Eco Chapter 1 Notes

- Economy is greek for "one who manages a household"
- Economics is about the allocation of scarce resources, ie: How the pie is divided
- Scarcity means that society has limited resources

Principle 1: People face tradeoffs

- Efficiency refers to the size of the pie
- Equity refers to how the pie is divided
- ex: pollution regulations = better earth, but worse economy
- ex: welfare = good for equity (how pie is divided), bad for efficiency (size of pie) because of higher taxation

Principle 2: The cost of something is what you give up to get it

- ie: opportunity cost
- opportunity cost = direct cost ⊕ what you forgoe

Principle 3: Rational people think at the Margin

- Marginal changes: small incremental adjustments to a plan of action.

MB > MC = Action should be taken

Principle 4: People respond to incentives

- Incentive: Something that induces someone to act ie(prospect of punishment or reward)
- Incentives are as valuable/important as $

Principle 5: Trade Can Make Everyone Better off

- Trade between two countries can make each country better off
- By trading, people can buy a greater variety of

goods and services at a lower cost.

Principle 6: Markets are usually a good way to organize Economic Activity
- Central planning (communism) doesn't work
- Capatalism involves every person looking out for their own self-interests.

Why does it work?

"The Invisible Hand" directs economic activity
- Taxes hinder the invisible hand

Principle 7: Goverments can sometimes improve Market Outcomes
- Economy cannot go completely unregulated
- Govt. needs to enforce some rules

ie: Farmer won't grow if he expects his crops/land to be stolen
- Market Failure: when the invisible hand fails and the Govt needs to intervene and get the economy going again
- Market Power: The ability of one person/company to influence Market prices
- Invisible hand helps efficency (size of pie), doesn't help eavity (distribution of slices)

Principle 8: A country's standard of living depends on its ability to produce goods/services
- Productivity: the quanitity of goods/services produced from each hour of a worker's time
- People making more things = More people buying = higher wages = good for economy
- Real hero of rising living standards is increased productivity

Principle 9 Prices rise when the Govt prints too much money
- Inflation: an increase in the overall level of prices in the economy.

- When a goverment creates large quantities of the nations of the nation's money, the value of the money falls

Principle 10 Society faces a short-run tradeoff between inflation and unemployment

-Business Cycle: fluctuations in economic activity such as employment and production

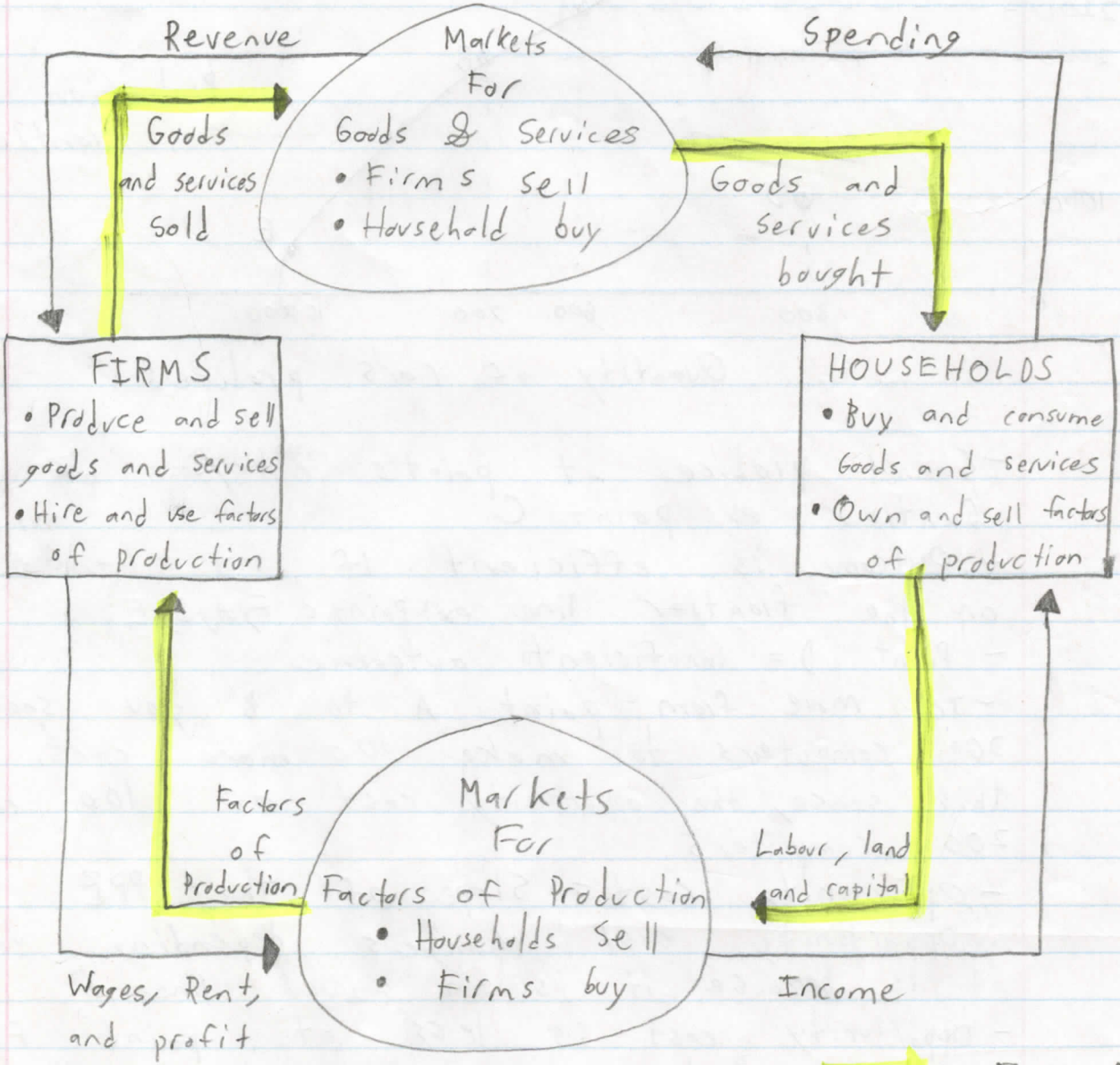
-During the recession. Canada govt increased supply of money to help unemployment, but this inversely affected inflation

- Productivity is the ULTIMATE Source of living standards
- Money growth is the Ultimate source of inflation
- Society constantly faces short-turn tradeoff between inflation and unemployment

Two Main Causes of Market Failure => Externality & Market Power

Eco Chapter 2 Notes

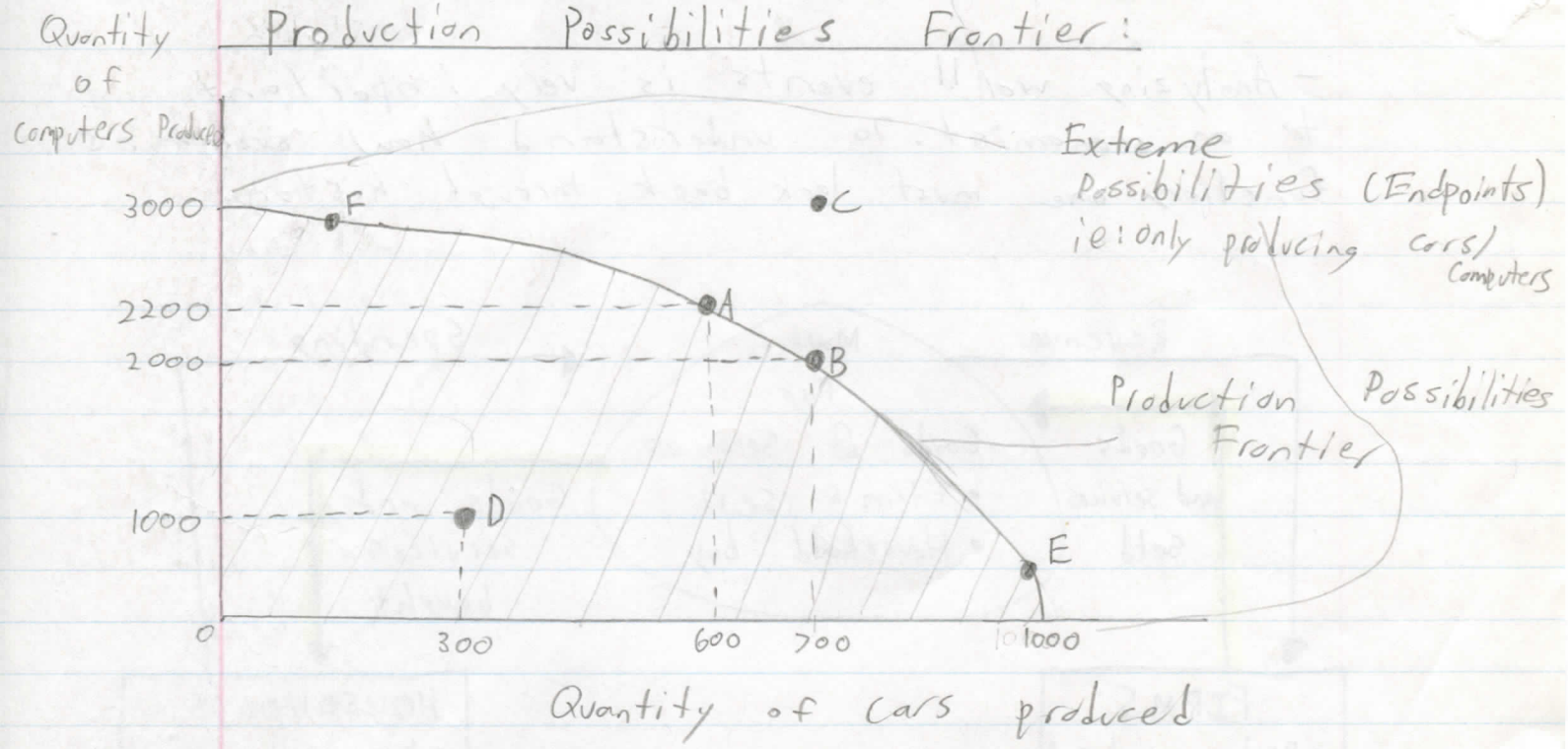
- Analyzing world events is very important to an economist. To understand how economies function one must look back through history



= Flow of inputs and outputs

= Flow of $Dollars

Production Possibilities Frontier:



- Cannot produce at points outside of the frontier ex: point C
- Outcome is efficient if it lands on the frontier line ex: Points F, A, B, E
- Point D = inneficient outcome
- To move from point A to B you sacrifice 200 computers to make 100 more cars, in this sense, the opportunity cost of 100 cars is 200 computers
- Opportunity cost = Slope of the PPF
∴ Opportunity cost changes depending where it is because it is a curved line.
- Opportunity cost is less at point F than at Point B, because curve is "flatter"
- Economic growth can change shape of PPF

Microeconomic: the study of how households and firms make decisions and how they interact in markets. (SMALL SCALE)

Macroeconomic: The study of economy-wide phenomena, including inflation, unemployment, and economic growth. (BIG PICTURE)

Positive Statements: claims that attempt to describe as it is
Normative statements: Claims that prescribe how the world should be

deduction → ex: Problem = Minimum Wage laws
Polly: Minimum-Wage laws cause unemployment
Norma: The govt. should raise the minimum wage ← solution

-Economist disagree because:
disagree about the validity of a theory (Polly)
Have different values and therefore different views (Norma)

-Omitting certain variables (keeping them constant) can yield deceptive (or inaccurate results)
ie: Something else is changing the value of your results, something you aren't considering

-Cigarette lighters don't cause cancer (omitted variable)
-Minivans don't cause larger families (reverse causality)
-reverse causality: Basically graph doesn't let you determine whether crime causes more police or if more police causes crime.

Chapter 3

Trade benefits both parties

Absolute Advantage: Someone who can produce more of each good then someone else

Comparative Advantage: Someone who can produce at a lower opportunity cost than someone else

Opportunity costs of 2 goods are inversely Related:

	Farmer	16 Potatoes	4 Meat
Inverse	Rancher	4 Potatoes	2 Meat

$\frac{16}{4}, \frac{4}{16}$ Farmer: O.C. of Meat = 4 potatoes
O.C. of potatoes = 0.25 Meat

$\frac{4}{2}, \frac{2}{4}$ Rancher: O.C. of Meat = 2 potatoes
O.C. of potatoes = 0.5 Meat

* For both parties to gain from trade, the price lies between the 2 opportunity costs

Imports: Produced abroad, sold domestically

Exports: Produced domestically and sold abroad

* Trade allows countries to consume outside their original Production possibilities Frontier

* Only comparative Advantage matters, Absolute Advantage is irrelevant *

Chapter 4

Market: A group of buyers and sellers

Buyers determine demand

Sellers determine supply

Competitive Market: So many options, no one seller can influence price.

Monopoly: few or one seller that can influence price

Quantity Demanded: amount buyers are willing and able to purchase. Is negatively related to price
ie: Price falls, quantity demanded increases

Law of Demand: Quantity demanded falls when price rises

Demand Schedule: Table that shows the relationship between price of a good and quantity demanded

Demand Curve: Graph of the relationship between Quantity demanded and Price

Normal Good: Increase in income = increase in demand

Inferior Good: Increase in Income = decrease in demand
ie: Bus rides, Ramen noodles, etc.

Yogurt vs. Icecream

Substitutes: Increase in Price for one product = increase in demand for the other

Complements: Increase in price for one = decrease in demand for the other
ie: PB & J

Variables that can shift demand curve:

- Prices of related Goods
- Tastes
- Expectations
- # of buyers

Quantity Supplied: amount that sellers are willing and able to sell

* Quantity supplied is positively related to price of a good

Law of Supply: Supply rises when price rises

Supply Schedule: Table showing relationship between price and quantity supplied

Supply Curve: Graph showing relationship between price of a good and quantity supplied.

Variables that Shift Supply Curve:

- Input Prices
- Expectations
- Technology
- # of sellers

Equilibrium: Quantity Supplied = Quantity demanded

*At the equilibrium price, the quantity that buyers are willing to buy exactly matches the quantity sellers are willing to sell

Market-clearing price = Equilibrium Price

Surplus: Quantity supplied > Quantity demanded

Shortage: Quantity Supplied < Quantity demanded

Law of Supply and Demand: The claim that the price of any good adjusts to bring the quantity supplied and quantity demanded for that good into balance

What Happens?	No change Supply	Increase Supply	Decrease Supply
No change Demand	P: Same Q: Same	P: down Q: up	P: up Q: down
Increase Demand	P: up Q: up	P: uncertain Q: up	P: up Q: uncertain
Decrease Demand	P: down Q: down	P: down Q: uncertain	P: uncertain Q: down

Chapter 5

Elasticity: Measure of how much buyers and sellers respond to changes in market conditions

Elasticity of Demand: How much the quantity demanded responds to a change in price.

* Demand for Good is *elastic* if the quantity demanded responds substantianally to a change in price

* Demand is *inelastic* is quantity demanded responds only slightly to a change in price.

What influences Price Elasticity of Demand:

- Availability of close substitutes
- Definition of the Market
- Necessities vs. Luxuries
- Time Horizon

$$\text{Price Elasticity of Demand} = \frac{\text{Percentage change in quantity demanded}}{\text{Percentage change in Price}}$$

$$\text{Price Elasticity of Demand} = \frac{(Q_2 - Q_1)/[(Q_2 + Q_1)/2]}{(P_2 - P_1)/[P_2 + P_1)/2]}$$

Elasticity > 1, Elastic

Elasticity < 1, Inelastic

Elasticity $= 1$, Unit Elastic

Elasticity $= 0$, Perfectly inelastic

Elasticity $= \infty$, Perfectly elastic

Total Revenue: $P \times Q$, price of the good multiplied by quantity sold

* If inelastic: ↑Price = ↑revenue

* If elastic: ↑Price = ↓revenue

Income Elasticity of Demand = $\frac{\%\text{ change in Quantity demanded}}{\%\text{ change in income}}$

* Inferior Goods have negative income elasticities
* Normal Goods = positive ↑

Cross-Price elasticity of demand = $\frac{\%\text{ in quantity demanded of Good (1)}}{\%\text{ in price of Good (2)}}$

* Complements have negative cross-price elasticities
* Substitutes = positive ↑

Price elasticity of Supply: How much quantity supplied is affected by change in price

Price Elasticity of Supply = $\frac{\%\text{ change in quantity supplied}}{\%\text{ change in price}}$

Chapter 6

Price Ceiling: Legal maximum on the price at which a good can be sold

Price Floor: Legal minimum on the price at which a good can be sold

*If price ceiling in above equilibrium it has no effect
* If below, it can cause a SHORTAGE

ex: A ceiling is placed on rent. As a result, landlord acquire less tenants and everybody loses

* If price floor is below equilibrium it has no effect
* If above equilibrium, causes a SURPLUS

ex: Minimum wage is raised. As a result, employers hire less and unemployment rises= everybody loses

Tax incidence: Distribution of a tax burden between buyers and sellers

*A tax burden falls more heavily on the side of the market that is less elastic