

Fall 2009 -- ECON 130(3) – Midterm I—University of Hawaii-Manoa—Prof. Sumner La Croix

REVIEW SHEET – THE BASICS – OF COURSE, NOT ENOUGH TO DO REALLY WELL ON THE EXAM!! BUT IT’S A START ... AND YOU HAVE TO START SOMEWHERE!!

I. CHAPTER 2

1. The Production Possibilities Frontier (PPF)
 - Efficient combinations: any point along the PPF; Inefficient combinations: any point inside the PPF;
 - Unattainable combinations: any point outside the PPF
2. Microeconomics vs. Macroeconomics
3. Positive statements (descriptive analysis) vs. Normative statements (prescriptive analysis)

II. CHAPTER 3

1. Opportunity Cost: the value of the next-best foregone alternative
2. Absolute Advantage: based on who can produce a good with a **smaller quantity of inputs**
3. Comparative Advantage: based on who can produce a good with a **smaller opportunity cost**
4. What are the benefits of trade?

III. CHAPTER 4

1. Perfectly Competitive Market
 - Products are homogeneous
 - Numerous buyers and sellers so that each has no influence over price.
 - Buyers and sellers are “price takers” (no single firm or consumer can affect the price of a good)
2. Demand/Consumer Behavior
 - The demand curve is the downward-sloping line relating price (P) to quantity demanded (Qd).
 - Law of Demand: There is an inverse (a negative) relationship between price and quantity demanded.
 - Determinants of Demand
 - Market price of the good: change in quantity demanded → **Movement along** the demand curve
 - Consumer income (Normal vs. Inferior goods)
 - Prices of related goods (Substitute vs. Complement goods)
 - Tastes
 - Expectations
 - Number of buyers

} change in demand
→ **Shifts** the demand curve
3. Supply/Firm Behavior
 - The supply curve is the upward-sloping line relating price to quantity supplied.
 - Law of Supply: There is a positive relationship between price and quantity demanded.
 - Determinants of Supply
 - Market price of the good: change in quantity supplied → **Movement along** the supply curve
 - Input prices
 - Technology
 - Expectations
 - Number of producers

} change in supply
→ **Shifts** the supply curve
4. Equilibrium P and Q balances S and D. On a graph, it is P and Q where the S and D curves intersect.
5. If price is above equilibrium price, $Q_s > Q_d$ → Surplus
6. If price is below equilibrium price, $Q_d > Q_s$ → Shortage
7. Three Step Analysis to Find out how events affect the market equilibrium
 - Decide whether the event move **along/shifts** the S or D curve (or both)
 - Decide whether the curve(s) move along/shifts to the **left or right**.
 - Examine how the shift **affects** equilibrium P and Q.

IV. CHAPTER 5

1. Price Elasticity of Demand (PED) – a measure of how responsive buyers are to changes in price

$$\text{PED} = \text{Percentage Change in Quantity Demanded} / \text{Percentage Change in Price}$$

- Perfectly Elastic: $\text{PED} = \infty$ (D curve is flat)
- Elastic: $\text{PED} > 1$ (D curve is relatively flat)
- Inelastic: $\text{PED} < 1$ (PED is relatively steep)
- Perfectly Inelastic: $\text{PED} = 0$ (D curve is vertical)
- Unit Elastic: $\text{PED} = 1$

- What determines the PED of a good?
 - Luxury vs. Necessary Goods, Short vs. Long-Run, Existence of Substitutes, Narrowness of the Market

2. Price Elasticity of Demand and Total Revenue (P * Q)

Price Elasticity of Demand		To Increase Total Revenue
Greater than 1 (Elastic)	Percentage Change in $Q_d >$ Percentage Change in P	Decrease Price
Less than 1 (Inelastic)	Percentage Change in $Q_d <$ Percentage Change in P	Increase Price

3. Price Elasticity of Supply (PES)

$$\text{PES} = \text{Percentage Change in Quantity Supplied} / \text{Percentage Change in Price}$$

- What determines the PES for a good?
 - Ability of sellers to change the amount of the good they produce; Time period (Short Run vs. Long Run)

V. CHAPTER 6

1. Price Ceiling - a legally established maximum price at which a good can be sold

- Binding if set below the equilibrium price, leading to a shortage: $Q_d > Q_s$
- Effects: non-price rationing (discrimination), bribery and low-quality apartments (for the case of rent control)
- Application: Rent Control

2. Price Floor - a legally established minimum price at which a good can be sold

- Binding if set above the equilibrium price, leading to a surplus: $Q_s > Q_d$
- Effects: non-price rationing, unemployment
- Application: Minimum Wage

3. Tax incidence: the way in which the burden of a tax is shared among participants in a market

- Same whether the tax is imposed on buyers or sellers
- Buyers and sellers share the burden of taxes (buyers pay more, sellers receive less)
- The burden of a tax falls more heavily on the side of the market that is less elastic.