Lab 6 – Test Review

Test Review

1. Marginal Analysis – a method used by economists to study decision making based on the idea that it's possible for you to gain from engaging in more of an activity if MB > MC
    a. Seek to gain by acting when MB > MC and not engage when MB < MC
    b. Suppose you are an avid coffee drinker. At your local Starbucks, you can get a cup of coffee for $4. Your marginal benefit for coffee is shown below. How much coffee will you consume at Starbucks?

Cups of Coffee	Marginal Benefit	Marginal Cost
1	$11	
2	$10	
3	$8	
4	$5	
5	$1	

    c. If the price of coffee doubles, then how much coffee will you consume?

2. Production Possibilities Curve – represents the maximum possible output of one good that can be produced with available resources, given the output of the alternative good over a period
    a. Calculating average opportunity cost per unit of good gained:
    b. Why is the PPC shaped the way it is?
    c. Ways the PPC could shift:
        i.
        ii.
        iii.

3. Budget Line – a graphical illustration of your possibilities for consumption given two goods, prices of the goods, and your income
    a. Assume you have $70 to spend each week on food. You can choose between steak ($10) or top ramen ($0.70). Draw your budget line. What does the slope represent?

    b. Suppose your income decreases by 10%, also the price of steak decreases to $9 and the price of top ramen decreases to $0.60. What is the opportunity cost of steak now? Of top ramen?

4. Demand
    a. Law of Demand, as the price of a good _________, the amount of the good demanded ________
    b. Reasons for a change in demand:
        i.
        ii.
        iii.
        iv.
        v.
    c. Reasons for a change in *quantity* demanded:
        i.
        ii.

5. Supply
    a. Law of Supply – as the price of a good ________, the amount of the good supplied __________
    b. Reasons for a change in supply:
        i.
        ii.
        iii.
        iv.
        v.

c. Reasons for a change in *quantity* supplied:
   i.
   ii.

6. Market Equilibrium
   a. We call equilibrium the point where demand=supply
   b. Suppose we are given a market price above the equilibrium. Will this result in a shortage or surplus?

      What if we are given a market price below the equilibrium?

   c. Price Ceiling – a maximum price that can be legally charged for a good/service
      i. This is effects the market price only when placed below the equilibrium level

   d. Price Floor – a minimum price that can be legally charged for a good/service
      i. This effects the market price only when placed above the equilibrium level

7. Price Elasticity
   a. Elasticities show relative changes and are a ratio of the percent change in quantity demanded/supplied to a change in price
      i. Elasticity Formula:

      ii. Percentage Change Formula:

   b. We call a good elastic when its absolute value of elasticity is _________ than 1.
      i. What does this imply about the magnitude?

   c. We call a good inelastic when its absolute value of elasticity is __________ than 1.
      i. What does this imply about the magnitude?

d. To increase total revenue, how should a firm change its price?
    i. Elastic Good:

    ii. Inelastic Good:

e. To increase total revenue, how should a firm change its quantity?
    i. Elastic Good:

    ii. Inelastic Good:

8. Tax Shifting
    a. Suppliers bear all the burden when:
        i. Perfectly Inelastic Supply:

        ii. Perfectly Elastic Demand:

    b. Demanders bear all the burden when:
        i. Perfectly Elastic Supply:

        ii. Perfectly Inelastic Demand: