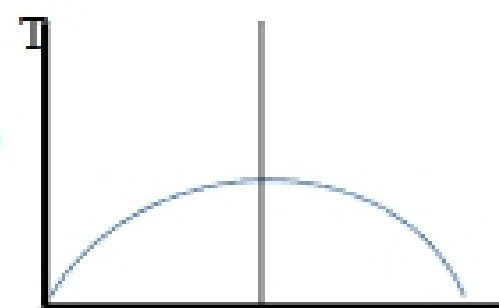
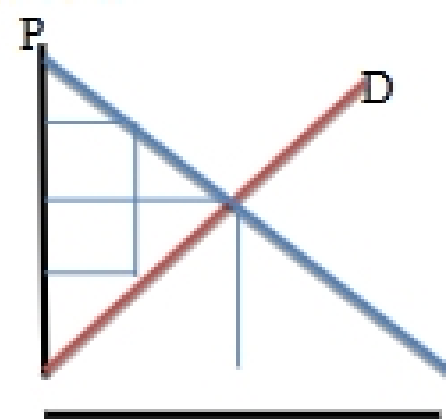


Micro Midterm #2 Study Guide

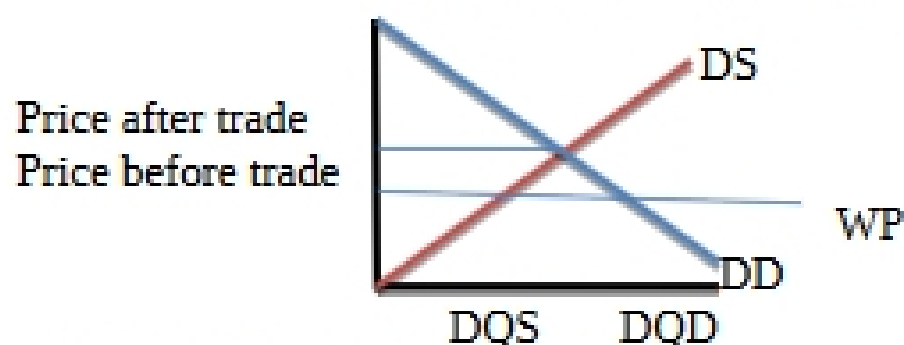
Chapter 8

- Costs of Taxation
- Tax on good levied on buyers \rightarrow demand curve shifts left
- Tax on good levied on sellers \rightarrow supply curve shifts left
- Price paid by buyers rises, price received by sellers falls
- Tax on a good causes the size of the market for the good to shrink
- Use government's tax revenue to measure the public benefit from the tax
- Tax revenue = $T \cdot Q$
- Gains and losses from a tax on a good
 - buyers: CS
 - sellers: PS
- Price elasticities of supply and demand
 - more elastic supply curve or demand curve \rightarrow larger DWL
- As tax increases \rightarrow DWL increases (more rapidly than size of tax)
 - tax revenue increases initially, then decreases
 - higher tax \rightarrow drastically reduces size of market
- Government tax's revenue = size of tax * amount of good sold
- very large tax \rightarrow no revenue would be raised b/c people would stop buying and selling the good



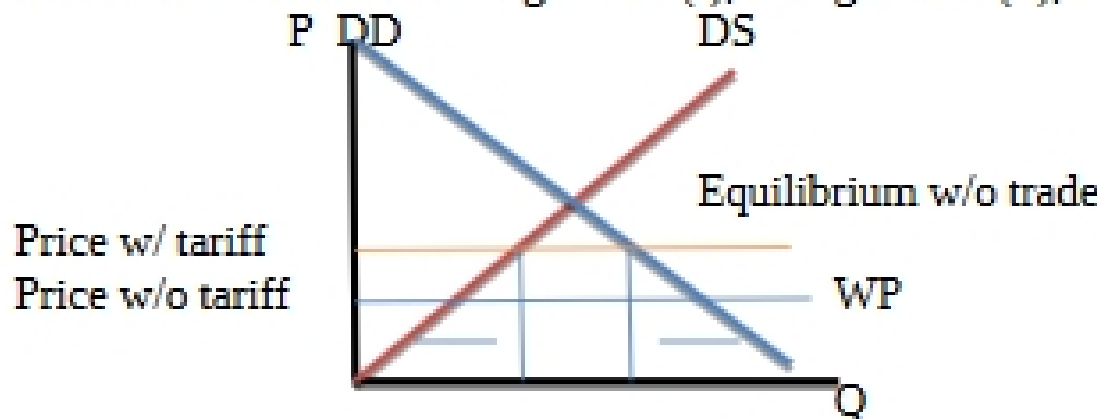
Chapter 9

- International Trade
- Regular equilibrium w/o trade
- Determinants of Trade:
 - world price \rightarrow price of a good that prevails in the world market for that good
 - domestic price \rightarrow opportunity cost of the good on the domestic market
 - small country model \rightarrow trade doesn't affect
- Compare domestic w/ world price
 - domestic $<$ world \rightarrow export good, country comparative advtg.
 - domestic $>$ world \rightarrow import good, country comparative advtg.



- Importing country:
 - domestic equilibrium price before trade is above world price
 - after trade, higher CS, smaller PS (higher ts)
 - domestic producers worse off, domestic consumers better off
 - trade raises economic well-being of a nation (gains of winners $>$ losses of losers)
- Exporting country:
 - domestic equilibrium price before trade is below world price

- once trade → domestic price raises to world
 - >domestic $Q_S > Q_D$ (difference=exports)
- domestic producers of good are better off
- **Winners and losers of Trade (protectionism)**
 - Tariff: tax on goods produced abroad and sold domestically
 - free trade-domestic price=world price
 - tariff on imports → raises domestic price above world price (by amount of tariff)
 - >domestic suppliers can sell their textiles for world price + amount of the tariff
 - tariff reduces quantity of imports and moves the domestic market closer to its equilibrium w/o trade
 - government revenue: quantity of after-tariff imports * size of the tariff
 - total welfare effects → change in CS(-), change in PS (+), change in gov. revenue (+)



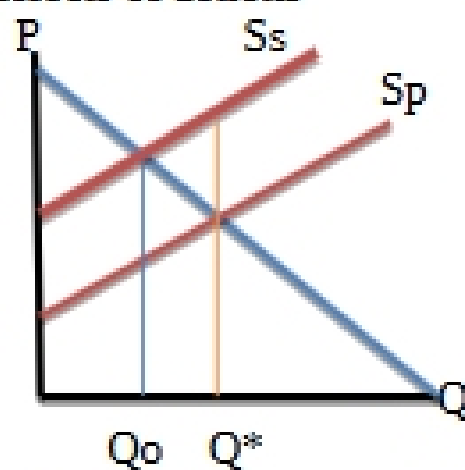
| | Before Tariff | After |
|----------|---------------|-------|
| CS | ABCDEF | AB |
| PS | G | CG |
| Gov. Rev | none | E |
| TS | ABCDEF G | ABCEG |

- $D+F=DWL$
- **Other benefits of international trade**
 - increased variety of goods
 - lower costs through economies of scale (low cost only if produced at large quantities)
 - increased competition
 - enhance flow of ideas
- **Arguments for restricting trade**
 - jobs argument → “trade w/ other countries destroys domestic jobs”
 - >free trade creates jobs at the same time that it destroys them
 - national-security argument → “industry is vital for national security”
 - >only when there are legit concerns over national security
 - infant-industry argument → “new industries need temporary trade restriction to help them get started”
 - >difficult to implement in practice
 - > “temporary” policy is hard to remove
 - >protection isn’t necessary for an infant industry to grow
 - unfair-competition argument → “free trade is desirable only if all countries play by same rules”
 - >increase in total surplus for country
 - protection-as-a-bargaining-chip argument → “trade restrictions can be useful when one bargain w/ our trading partners

>threat doesn't work, implement trade restriction which would reduce economic welfare or back down and lose prestige

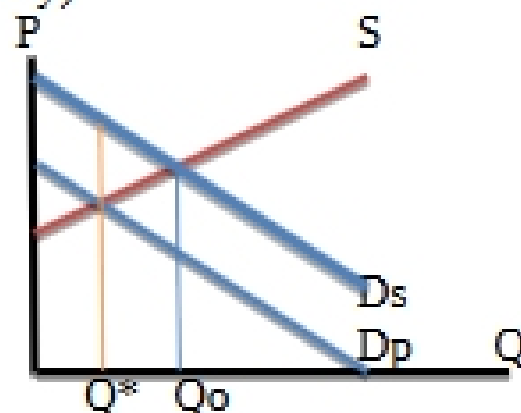
Chapter 10

- Externalities
- Externality: uncompensated impact of one person's actions on well-being of a bystander
 - market failure
 - negative externality: impact on bystander is adverse (Q down, ← too much)
 - positive externality: impact on bystander is beneficial (Q up, → to little)
- Market equilibrium: inefficient allocation of resources, buyers/sellers neglect externalities to determine demand/supply
 - not efficient when there are externalities
- Negative externality (cost to society of producing good)
 - larger than cost to good producers
 - social cost curve → above supply curve
 - >private costs of producers (supply)
 - >plus costs to those bystanders affected adversely
 - >optimum quantity → social-value curve and supply curve intersect
 - optimum (all costs are being recognized) quantity produced
 - maximize total welfare
 - smaller than market equilibrium quantity
 - government → correct market failure (tax)
 - >internalizing the externality: alternating incentives so that people take account of external effects of actions



| |
|---|
| P=private S=social (all)=private external o=optimum |
|---|

- Positive externalities
 - education (benefit=private)
 - externalities: better gov, lower crime rate, higher productivity and wages
 - social value → demand higher than private value
 - > Curve > demand curve
 - gov (subsidy)



- Command-and-control Policies