**TOPIC 2**

* The supply curve will SHIFT to the right if:
  + the price of inputs falls
  + the supply of inputs increases
  + technology increases
  + the natural environment becomes more favourable, such as with good weather
  + the number of suppliers increases

There are **four main characteristics** of perfect competition:

* Large numbers of buyers and sellers
* Homogeneous or identical products
* Information flows very quickly and accurately
* Ease of entry into and exit from the market.

Eg, the demand curve will shift to the RIGHT if:

* + consumers’ incomes increase (for a normal good)
  + population increases
  + people’s tastes change toward the good
  + the price of complementary goods falls
  + the price of substitutes rises

**TOPIC 3**

* **Why is the share market so volatile?**

Because expectations are volatile:

* + is the economy heading into sustained growth or a recession?
  + impact of technological change on product S&D
  + political change
  + informational problems

**TOPIC 4**

Factors influencing own price elasticity:

* Availablity of substitutes
* Proportion of income spent on the good
* Significance of price in total cost to a consumer
* Normal or inferior good
* Time horizons (adjustment period)
* How Narrowly we define the market (i.e. food vs steak)

**TOPIC 5**

**Sometimes people interfere with markets, eg with:**

* + Price and quantity regulation
  + Taxes and subsidies
  + Environmental policy

**PROBLEMS With Coase Theorem:**

* Bargaining costs
  + Large number of parties involved
  + Complex, technical issues; knowledge in a state of flux
  + Specifying and enforcing the bargaining contracts
* Free-riders
* Hold-out minority
* Income inequality/income distributional problems

**TOPIC 6**

**Factors that favour performance pay:**

* Employees’ output is sensitive to their effort
* Employees are not very risk averse
* The level of risk that is beyond the employees’ control is low
* Employees respond highly to increased incentives.

**TOPIC 7**

* How is the budget line affected by the following situations?
  + Price discounts – e.g. buy one pizza slice and additional slices at half price (block pricing – Topic 9)
  + Connection fees (two-part pricing – Topic 9) – e.g. internet $30 per month base fee and $3 a gigabyte
  + Quantity constraints and rationing – e.g. a maximum of three drinks per person
  + Combinations of these – e.g. text messaging at $25 a month, which gives you 1000 ‘free’ texts, then 20c each text after that
* Let’s see how we can influence consumers to buy more of our product, *x*:
* By influencing the budget constraint, e.g.
  + Lowering our price
  + Price discount for additional purchases (block pricing) – we’ll cover this in Topic 9
  + Fixed charge plus lower price (two-part pricing) – we’ll cover this in Topic 9
* By influencing preferences, e.g.
  + Advertising – we’ll cover this in Topic 9
* Consider the income and substitution effects for inferior and normal goods
  + For normal goods, the income and substitution effects reinforce each other (i.e. work in the same direction) -> relatively more elastic
  + For inferior goods, the income and substitution effects work in opposite directions -> relatively less elastic

**TOPIC 8**

* The goal for the firm then is to find the price that will maximise their profit
  + For a perfectly competitive firm, this is the market price – they are **price takers**
  + For a firm with market power, they can set any price they want – they are **price makers**
* How do firms get market power?
  + By moving away from the conditions of perfect competition!
    - Few sellers (rather than many sellers)
    - Selling a differentiated product (rather than the same product)
    - Restricting information to buyers or other firms
    - Creating barriers to entry or exit in the market
* Barriers to entry can be created when:
  + A key resource is owned by a single firm
    - e.g. DeBeers (diamonds)
  + The government gives a single firm the exclusive right to produce some good or service
    - e.g. Prescription medicines (patented)
  + Costs of production make a single producer much more efficient than a large number of smaller producers (economies of scale)
    - e.g. Transpower (electricity transmission)
* If monopolies have so many bad social effects, then government might use policy to restrict the market power of monopolies, or prevent them forming, e.g.
  + **Price regulation**, to force the monopoly to charge a price closer to the perfectly competitive price
  + **Public ownership**, where the government owns the monopoly firm and charges the price that most benefits society (maybe!)
  + **Antitrust laws**, which can be used to prevent monopolies from forming (preventing mergers). The Commerce Commission performs this role in New Zealand.
* The necessary conditions for effective price discrimination are:
  + Different price elasticities of demand for groups of customers
  + Different groups of customers can be identified
  + No transfers across submarkets
* We have seen that firms with market power can be bad for society as a whole:
  + Deadweight loss, rent seeking, X-inefficiency
  + This applies to oligopolies as well as to monopolies if the oligopoly firms cooperate and/or form a cartel
* Government also uses policy to restrict business practices, such as:
  + Resale price maintenance – when a wholesaler or manufacturer requires retailers to not sell its products below a specified retail price
  + Predatory pricing – when a firm sells its product at an artificially low price in order to drive out competitors

**TOPIC 9**

* In theory, we use MC=MR (see Topic 8), but in practice managers may not know exactly the demand curve and therefore MR is unknown (as in the two exercises we just did)
* In this case, managers could either:
  + Try to estimate demand using market research (costly)
  + Use heuristics (rules of thumb) in order to price their product
    - Keep prices the same, even when market conditions change (it’s costly to change prices)
    - Use cost-plus or markup pricing
* Coupons and rebates
  + Users likely to be more price sensitive
  + Users who are new customers may stick with the product
  + This is a type of price discrimination and/or multi-period pricing
* Bundling (or tying)
  + Theater season tickets, restaurant fixed price meals
  + Works best when demand for different goods is heterogeneous
  + Tying (which is often illegal) occurs when the customer is not able to separately purchase the goods/services and must buy the bundle if they want either good
* Consider the effect of advertising on consumer demand for your product
  + Effective advertising makes your product more appealing to consumers
  + This increases the marginal rate of substitution (consumers are willing to give up more of other goods to purchase your good)
  + This makes the indifference curves steeper at each and every point
  + Consumers will buy more of your product
* Increasing product quality has a similar effect on consumers

**TOPIC 11**

* Adam Smith (1776) suggested there are gains from trade because of:
  + Mutual gains from voluntary exchange of existing goods
  + Increasing competition
  + Division of labour

Better use of skills and resources (efficiency gains)

* Why do some countries have comparative advantage in the production of certain goods?
  + Differences in climate and natural resources
  + Investment and saving decisions over time
  + Factor abundance of countries
  + Factor intensity of industries
* Each country should:
  + Specialise in what it has comparative advantage in producing
  + Trade with other countries for goods that it has comparative disadvantage in producing
* In particular, free trade refers to the absence of policies that restrict trade, such as:
  + Tariffs on imports or exports
  + Quotas on imports or exports
  + Non-tariff trade barriers (such as subsidies to domestic firms, local content requirements, bogus health-and-safety requirements, or other regulations or laws) that give domestic firms, households or factors of production an advantage over foreign ones
* We have shown that there are gains from trade, even when a country is more efficient (has absolute advantage) in producing everything
* Other arguments for free trade include:
  + Increased variety of goods (some goods would not be available without trade)
  + Economies of scale (lower costs due to higher production)
  + Increased competition in the market (higher total welfare)
  + Division of labour leads to more efficiency in production (lower marginal costs of production)
  + Better use of skills and resources (resources flow to the most efficient industries)
  + Enhanced flow of ideas (transfers of technology)
* If there was no trade:
  + Every country could only consume what they produced themselves
  + The **Consumption Possibilities Frontier** (CPF) for each country would be the same as its Production Possibilities Frontier (we can label the PPF as the CPF without trade)
  + The country would be consuming on the highest ‘aggregate indifference curve’ they can get to
* The arguments against free trade include:
  + The jobs argument
  + The national security argument
  + The “infant industry” argument
  + The “protection-as-a-bargaining chip” argument
  + The unfair competition argument