

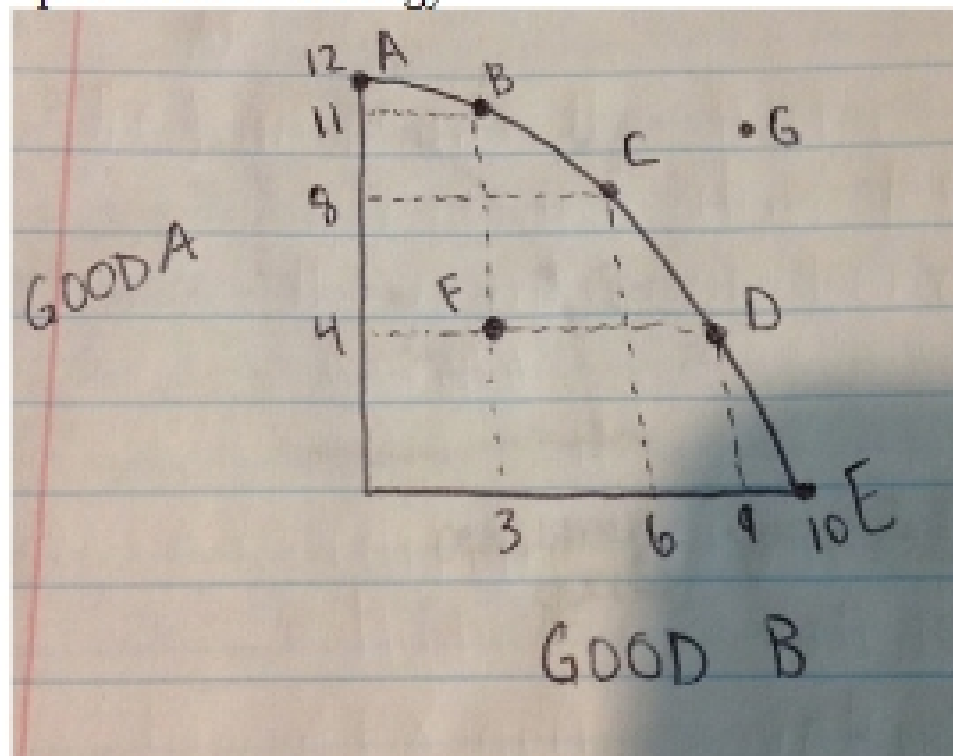
Micro Midterm Study Guide

Chapter 1

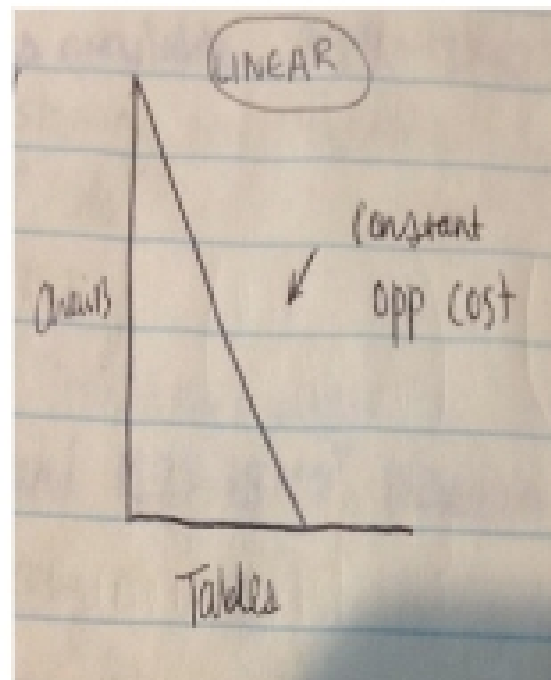
- Scarce → demand exceeds supply
- Economics: 1) How people make decisions?
2) How people interact with one another?
- Efficiency (size of economic pie)
- Equality (how pie is divided into individual slices)
- Rational decision maker → marginal benefits > marginal costs
- Trade can make people better 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

> opportunity 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 oz 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
 - $Q_d = f(p)$ → 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)