

A.P. Microeconomics

In Class Review #1

Economic Principles & Systems

Micro vs. Macro

- Economics: study decisions and use of resources
- Micro: study decisions of small units (households & firms)
- Macro: study decisions of nation as whole (govts, banking system)

Normative vs. Positive

- **Positive:**
- **Based on scientific method**
- **Hypotheses are formulated and tested**
- **Normative:**
- **Value judgments**
- **Based on the way someone believes things *ought* to be**

Ceteris Paribus

- “all others things remain unchanged”
- Used by economists to analyze economic choices when there is only one variable
- Assume nothing else changes.

Inputs or Factors of Production

- **The resources available to manufacture into outputs (G&S)**
- **LAND**
 - natural
- **LABOR**
 - Human ability
- **CAPITAL**
 - Tools, machines
- **ENTREPRENEUR**
 - Idea maker / risk taker

Economics & Scarcity

- Resources are Limited, therefore economic systems are set up to determine:
 - *What to produce?*
 - *How to produce?*
 - *For Whom to produce?*

Trade-Off & Opportunity Cost

- **T/O: choice made**
- **O/C: sacrifice because a choice was made**
- **Used with PPC models!!**
 - Study vs. working:**
 - Working means more \$
 - Studying means better grades
 - Studying now means opportunity of more \$ later

Comparative Advantage, etc.

- **Comp. Adv**: the ability to produce something with a lower opp. cost.
- **Absolute Adv**: ability to produce something more efficiently
- **Specialization**: focus on comp. adv.
And trade, hone skills leads to more efficiency

More Comparative

- What is the best choice:

	Output per Hour	
	Kristen	Anna
Wristbands	15	12
Potholders	3	2

Kristen: 1 PH = 5 WB and 1 WB = 1/5 PH

Anna: 1 PH = 6 WB and

Kristen has the comparative advantage in potholders, her O/C is least

Anna has the comp. adv. in wristbands, her O/C is least

Production Possibilities Frontier

- (PPC)
- Combinations of 2 goods that can be produced if all resources are fully employed and used efficiently

PPC, cont.

a. Guns or Butter

Used by economists when studying gov't

Guns = foreign (military) budget

Butter = domestic budget

b. Straight or Curved

Curved: Law of Increasing Opportunity Cost

when reallocating resources, some efficiency can be lost

Straight: all resources are perfectly versatile (transferable)

PPC, cont.

c. Present consumption or future choices today could foster faster growth tomorrow:

ex) capital investments can lead to more efficiency

ex) ovens & bread

Comparing Economic Systems

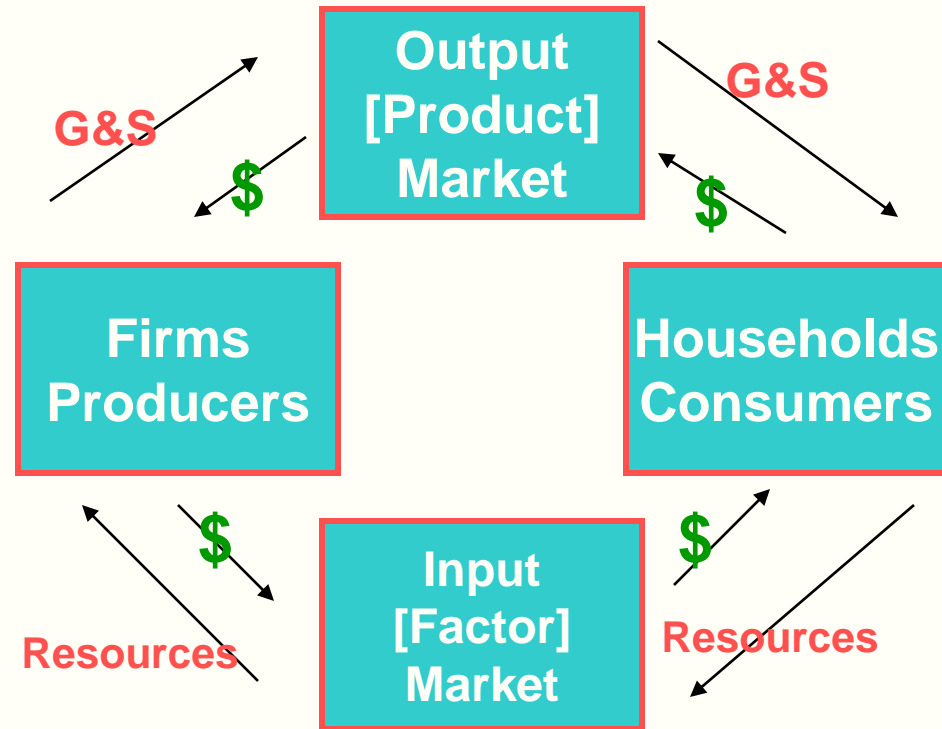
- a. Command: gov't makes eco decisions**
 - communism, N. Korea, USSR, Cuba**

- b. Traditional: past/customs make decisions**
 - tribal communities**

- c. Market: households & firms make decisions**
 - U.S., Western Europe, etc.**

Circular Flow of Economic Activity

- **Factor Market:**
market where inputs are bought and sold
- **Product Market:**
market where G&S are bought and sold



Consumers:

- The goal is to satisfy needs & wants
- Households demand when they desire, and are willing and able to buy g&s
- a. Law of Demand: as the price increase the quantity demanded decreases (and conversely)
- b. Demand Schedule & Curve
 - chart of numbers
 - graph of p & q
 - p & q have an inverse relationship
 - p on vertical, q on horizontal axis

Determinants of Demand

- Outside of price, what affects a consumer's demand for g&s?
 1. Tastes and preferences
 2. Prices of related goods – complements & substitutes
 3. Consumers' income
 4. Change in expectations

Change vs. Shift

Δ in Q.D.

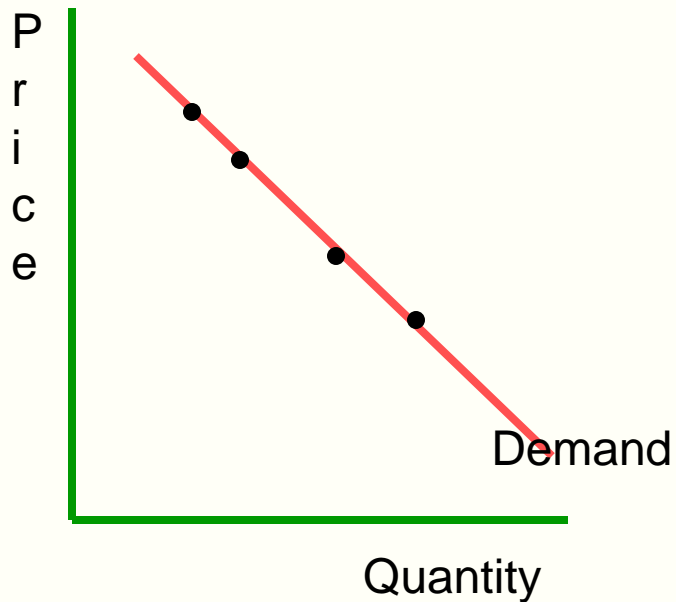
1. Law of Demand
2. Price change is cause
3. As price changes quantity will vary inversely
4. Move from point to point along same curve

Shift in Demand

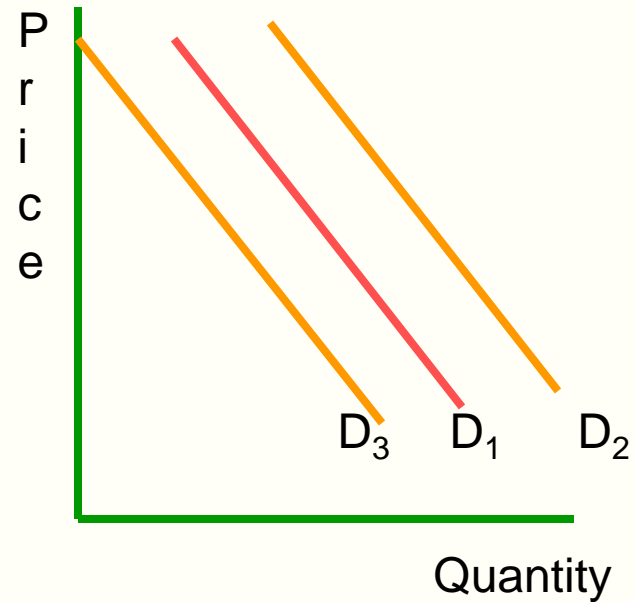
1. Demand Determinant
2. Price change is result of another factor
3. Move all quantities at same price (shift curve)
4. Increase = Right
Decrease = Left

Change vs. Shift

Δ in Q.D.



Shift in Demand



Producers

Role: make a profit

- a. Law of Supply: as price increases the quantity supplied will increase (and conversely)**
- b. Supply Schedule & Curve**
chart of #s positive graph
p and q have a direct relationship

Determinants of Supply

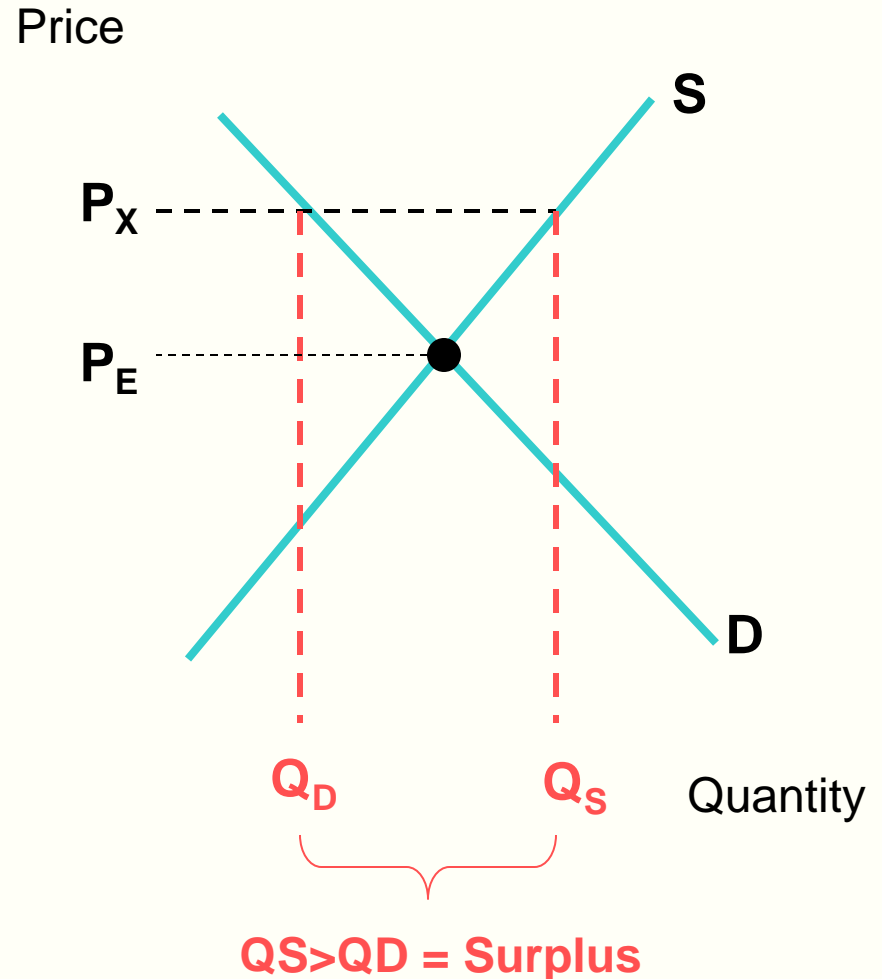
- **Outside of price, what can affect a firm's ability to offer g&s to the market?**
 - 1. Costs of resources or production**
 - 2. Technology**
 - 3. Government: regulation, taxes & subsidies**
 - 4. Number of sellers**
 - 5. Producer expectations**

Equilibrium

- Quantity supplied equals quantity demanded; the market is cleared
- On graph: the intersection of the two curves
- Adam Smith's *Invisible Hand*, guides the market to find this equilibrium w/o govt intervention

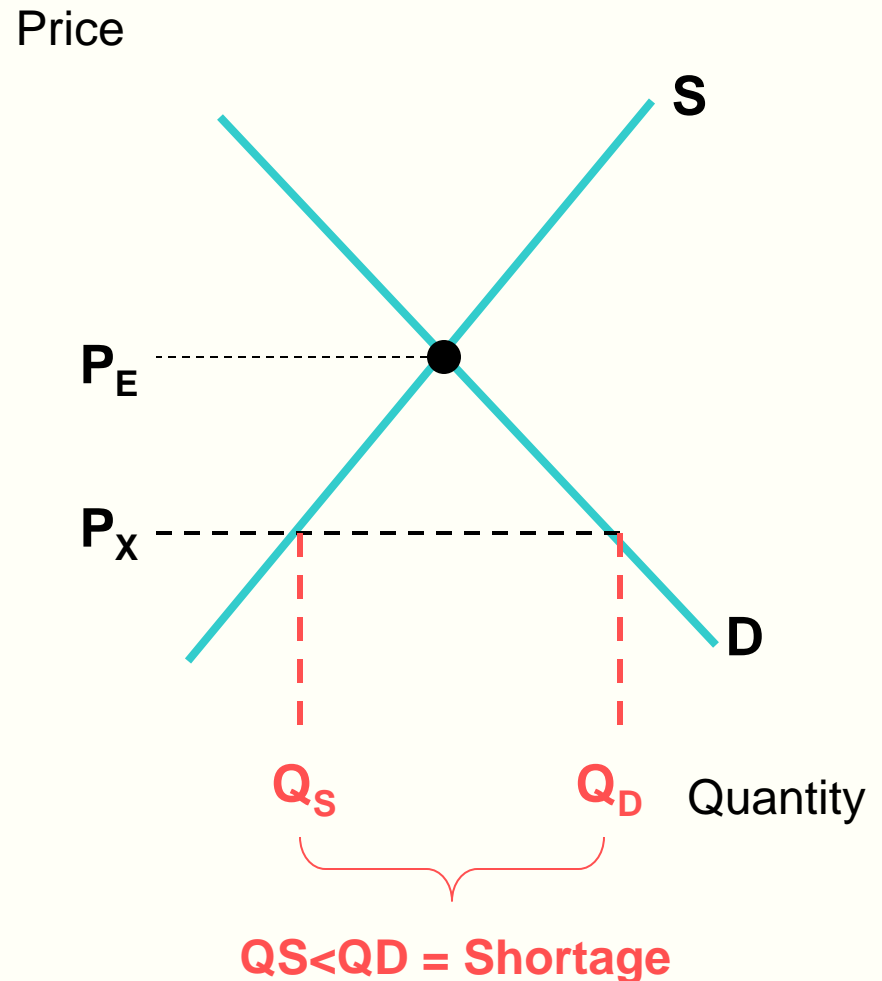
a. Surplus

- $Q.S. > Q.D.$
- Price was too high, above equilibrium: consumers not willing or able
- Result: firms must either withhold supply, lower price, or stimulate demand



b. Shortage

- $Q.S. < Q.D.$
- Price was too low, below equilibrium: consumers too eager and firms unable to meet it
- Result: firms must either increase supply or raise price



c. Price Ceiling

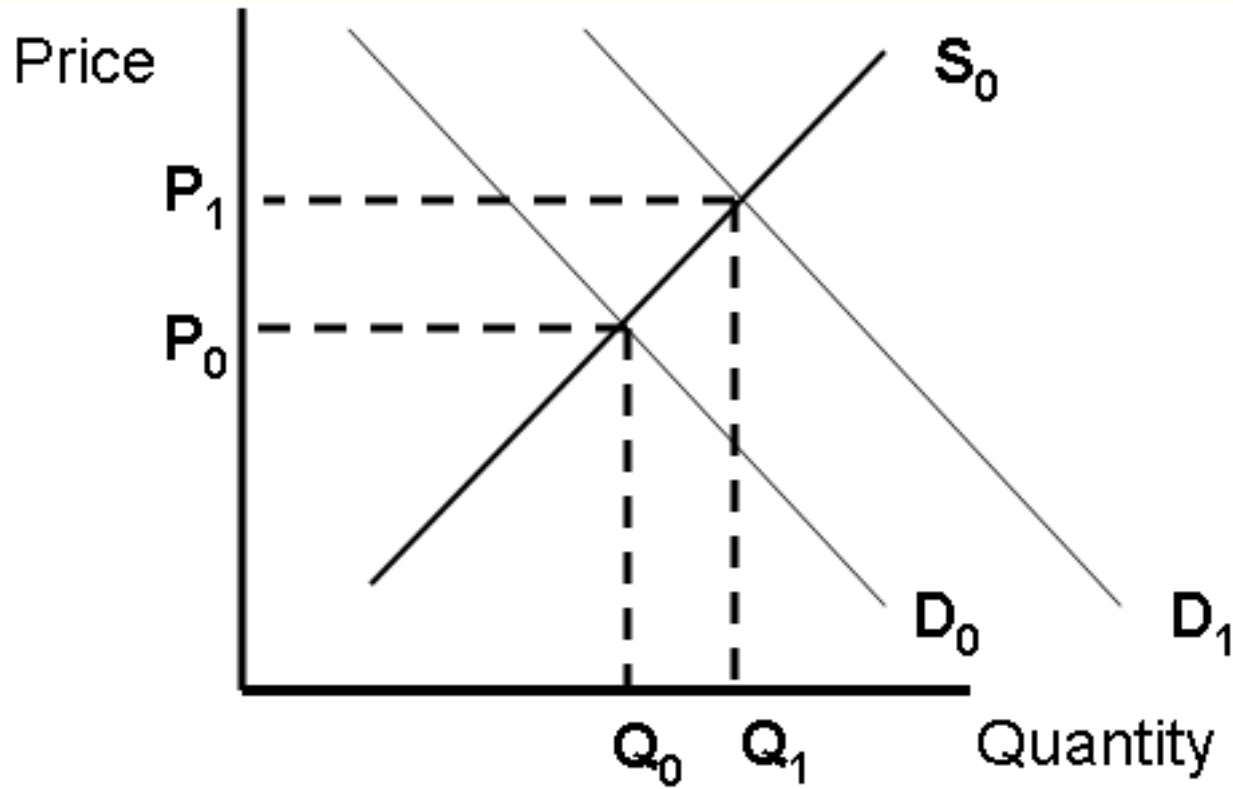
- Maximum legal price that can be charged for a product
- Goal: equity
- Ex) concert tix, rent control apts, NCAA tix

- Graph = Shortage
- Result = permanent shortage leads to black market, scalping, the market finds a way!!

d. Price Floor

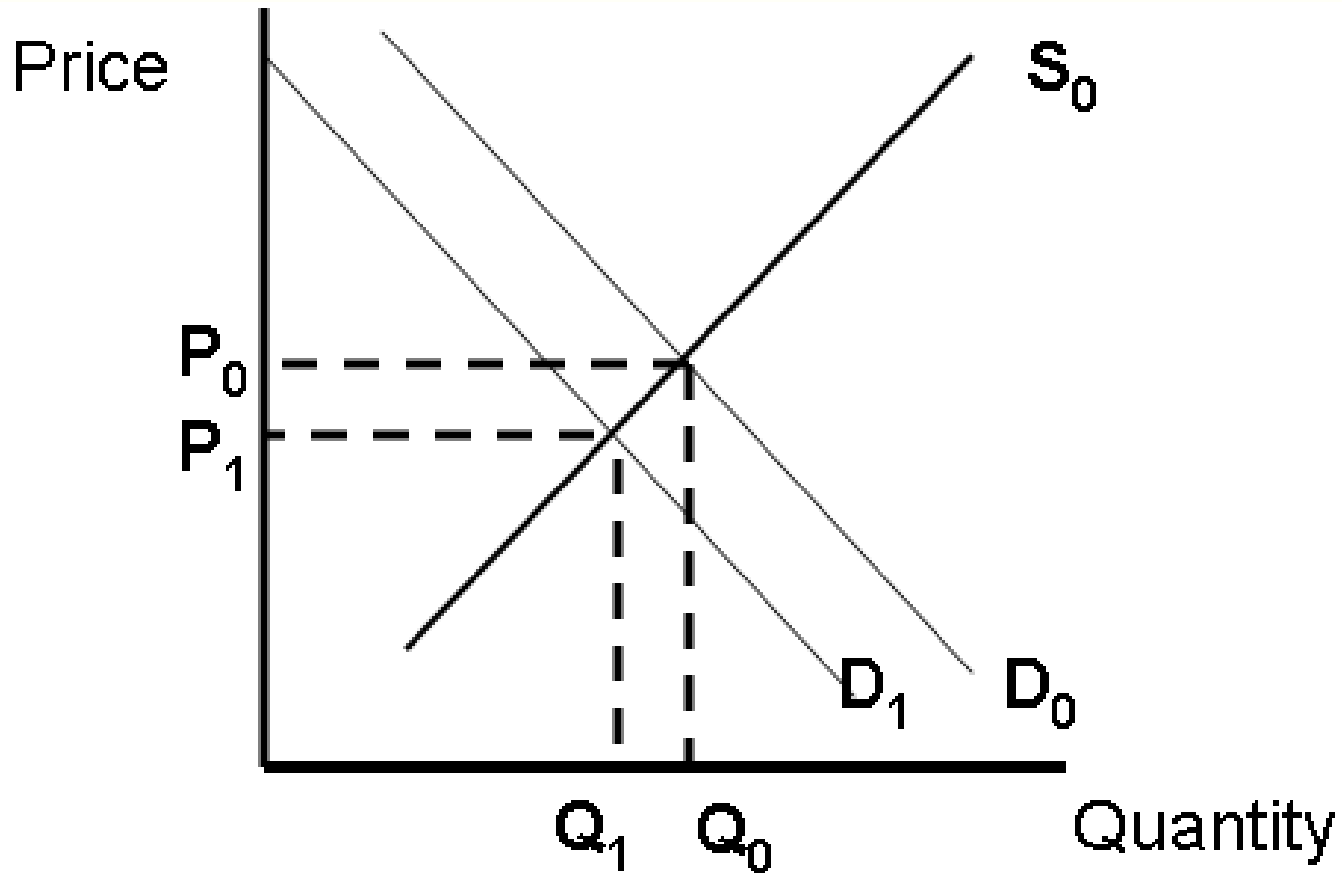
- Minimum legal price that can be charged for a g&s or even input.
- Goal: equity
- Ex) minimum wage

- Graph: Surplus (there are $S_L > D_L$)
- Result: surplus of labor leads to under-the-table wages, the market finds a way!!



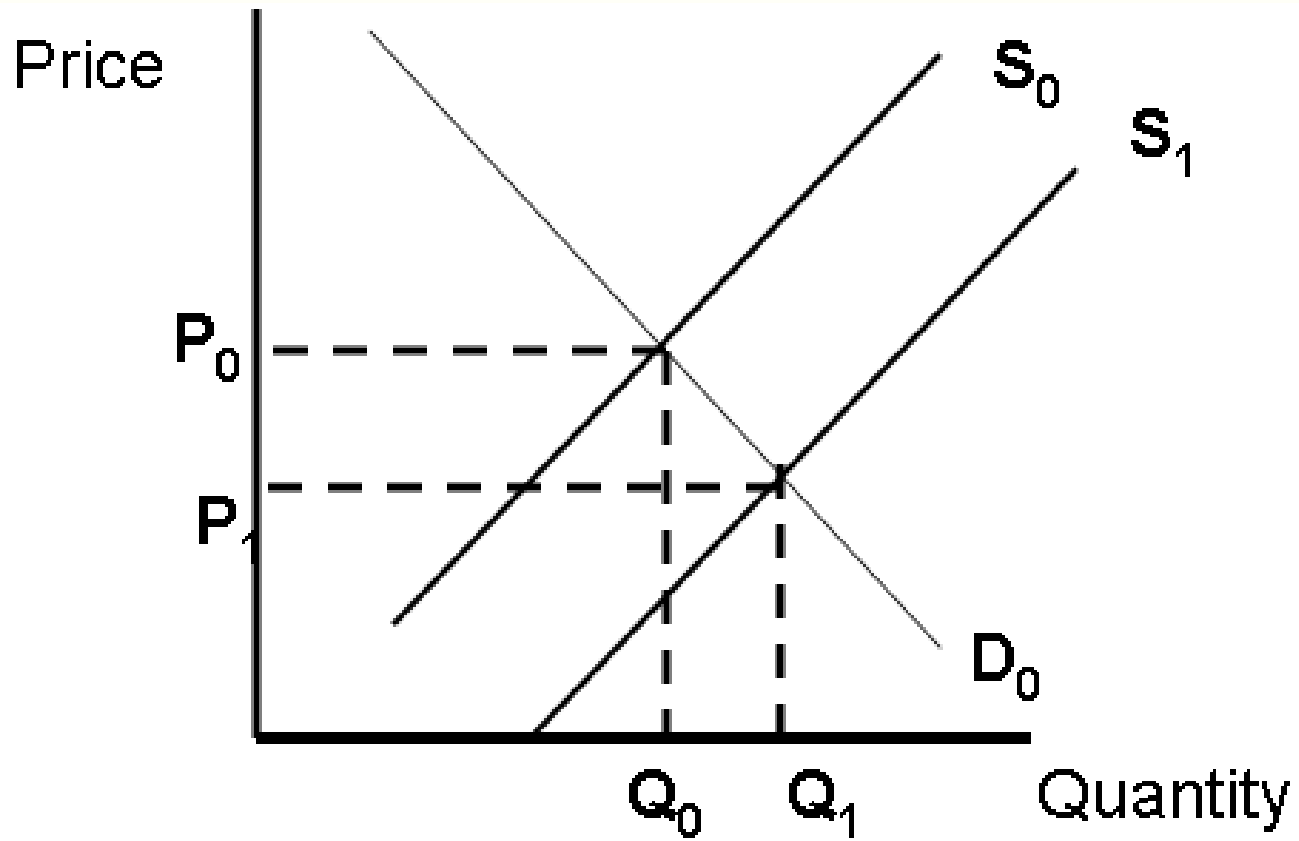
Increase in Demand

$P \uparrow Q \uparrow$



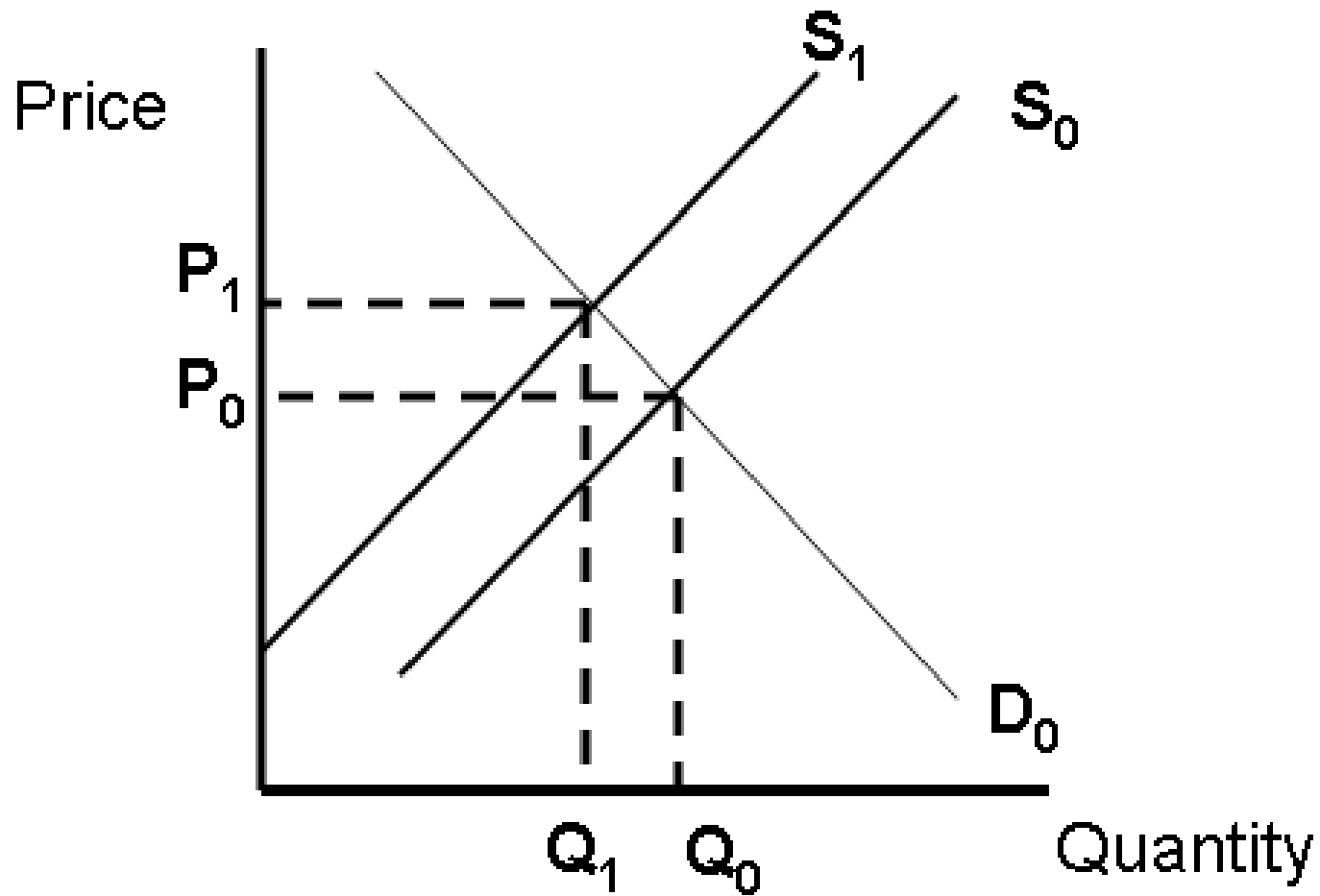
Decrease in Demand

$P \downarrow Q \downarrow$



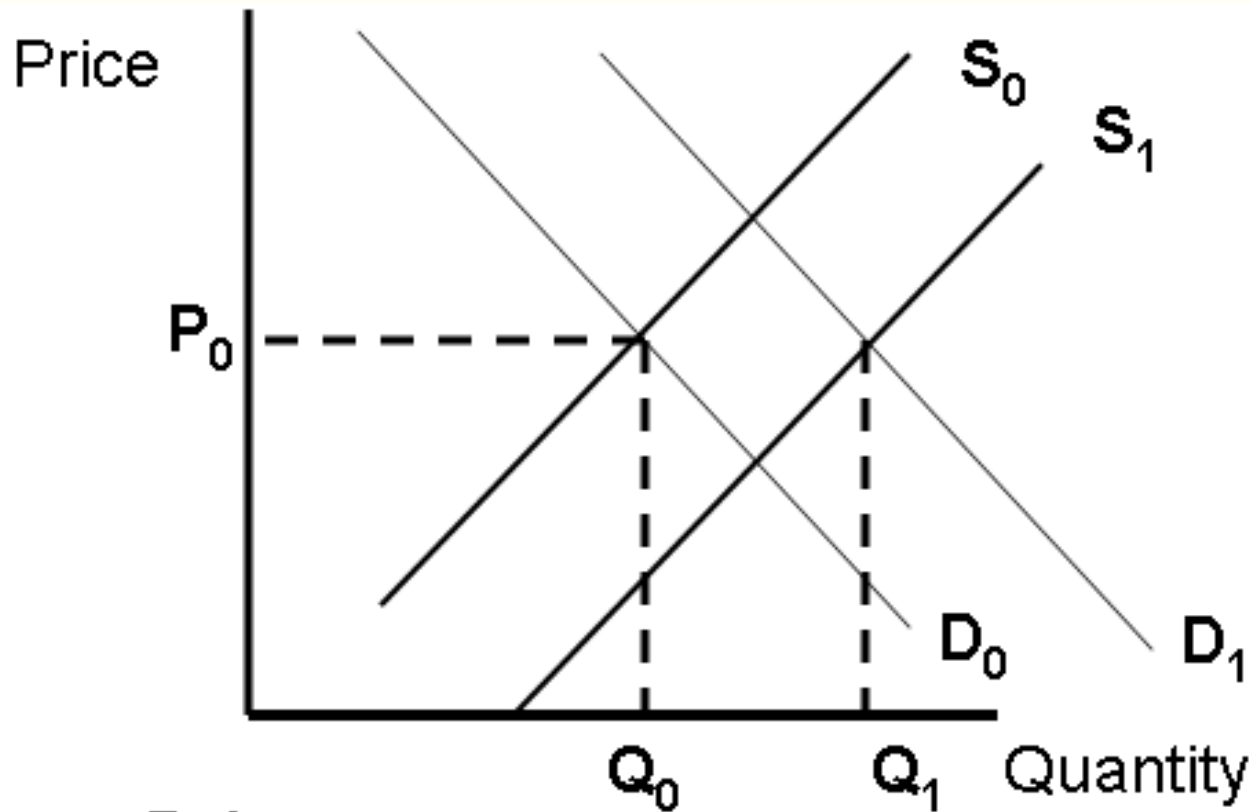
Increase in Supply

$P \downarrow Q \uparrow$



Decrease in Supply

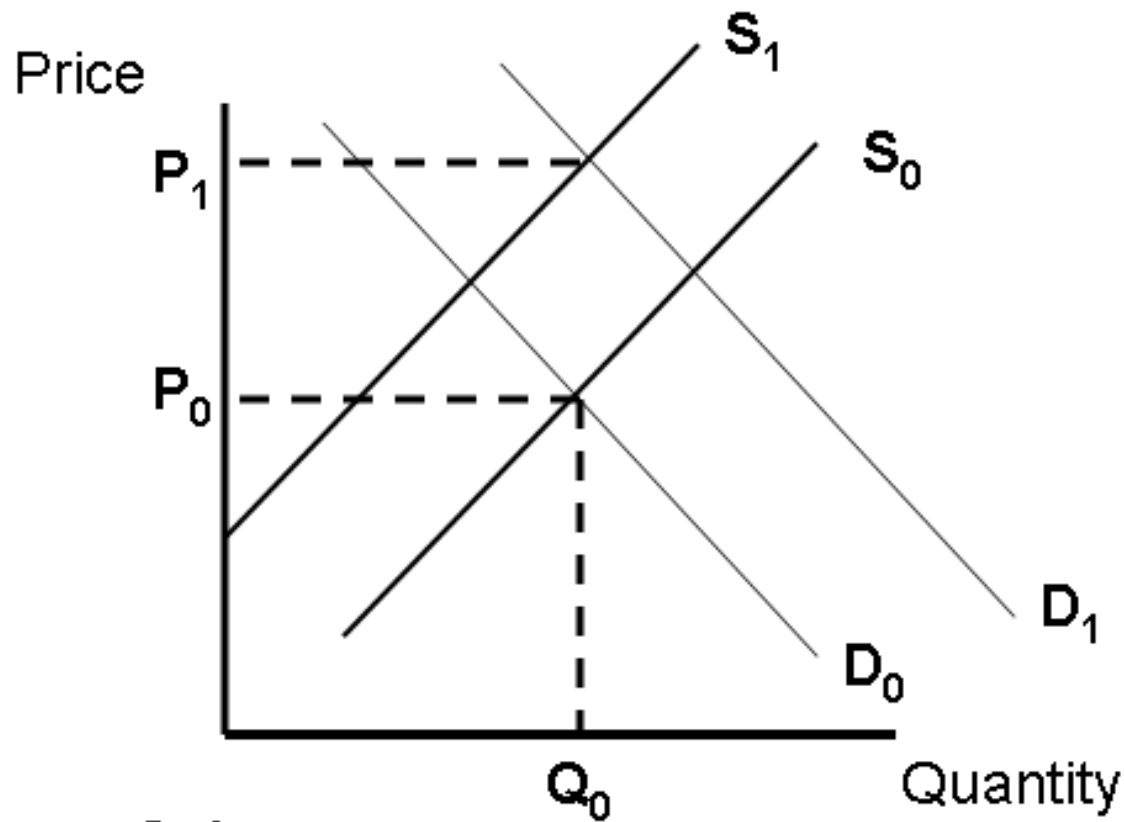
$P \uparrow Q \downarrow$



P_1 is
indeterminable

Increase in Supply & Demand

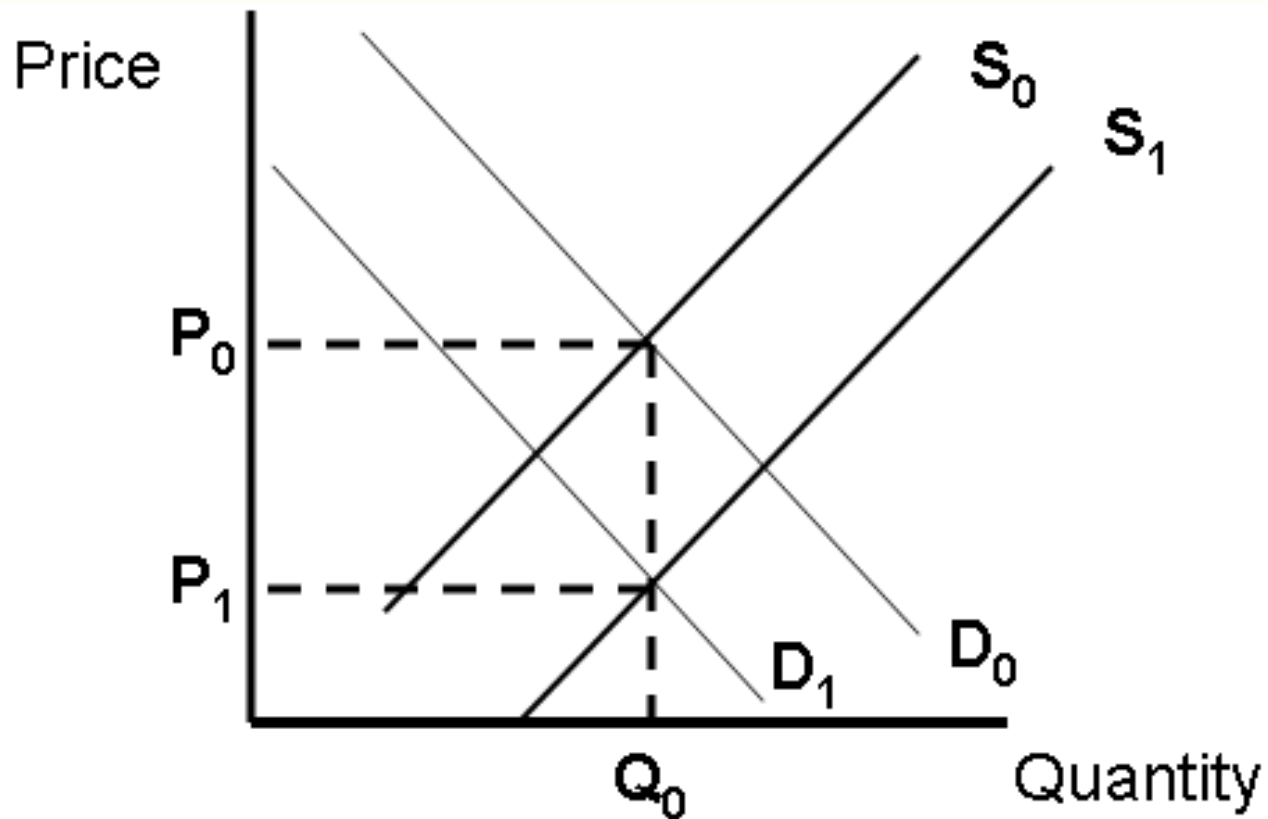
P unknown Q \uparrow



Q_1 is
indeterminable

**Increase in Demand &
Decrease in Supply**

$P \uparrow$ Q unknown

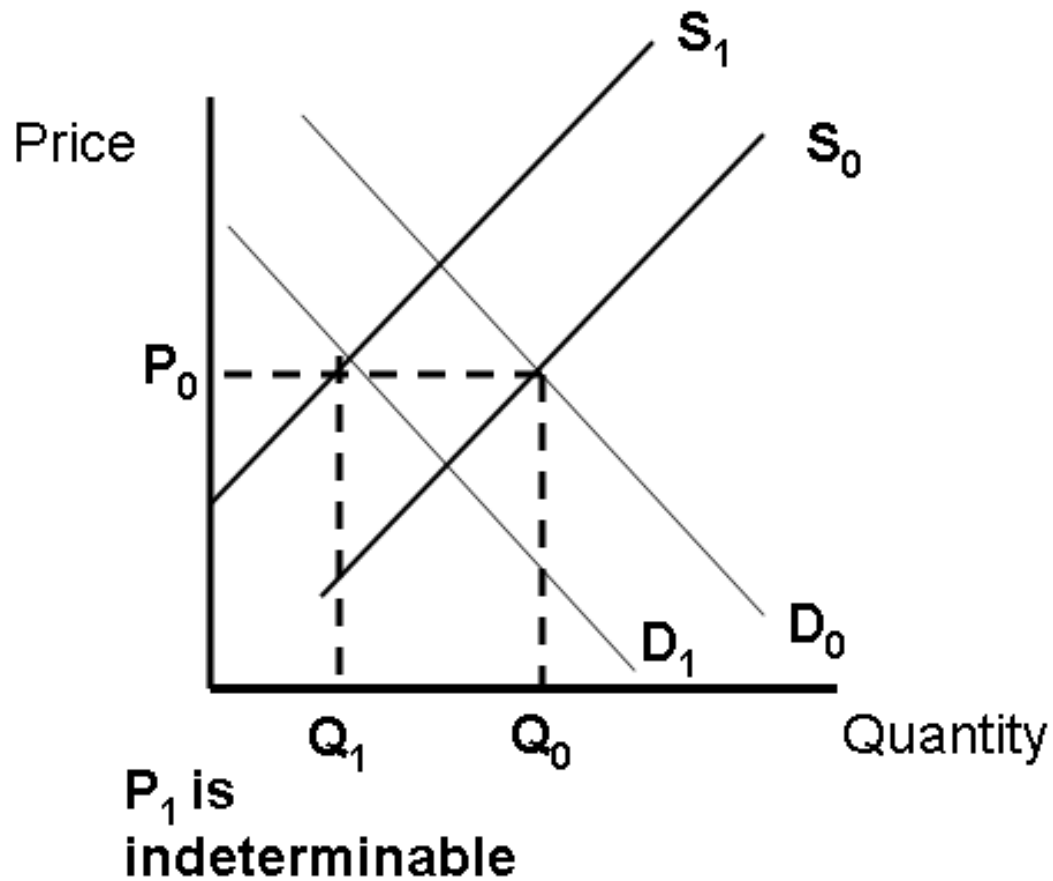


Q_1 is
indeterminable

Increase in supply &

Decrease in demand

$P \downarrow$ Q unknown



Decrease in supply & demand

$Q \downarrow$ P unknown