilibrium is a market equilibrium with many buyers and sellers.

- What it means to be at equilibrium
  - Where supply & demand curves intersect.
  - Everyone is "happy", both producers and consumers. Everyone is willing to buy and sell, & able to do so.
  - A stable situation
- What it means to be away from equilibrium
  - Basic characteristics are violated, not everyone is happy, & surplus can result.
  - At a price below equilibrium consumers are frustrated because they're willing & able to buy Q_1, but can buy only Q_2, excess demand results. Prices rise and producers can charge more, & consumers are willing to pay more, excess demand then disappears.
  - At a price above equilibrium producers are unhappy because they're willing and able to sell Q_1, but can only sell Q_2 (less). Prices fall and consumers can pay less, & producers are willing to charge less.
  - A market that is not in equilibrium moves towards equilibrium. Once a market is in equilibrium, it remains in equilibrium.
  - When quantity supplied is greater than quantity demanded there is a surplus.
  - When quantity demanded is greater than quantity supplied there is a shortage.

What happens when we interfere?

- Not every individual is better off if a market is at competitive equilibrium, only the total net benefit to society is greatest. So, the government can interfere by overriding market outcome with price ceilings & floors.

- Price ceilings and floors
  - Government can attempt to aid sellers by requiring that a price be above equilibrium, a price floor.
  - Or they may aid buyers by requiring that a price be below equilibrium, a price ceiling.