

Test Yourself: Core Concepts Part III



If all economists were laid end to end, they
would still not reach a conclusion.

GB Shaw



What is market supply?

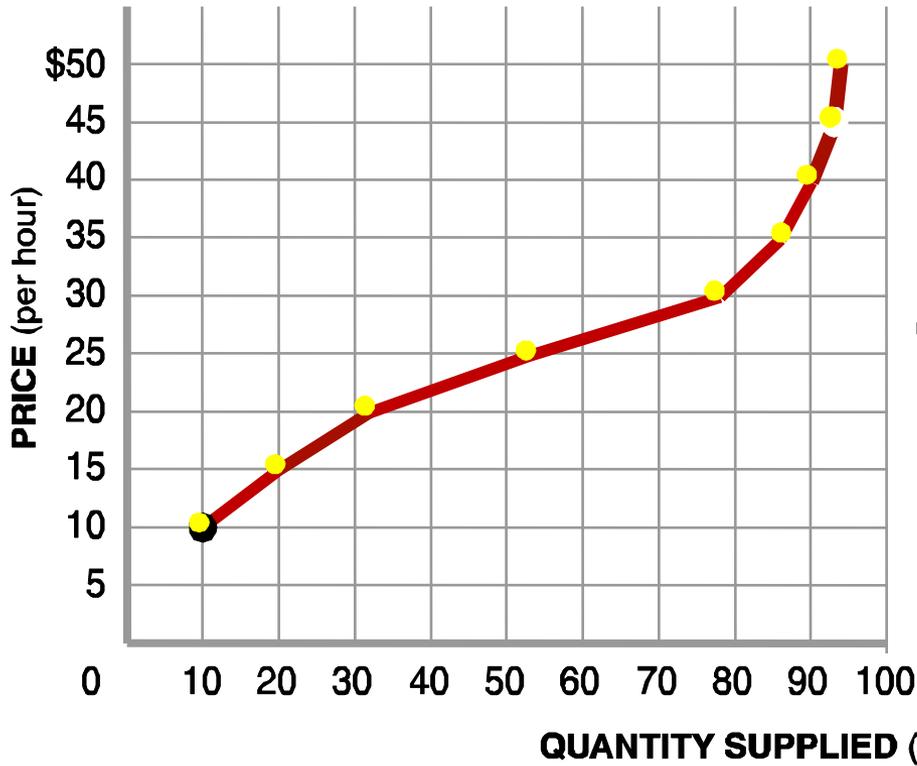


Market supply is the summation of all the quantities supplied at various prices that might prevail in the market.

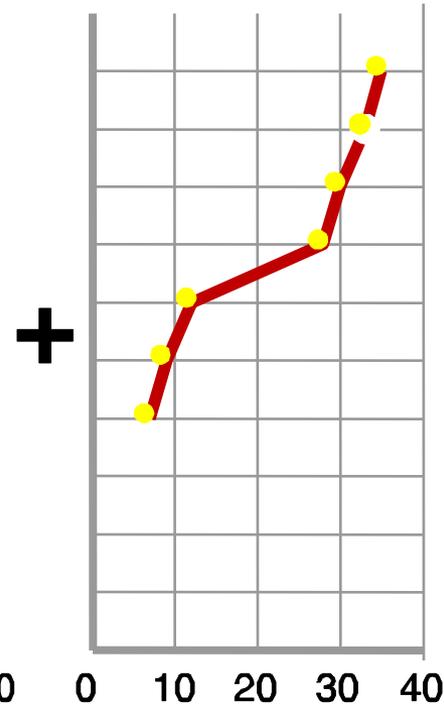


Charts: Construction of the Market Supply Curve

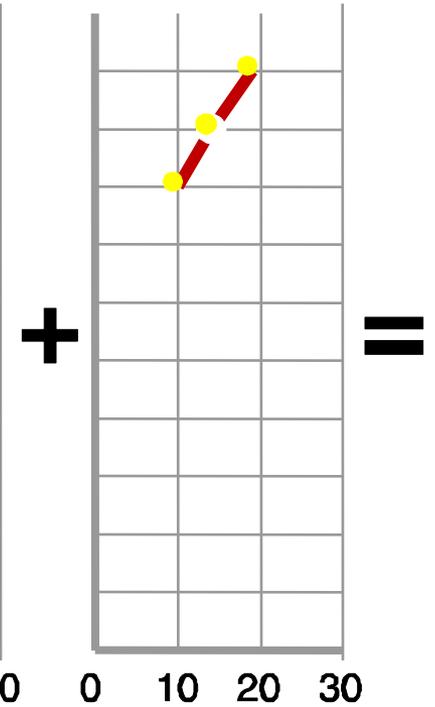
(a) Ann's supply curve



(b) Bob's supply curve



(c) Cory's supply curve



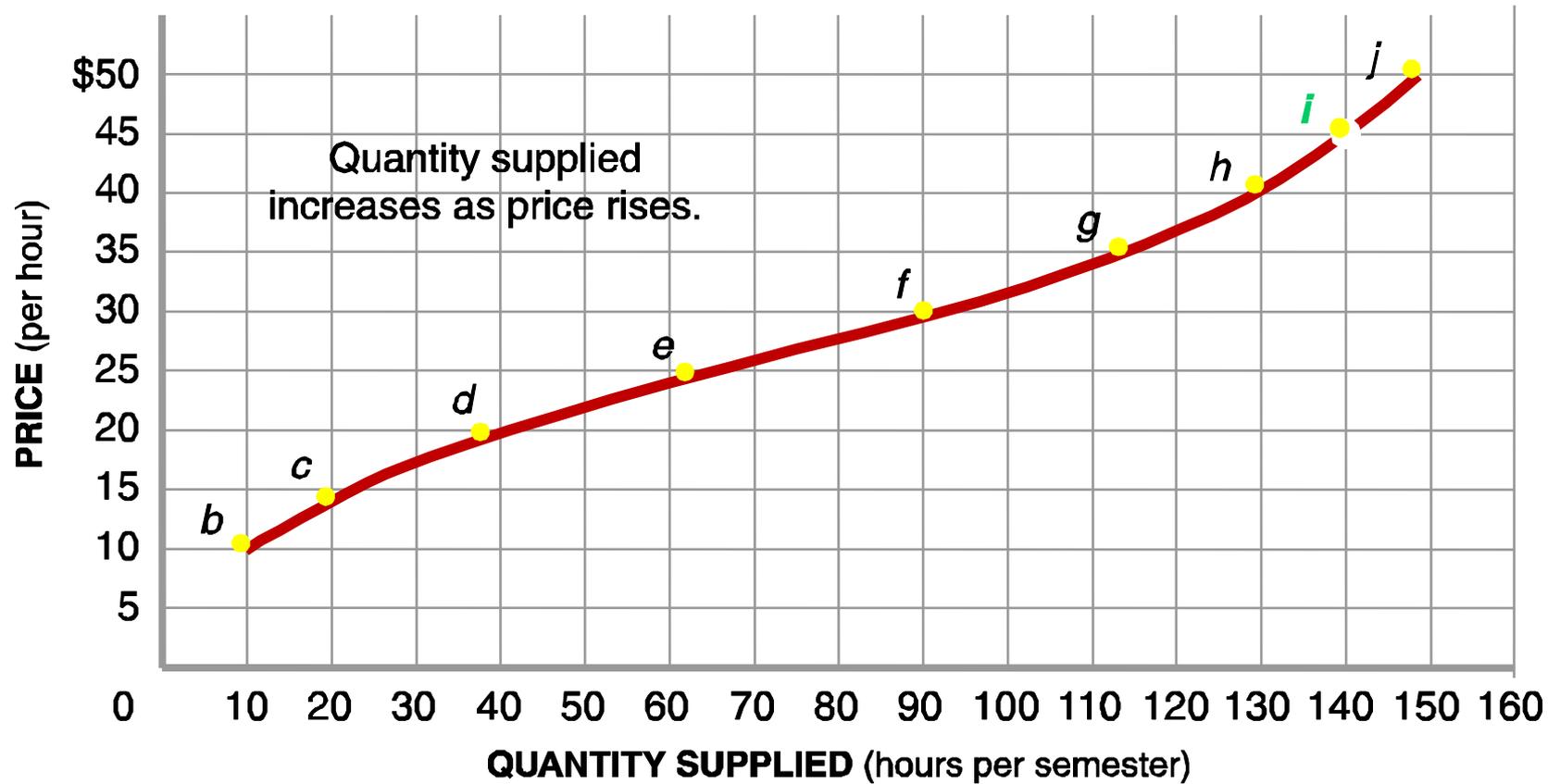
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Chart: Construction of the Market Supply Curve





IMPORTANT: KNOW THE DIFFERENCE
BETWEEN A CHANGE IN THE
QUANTITY SUPPLIED AND A CHANGE
IN SUPPLY!

- Change in the quantity supplied — movement *along* the supply curve
- Change in supply — shifts the entire supply curve



What happens when price
changes?

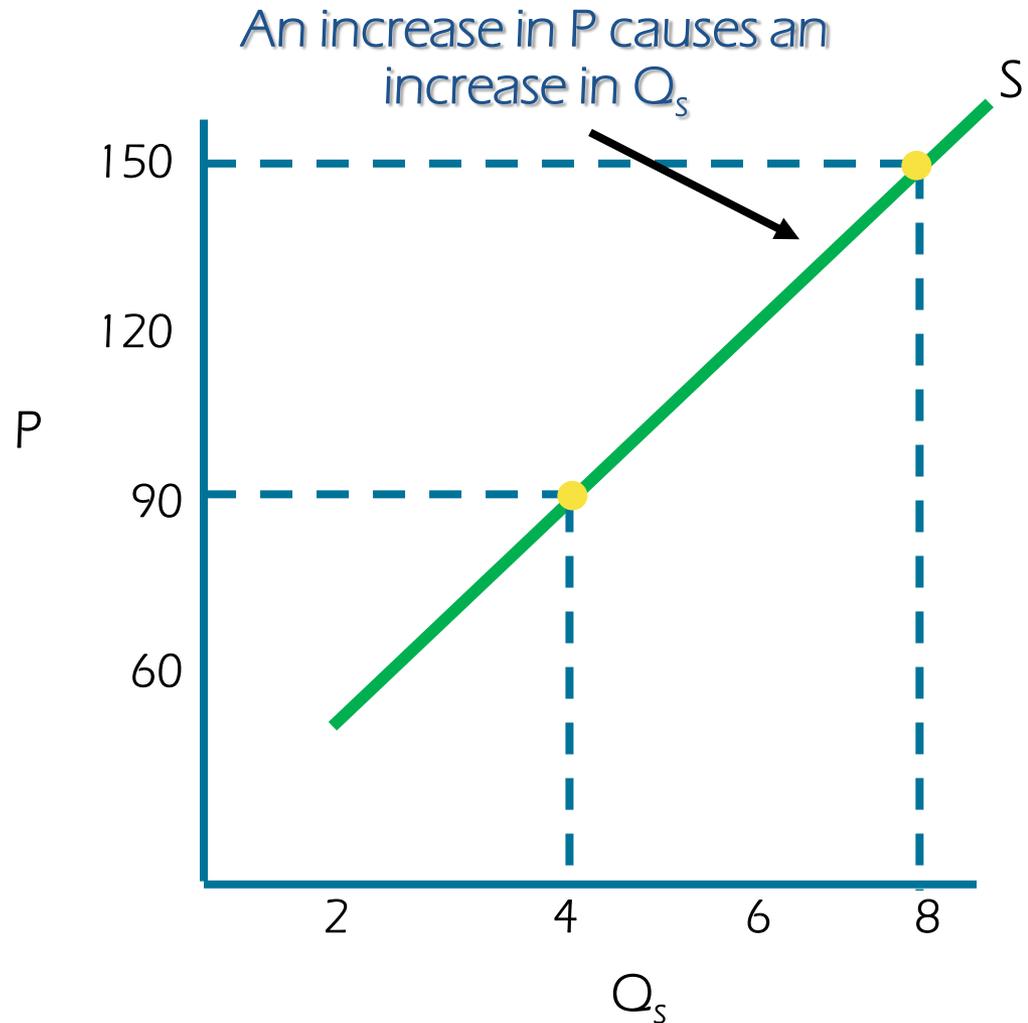


When price changes the curve does not shift. There is a change in the *quantity supplied* and so movement along the supply curve.



Table and Chart: Change in the Quantity Supplied (Q_s)

P	Q_s
\$150	8
120	6
90	4
60	2





What happens when something
other than price changes?



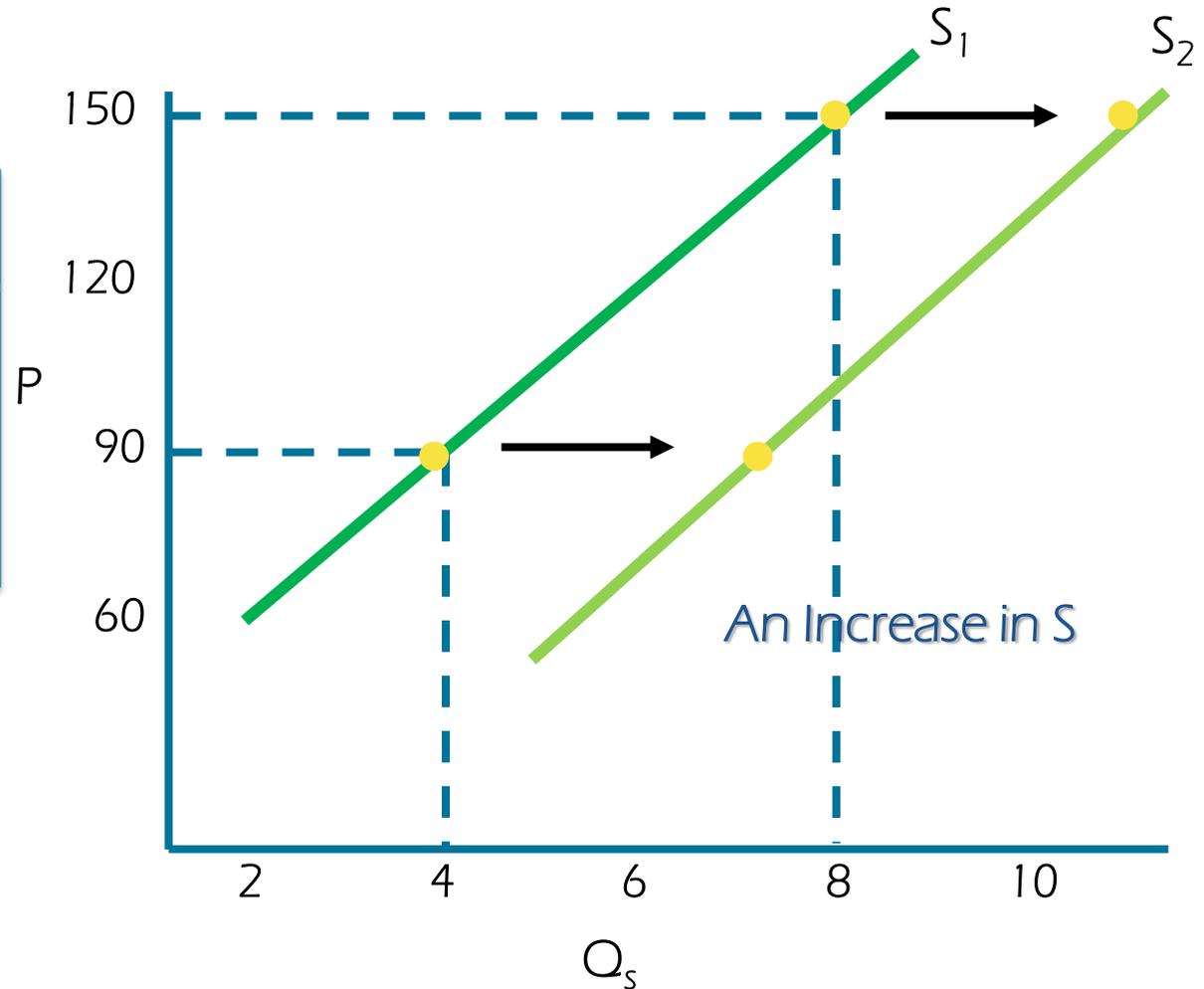
When something other than price changes, the whole curve shifts. There is a *change in supply*.

Changes in nonprice determinants can produce only a *shift* of the entire supply curve, not a movement *along* the supply curve.



Table and Chart: Change In Supply (S)

P	Q_{s1}	Q_{s2}
\$150	8	11
120	6	9
90	4	7
60	2	5





What can cause a supply curve to shift?



A change in any of the following can cause a supply curve to shift.

- the number of sellers in the market
- technology
- resource prices
- taxes and subsidies
- the expectations of producers
- the prices of other goods the firm could produce



What is the equilibrium price?

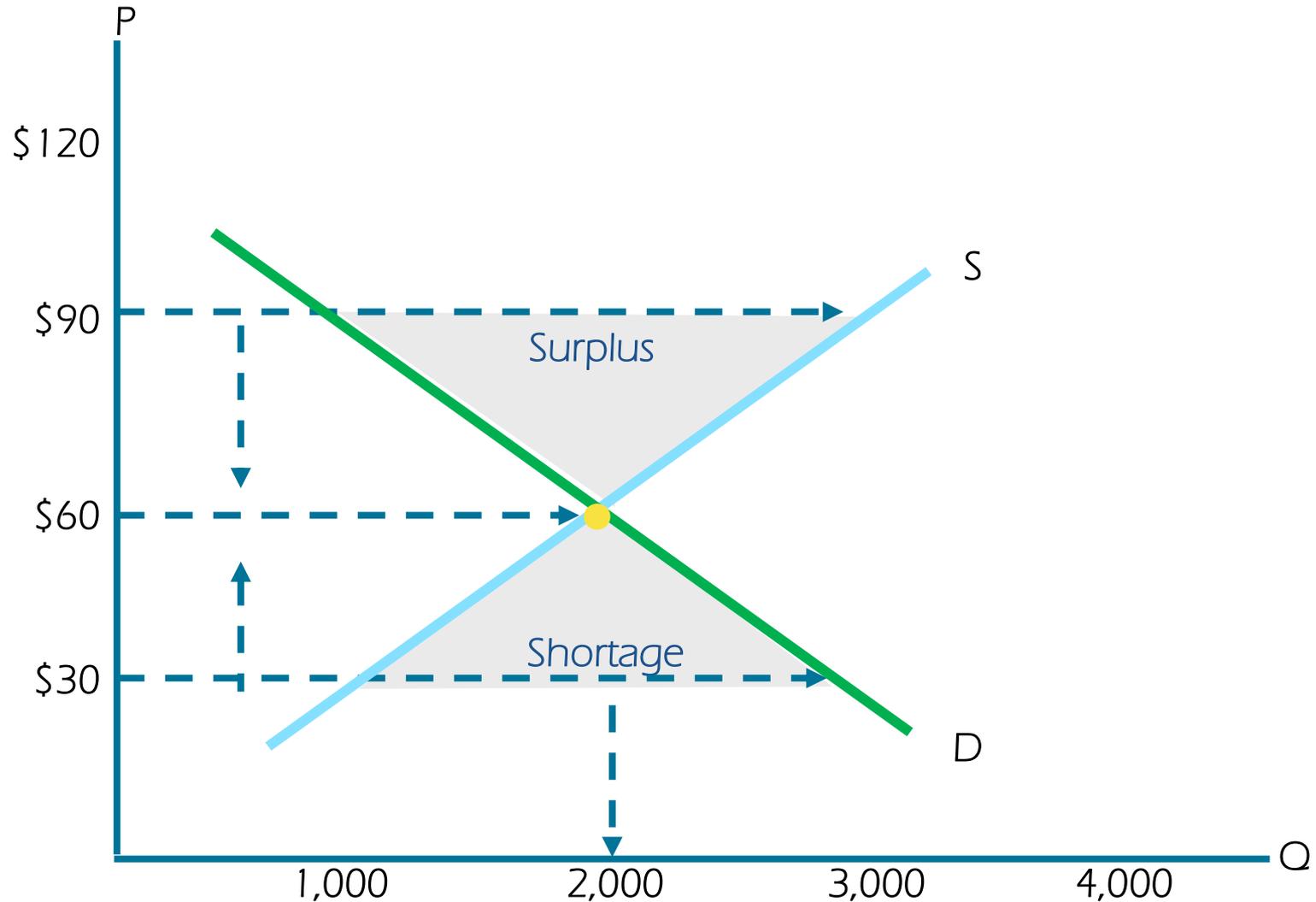


The equilibrium price is the price towards which the economy tends.

It is at the price where the quantity demanded and the quantity supplied are equal.



Chart: The Equilibrium Price





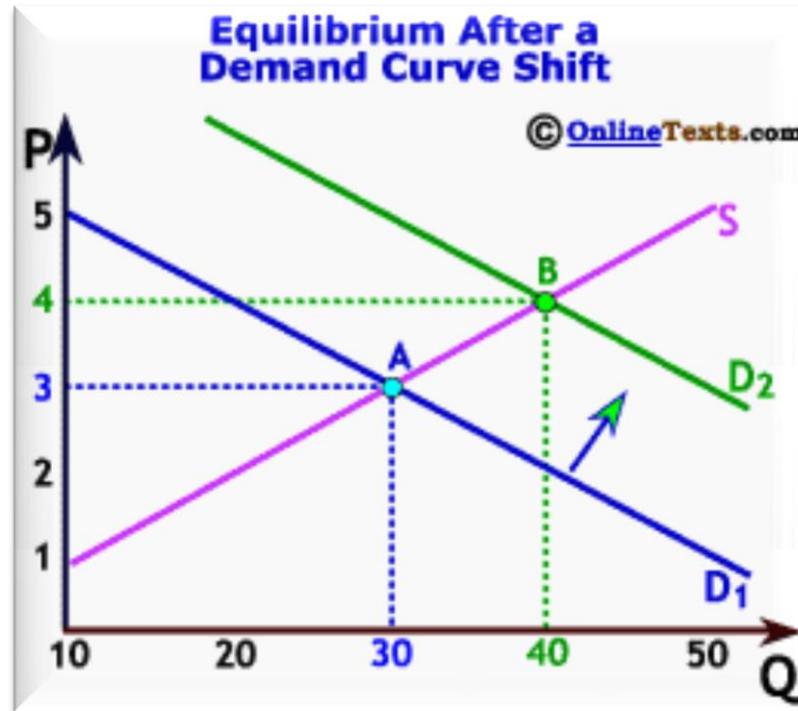
What causes a change in
market equilibrium?



A change in demand or a change in supply will cause a change in market equilibrium.



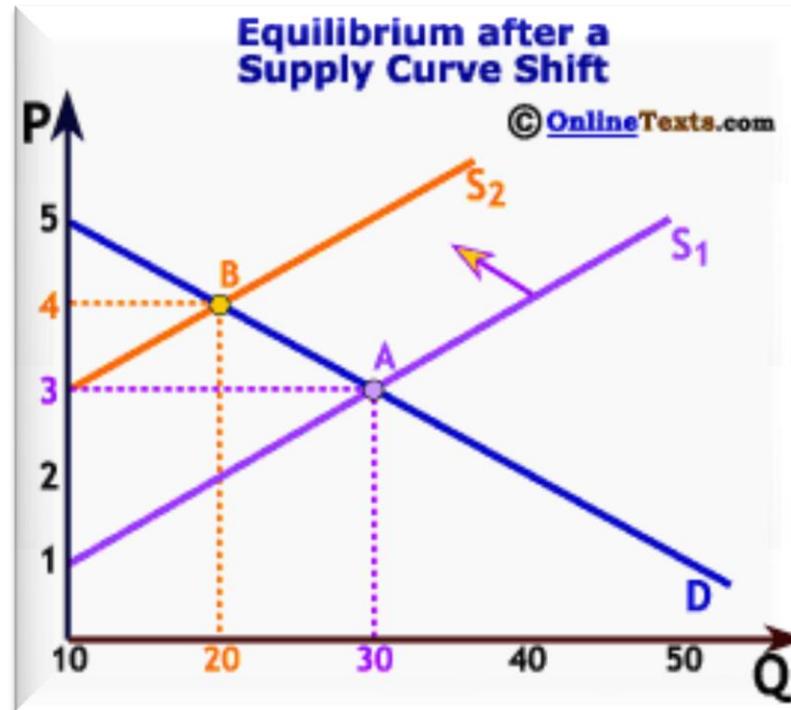
Chart: Changes in Equilibrium: Demand Shift



The shift in the demand curve moves the market equilibrium from point A to point B, resulting in a higher price (from \$3 to \$4) and a higher quantity (from 30 to 40 units). Note that if the demand curve shifts to the left, both the equilibrium price and the equilibrium quantity will decline.



Chart: Changes in Equilibrium: A Supply Shift



The shift of the supply curve moves the equilibrium from point A to point B, resulting in a higher price (from \$3 to \$4) and lower quantity (from 30 to 20). Conversely, a rightward shift of the supply curve reduces the equilibrium price and increases the equilibrium quantity.



What is the price system?



The price system is a mechanism that uses the forces of supply and demand to create an equilibrium through rising and falling prices.



What are the two types of price controls?



The two types of price controls are:

- **price ceilings** – a legally established maximum price a seller can charge ... for example, rent control, wage and price controls, usury laws
- **price floors** – a legally established minimum price a seller can be paid ... for example, minimum wage law, agricultural price supports



What is the purpose of price ceilings on rent (rent control)?

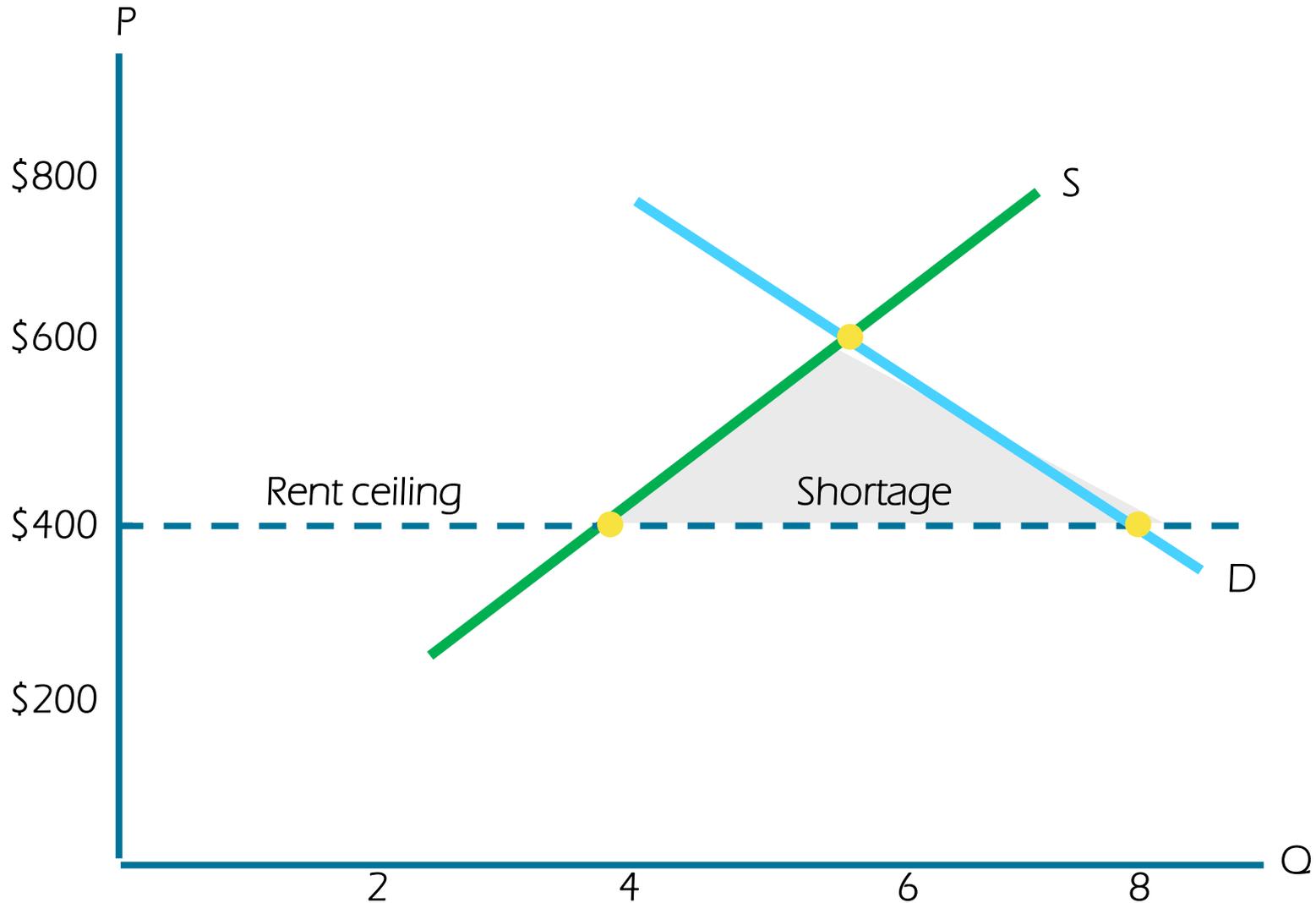


The purpose of price ceilings on rent (rent control) is to provide a lower rent than the equilibrium rent so poor people can afford to pay it.

Unfortunately, rent control leads to a shortage of rental units, illegal markets, less maintenance and discrimination, and so may be counterproductive.



Chart: Rent Control Results in a Shortage of Rental Units





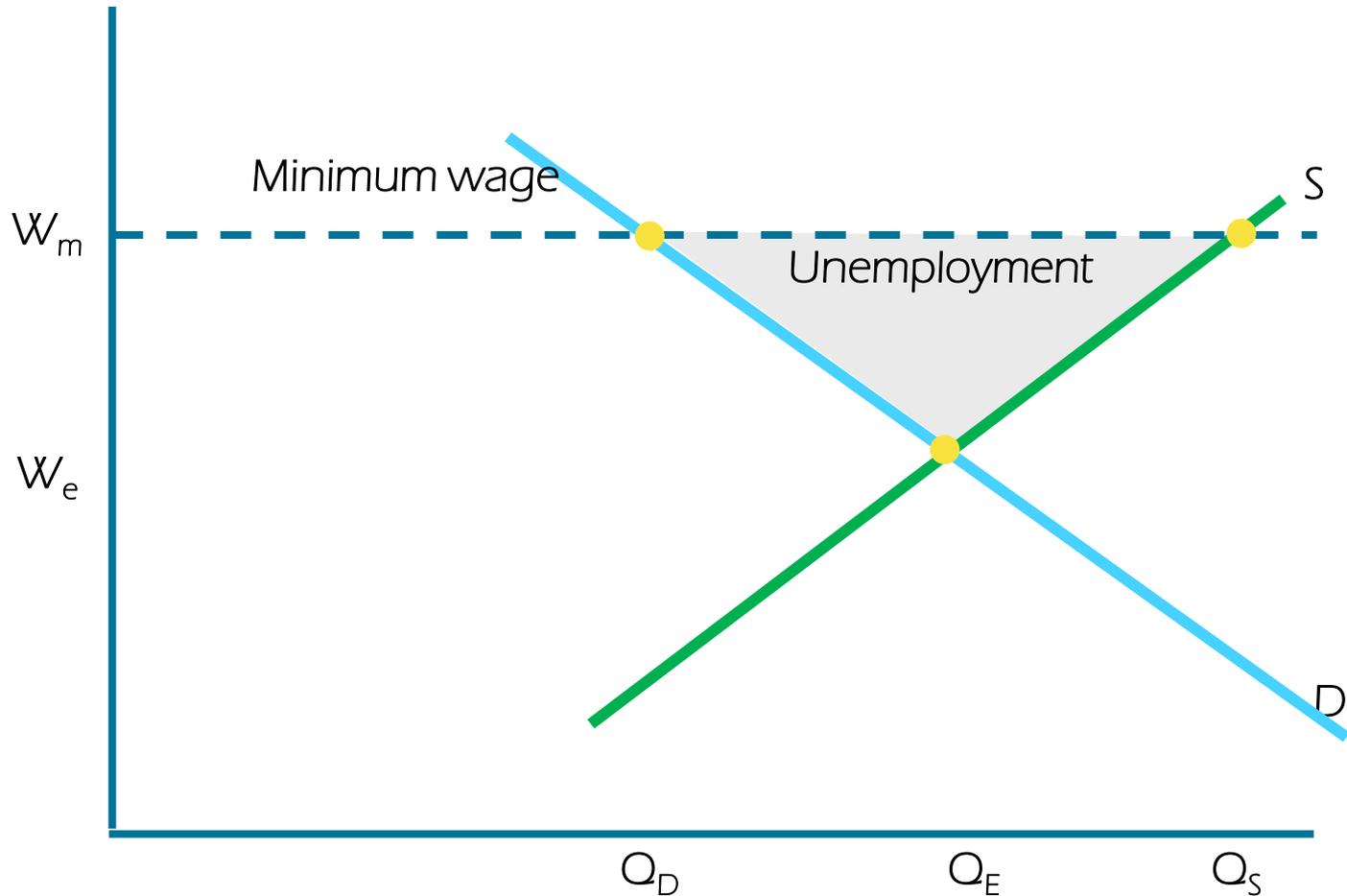
What is the result of a price floor on wages paid to labor (minimum wage)?



The result of a price floor on wages paid to labor (minimum wage) is a surplus of labor ... employers cannot afford to hire as many workers.



Chart: A Minimum Wage Results in a Surplus of Labor





Why do we have price ceilings
and price floors?



We have price ceilings and price floors because of failures in the free market.

A **market failure** is a situation in which the price system creates a problem for society or fails to achieve society's goals.

Market failure happens when competition is lacking.

Two examples of market failure are *income inequality* and *externalities*.



What is an externality?



An externality is a cost or benefit imposed on people other than the consumers and producers of a good or service.

A **negative externality** is one that is detrimental to third parties, such as pollution.

A **positive externality** is one that is beneficial to third parties, such as vaccinations or public goods.



What is the effect of externalities?



When the supply curve fails to include negative external costs, the equilibrium price is artificially low and the equilibrium quantity is artificially high.

External costs cause the market to over allocate resources, and external benefits cause the market to under allocate resources.

When externalities are present, market failure gives incorrect price and quantity signals, and resources are misallocated.



Chart: External Cost of Pollution

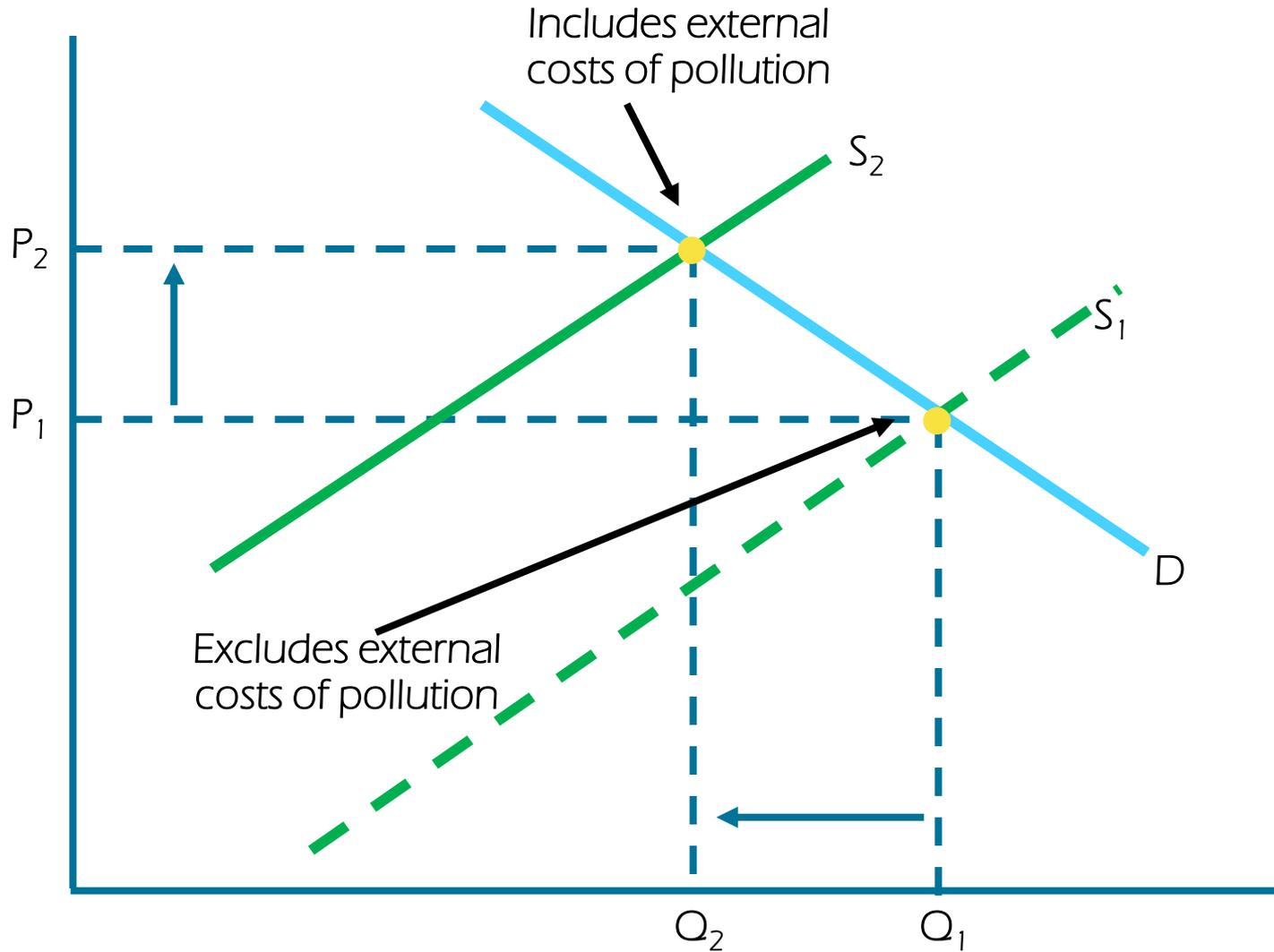
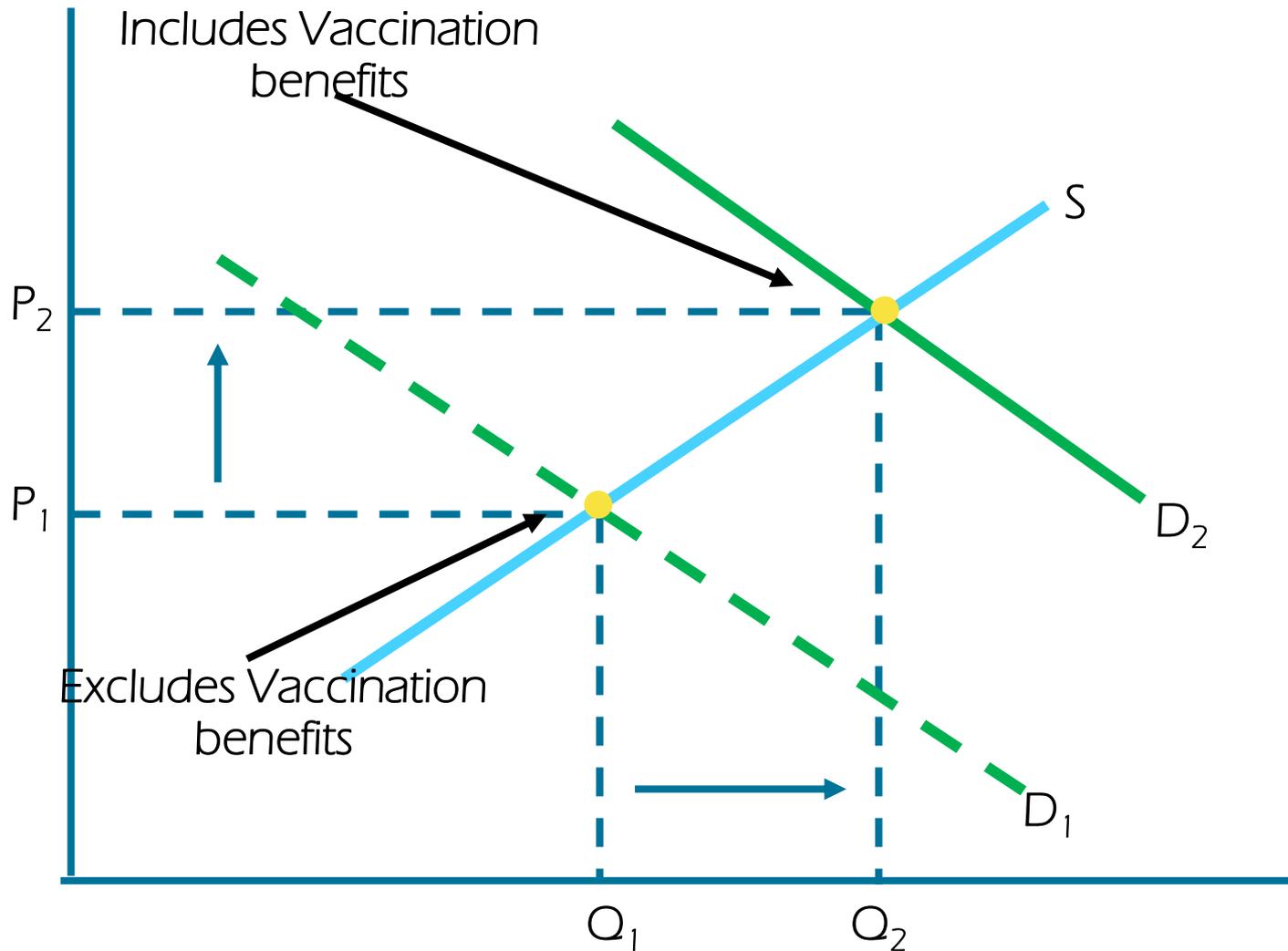




Chart: External Benefit of AIDS Vaccinations





What is a public good?



A public good is a good that, once produced, has two properties: (1) users collectively consume benefits and (2) no one can be excluded.

National defense, public education and roads are examples of public goods.

If public goods are available only in the marketplace, people wait for someone else to pay. The result is an underproduction or zero production of public goods.



In case
you're
interested...

Economists to Watch

When a number of senior economists were asked which young, untenured economists were doing impressive work on real-world problems, these were the 13 young researchers whose names came up most often.

	RESEARCH AREAS INCLUDE
Raj Chetty, <i>Berkeley</i>	Unemployment benefits and tax credits
Stefano DellaVigna, <i>Berkeley</i>	The decline in crime during the weekend a violent movie is released
Amy Finkelstein, <i>M.I.T.</i>	Medicare's role in increasing health spending
Roland Fryer, <i>Harvard</i>	The causes of racial inequality
Xavier Gabaix, <i>M.I.T.</i>	A rationale for chief executive pay
Matthew Gentzkow, <i>Chicago</i>	How newspapers cater to readers' political views
Dean Karlan, <i>Yale</i>	Microfinance in poor countries
Ulrike Malmendier, <i>Berkeley</i>	Irrational behavior, among everyone from chief executives to eBay customers
Benjamin Olken, <i>Harvard</i>	Corruption in Indonesia
Emily Oster, <i>Chicago</i>	Health in developing countries
Jesse Rothstein, <i>Princeton</i>	What school choice doesn't accomplish
Jesse Shapiro, <i>Chicago</i>	How television can benefit disadvantaged toddlers
Justin Wolfers, <i>Penn</i>	Online bettors' success in predicting elections

▲ Lines indicate married couples



let LIFE help you shop

sony live process



290403

Safe inc.

SONY

Levi

FICTION

FOOD 2 CLUB

SLUSH

The End