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1 Chapter 3

1.1 Introduction

- Markets are any arrangements that enable buyers and sellers to get information and do business with each other
- Competitive Market: many buyers and many sellers so no single buyer or seller can influence prices

1.2 Demand

- Reflects the buyers' side of the market
- If you demand something, you
 - want it
 - can afford it
 - have a definite plan to buy it
- Quantity demanded: amount that consumers plan to buy during a particular time @ a particular price
- Law of Demand: other things remaining the same, the higher the price of a good, the smaller the quantity demanded (and vice versa)

- Substitution Effect: when the relative price of a good rises, people seek substitutes so the quantity demanded decreases
- When the price of a good rises relative to income, people cannot afford all the things they previously bought so quantity demanded decreases
- Demand Curve and Demand Schedule
 - the term demand refers to the entire relationship between good and quantity demanded
- Demand Curve: exhibits relationship between quantity demanded and price when all other consumers' planned purchases remain constant
- Willingness and Ability to Pay
 - The smaller the quantity available, the higher the price someone is willing to pay for another unit
 - Willingness to pay measures marginal benefit
- Changes in Demand: when some influence on buying plans other than price changes, there is a shift in demand for that good
- 6 factors influencing demand:
 - Price of related goods
 - * substitutes - good that can be used in place of another
 - * complement - good that is used in conjunction with another
 - * If \$ substitute inc or \$ complement dec, demand of good inc
 - * if \$ substitute dec or \$ complement inc, demand of good dec
 - Expected future prices
 - * if expected future price inc, current demand inc
 - * if expected future price dec, current demand dec
 - Income
 - * normal good: a good for which demand inc as income inc
 - * inferior good: a good for which demand dec as income inc
 - * if expected future income increases/credit is easier to get, current demand inc
 - Population
 - * The higher the population, the higher the demand

- Preferences
 - * People with the same income have different demands if they have different preferences

1.3 Supply

- If a firm is a supplier, they
 - have the resources and tech to produce it
 - can profit from producing it
 - has a definite plan to produce and sell it
- Quantity supplied: the amount producers plan to sell during a given time at a particular price
- Law of Supply: Other things remaining the same, the higher the price of a good, the greater the quantity supplied (and vice versa).
- Supply Curve and Supply Schedule
 - Minimum supply price: As quantity produced inc, marginal cost inc.
 - The lowest price at which someone is willing to sell an additional unit rises
 - This lowest price is called the marginal cost
- Changes in Supply
 - Increases in supply shifts the curve to the right (and vice versa)
- Factors that affect Supply
 - Prices of factors of production
 - * If the price of an input inc, supply dec; curve shifts left
 - Prices of related goods produced
 - * denoted by substitute for production, not just substitute
 - * supply of a good inc if price of a substitute dec
 - * complements in production: goods that must be produced together (beef & leather)
 - * supply of a good inc if the price of a complement in production inc

- Expected Future Prices
 - * If expected future price inc, current supply dec
- Number of Suppliers
 - * as number of suppliers inc, supply inc
- Technology
 - * Advances in technology lower the cost of making existing products
 - * inc in technology means inc in supply
- State of Nature
 - * natural forces and disasters can dec supply

1.4 Equilibrium

- Equilibrium: a situation in which opposing forces balance each other
- Equilibrium Price: the price at which quantity demanded = quantity supplied
- Equilibrium Quantity: quantity bought and sold at equilibrium cost
- Price Regulation
 - Price regulates buying and selling plans
 - Price adjusts when plans don't match
- Price adjustments
 - Surplus forces prices down
 - Shortage forces prices up
- Increases in demand
 - When demand increases without changes in supply, shortages occur
 - Price therefore increases
- Decrease in demand
 - At the original price, there is a surplus
 - Price therefore falls

- Increase in supply
 - At the original price, there is a surplus
 - Price therefore falls
- Decrease in supply
 - At the original price, there is a shortage
 - Price therefore increases

2 Chapter 1

2.1 Scarcity

- all economic questions arise because we want more than we can get
- inability to satisfy all wants because of scarcity
- scarcity = limited resources

2.2 Definition of Economics

- because we face scarcity, we must make choices
- incentive = a reward that encourages an action or a penalty that discourages an action
- economics is the social science that studies the choices that individuals, businesses, etc. make as they cope with scarcity and the incentives that influence and reconcile those choices
- Economics divides into two parts:
 - Microeconomics = study of choices that individuals and businesses make & how those choices interact with markets and the influence of governments
 - Macroeconomics = the study of the performance of national and global economies

2.3 6 Key Ideas

- a choice is a tradeoff: every choice is an exchange giving up one thing for another
- making a rational choice: a rational choice compares costs and benefits, maximizing benefit
- benefit = what you gain: the gain or pleasure something brings about, determined by preferences
 - preferences = what a person likes, dislikes, and the intensity of those feelings
- cost = what must be given up
 - opportunity cost = highest valued alternative that must be given up
- choosing at the margin: the benefit of pursuing an incremental increase in some action is marginal benefit of that action
 - the opportunity cost of pursuing an incremental increase in some action is marginal cost
 - if $\text{marginal benefit} > \text{marginal cost}$, rational choice is to do more of that action
- choices respond to incentives: a change in marginal cost/benefit changes our incentives & choices

2.4 Positive & Normative

- economists distinguish between two types of statements:
 - positive statements: can be tested by checking the facts
 - normative statements: express an untestable opinion
- economists as social scientists
 - economists test economic models
 - economic model = a description of some aspect of the world with only the necessary features
- economists as policy advisors

2.5 Resources & Highest Valued Use

- the scope of economics:
 - how do choices end up determining "what, how, and for whom" goods and services get produced
- goods and services are produced using productive resources called factors of production
 - land
 - labor
 - capital
 - entrepreneurship
- who gets goods and services depends on income
 - land earns rent, labor earns wages, capital earns interest, entrepreneurship earns profit
- **resources gravitate towards their highest value use**

2.6 Self Interest & Social Interest

- self interest = choices that are made because you think they are the best for you
- social interest = choices that are best for society as a whole
- social interest has two dimensions:
 - efficiency: resource use is efficient if it is not possible to make someone better off without making someone else worse off (no waste to be eliminated)
 - fair shares/equity: refers to the fairness with which resource division occurs in a society
- tension between self & social interest: information revolution, climate change, globalization