CHEAT SHEET

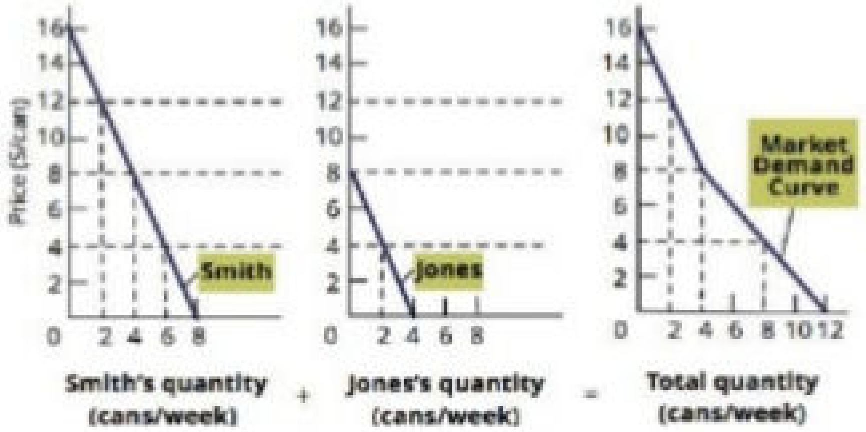
Want - something you would like to have, but don't need, e.g. ribs. Demand represents wants

Law of diminishing marginal utility – additional utility (benefit) of consuming an extra unit of a good decreases with consumption

Rational spending rule – Spend until marginal benefit = marginal cost

Law of Supply – Quantity supplied goes up as price goes up and vice versa

Constructing Market demand and supply curves – Add HORIZONTALLY

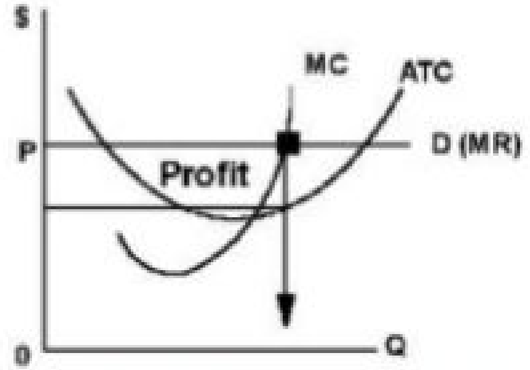


Perfect competition – Profit maximizing firms, price takers, identical products, many buyers and sellers, no barriers to entry or exit, well informed buyers and sellers

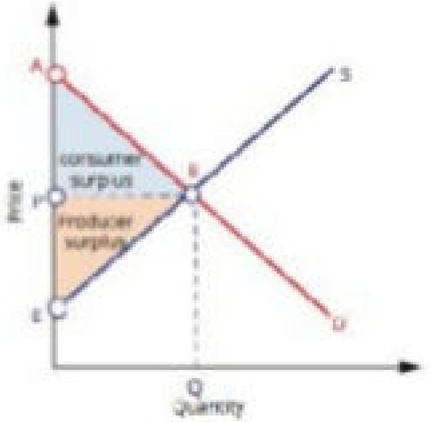
Fixed costs – Don't change

Variable costs – Change with production

Profit maximization rule – Price = Marginal cost



Consumer and Producer surplus – Difference between reservation price and price paid



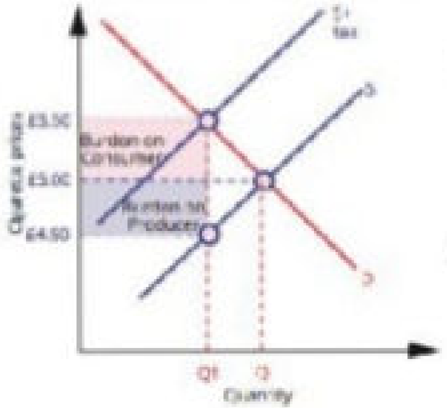
6 Efficiency and Exchange

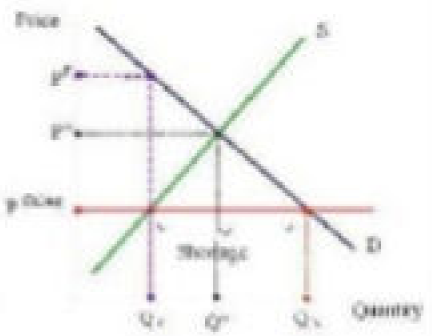
Pareto improvement – Somebody is made better off and nobody is made worse off

Pareto efficiency – No more Pareto improvements can occur

Economic surplus in a market is maximized when exchange occurs at the equilibrium price

Causes of deadweight loss – Price floors, price ceilings, price subsidies, taxes





7 The Quest for Profit and the Invisible Hand

Accounting profit – Revenue - explicit costs;

Economic profit – Accounting profit – opp. costs

Normal profit – Economic profit = 0 (Normal profit is opportunity cost)

Invisible Hand theory – Buyers and sellers acting selfishly and independently will result in socially optimal allocation of resources and best outcome for everyone

Forms of market efficiency

	Weak	Semi-strong	Strong
Info reflected in share price	Private	Public	Both

8 Monopoly and other forms of Imperfect Competition

Price taker – Firm will lose all sales if price higher than market price. Demand curve is perfectly elastic.

Price setter – Firm can change price and not lose all sales. Demand curve is downward sloping.

Three types of imperfect competition

Pure monopoly	Oligopoly	Monopolistic competition
Single firm	Few large firms	Many firms with differentiated products
Sydney airport	ANZ, CBA, Westpac, NAB	Restaurants

Monopolies arise from – Exclusive access to resources, government, economies of scale

Economies of scale – Average cost goes down as production goes up. Average cost = (Fixed costs + Variable costs) / Quantity; FC/Q goes down with Q, VC/Q goes up (diminishing marginal returns). Diseconomies of scale when average starts to rise