Topic Outline for ECO101

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Oct. 2. 2017

Contents

1 What is Economics?

1.1 Basic ideas.

Scarcity Our inability to get everything.

Economics is the *social science* that *studies the choices* that individuals, businesses governments , and entire societies make as they cope with *scarcity* and the *incentives* that influence and reconcile those choices.

Central problems

1. *What* to produce.
2. *How*: allocation of **factors of production**
   - Land earns **rent**
   - Labour earns **wages**
   - Capital earns **interest**
   - Entrepreneurship earns **profit**
3. *For whom*: allocation of products among agents.

1.2 Economics as Social Science and Policy Tool

Positive Statements is about what *is*, and can be tested.

Normative Statements is about what *ought to be*, and can **not** be tested.

2 The Economic Problem

Production Possibility Frontier(PPF) is the boundary between those combinations of goods and services that can be produced and those that cannot. PPF is concave due to *increasing of opportunity cost.*

Production Efficiency produce at the *lowest* possible cost.

Allocative efficiency When goods and services are produced at the lowest possible cost and in the quantities that provide the greatest possible benefit.**MC=MB**.

Opportunity Cost of an action is the *highest-valued* alternative forgone.

Marginal Benefit *willingness to pay.*

The Cost of Economic Growth

Comparative advantage advantages on *opportunity cost.*

Absolute advantage advantages on *actual cost.*

Economic Coordination firms, markets, property rights, money.

3 Demand and Supply

3.1 Demand

The Law of Demand Other things remaining the same, the higher the price of a good, the smaller is the quantity demanded; and the lower the price of a good, the greater is the quantity demanded.[1]

- Substitution effect.
- Income effect.

Factors affecting demand

- The prices of related-goods.
- Expected future prices.
- Income.
- Expected future income and credit.
- Population.
- Preferences.

3.2 Supply

Law of supply Other things remaining the same, the higher the price of a good, the greater is the quantity supplied; and the lower the price of a good, the smaller is the quantity suppled.

[1] Graph required?

Factors affecting supply

- The prices of factors of production.
- The prices of related goods produced.
- Expected future pries.
- The number of suppliers.
- Technology.
- The state of nature.

⋆ **Shifting of demand and supply: diagrams** .

4 Elasticity

Calculating PED

- By definition.
- Mid-point.
- PED at a point.

Factors influencing PED

Total revenue and PED

XED

PES

YED [2]

5 Efficiency and Equity

Consumer/Producer Surplus

Marginal social benefit and marginal social cost

[2]See page 97 for a compact table

Source of market failure

- Price/quantity regulations.
- Taxes and subsidies.
- Externalities.[3]
- Public Goods and Common Resources.
- Monopoly.
- High transactions costs.

Fairness? *Fair-results* v.s. *Fair-rules*

- **Fair-results** require income transfers from the rich to the poor.
- **Fair-rules** require property rights and voluntary exchange.

6 Government Actions in Markets

Examples [4]

- A housing market with a *rent ceiling*.
- A labour market with a *minimum wage*.

Taxes/Subsidies

- Diagram.
- Tax incidence: related to *relative elasticity*.

Illegal Goods. *black market*.

7 Global Markets in Action

Comparative advantages drives international trade. Consider domestic price and international price(trade price) to calculate the *fair price* for international trade.

Rent seeking is the lobbying for special treatment by the government to create economic profit or to divert consumer surplus or producer surplus away from others.

[3] diagram!
[4] diagram!

Protection methods:

- import quota.
- tariff.
- subsidies to domestic producers.

Protection reasons:

- Infant industry.
- Jobs.
- Dumping?

8 Utility and Demand

Consumption choice

- Preferences.
- Budget line.
- Diminishing in marginal utility.

Utility-Maximizing Choice

New ideas :

- Behavioural economics.
- Bounded rationality.
- Neuro-economics.

9 Possibilities, Preferences, and Choices

Consumption Possibilities

- Budget.
- Indifference curve.
- Marginal rate of substitution.
- Price effect. *Substitution effects* and *Income effect*.

10 Organizing Production

Goal Maximizing *economic profit.*

Normal profit the opportunity cost of entrepreneurship and is part of the firm's opportunity cost.

Technologically efficient when a firm uses the least amount of inputs to produce a given output.

Economies of scale

Economies of scope

Four-firm concentration ratio

Herfindahl-Hirschman Index

Implicit rental rate the firm's opportunity cost of using the capital it owns.

11 Output and Costs

Diagrams !!!!

- Short Run v.s. Long run.
- A(T)FC, A(T)VC, ATC, TC.
- Increasing/Decreasing/Constant returns to scale.
- Minimum efficient scale.
- Marginal cost/product.

12 Perfect Competition

Diagrams !!!

Equilibrium MC=MR=P=D

- MR
- Short run supply
- Shutdown point
- Total revenue.

13 Monopoly

Causes of monopoly

Diagrams !!! MR=MC.

Price discrimination

Monopoly regulation

14 Monopolistic competition

Downwards sloping demand. *Product differentiation*

Long run entry and exit causes zero economic profit.

15 Oligopoly

Anti-combine Law

Game theory analysis

Nash equilibrium

16 Externalities

Difference between social benefit(cost) and private benefit(cost).

Diagrams !!!

17 Public Goods and Common Resources

Analyzing with the externalities.

Public good is *non-rival* and *non-excludable*, so it creates *free-rider problem.*

Tragedy of commons lack of private incentives.

18 Markets for Factors of Production

Bilateral monopoly

Derived demand for factors of production.

Hoteling Principle Traders expect the price of a non-renewable natural resource to rise at a rate equal to the interest rate.

Monopsony

Value of Marginal Product