Test Yourself: Core Concepts Part II

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

GB Shaw

What is investment?

Investment is the accumulation of capital – such as factories, machines and inventories – that is used to produce goods and services.

When an economy does not invest in new technology, everything else being equal, the economy will not grow.

The opportunity cost of investment is the consumer goods that could have been purchased with the money spent for plants and other capital. But an increase in investments makes it possible to have economic growth and more goods and services in the future.

What is demand?

Demand represents the choice-making behavior of buyers.

The law of demand says there is an inverse relationship between the price of a good and the quantity buyers are willing to purchase in a defined time period, *ceteris paribus.*

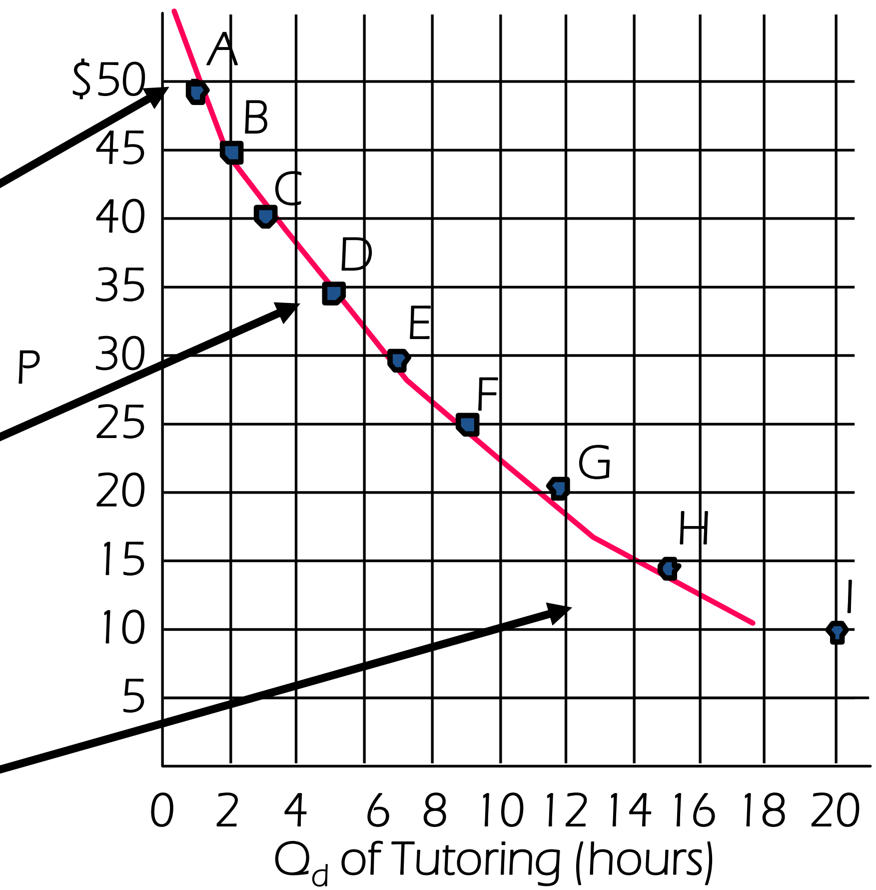
We use a demand schedule to show the relationship between the price and the quantity demanded on a demand curve.

Table and Chart: Demand Schedule and Demand Curve

Demand curves and demand schedules show the same information in different formats.

Demand Schedule

Price	Quantity Demanded
$50	1
45	2
40	3
35	5
30	7
25	9
20	12
15	15
10	20



What is a demand schedule?

A demand schedule shows the quantities of a good or service that people are willing and able to buy at different prices.

Why do demand curves have a negative slope?

Demand curves have a negative slope because at a higher price buyers will buy fewer units, and at a lower price they will buy more units, *ceteris paribus*.

What is a market?

A market is any arrangement in which buyers and sellers interact to determine the price and quantity of goods and services exchanged.

What is
market demand?

Market demand is the summation of the individual demand schedules in a market.

Charts: Construction of the Market Demand Curve

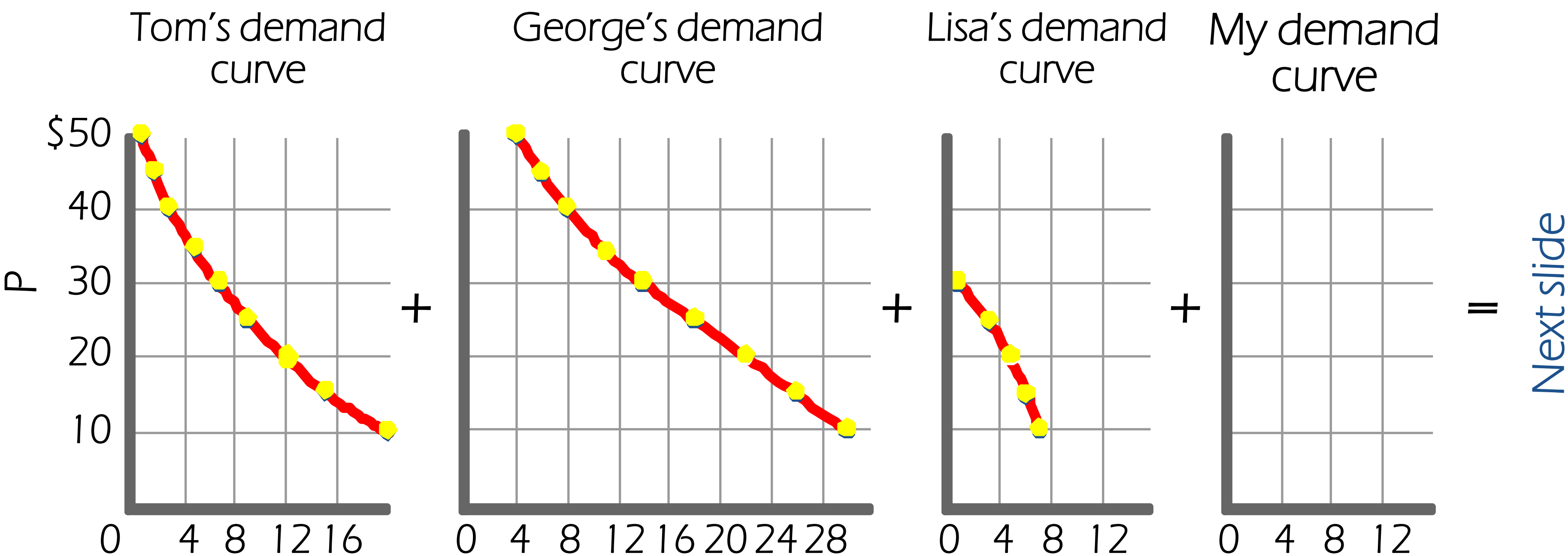
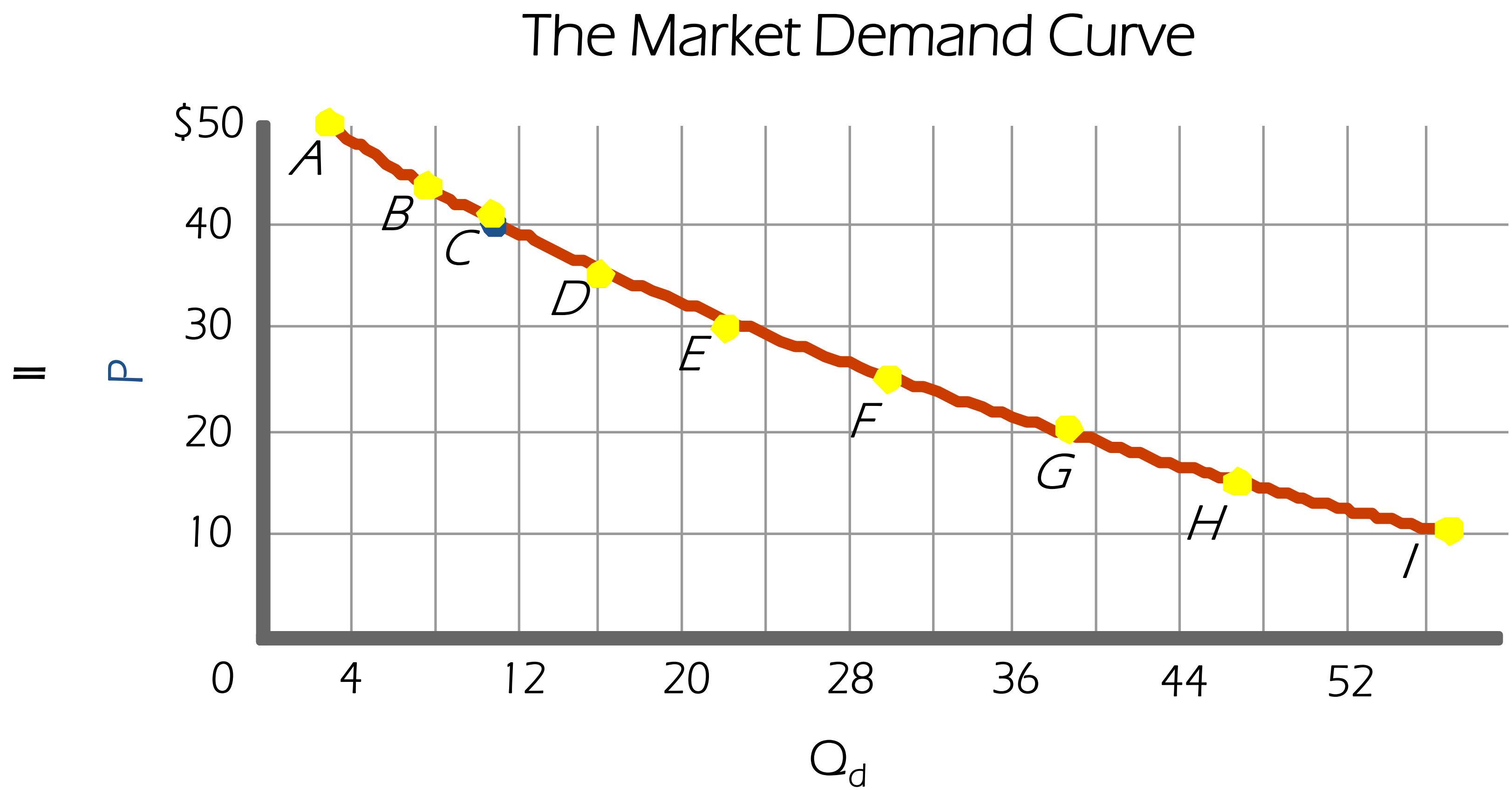


Chart: Construction of the Market Demand Curve



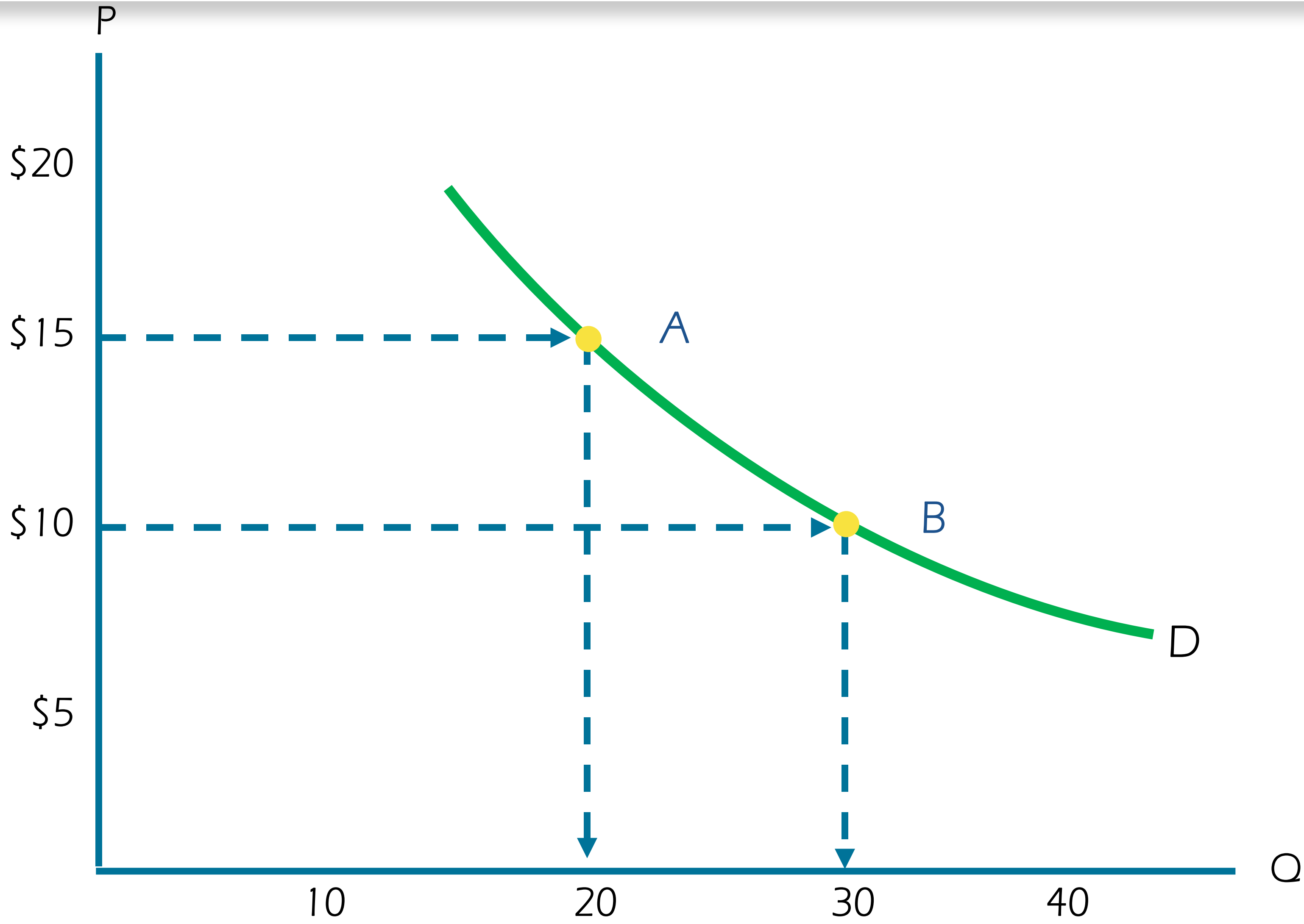
IMPORTANT: KNOW THE DIFFERENCE BETWEEN A CHANGE IN THE QUANTITY DEMANDED AND A CHANGE IN DEMAND!

- Change in the quantity demanded – movement *along* the demand curve
- Change in demand – shifts the entire demand curve

What happens when price changes?

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

Chart: Change in the Quantity Demanded

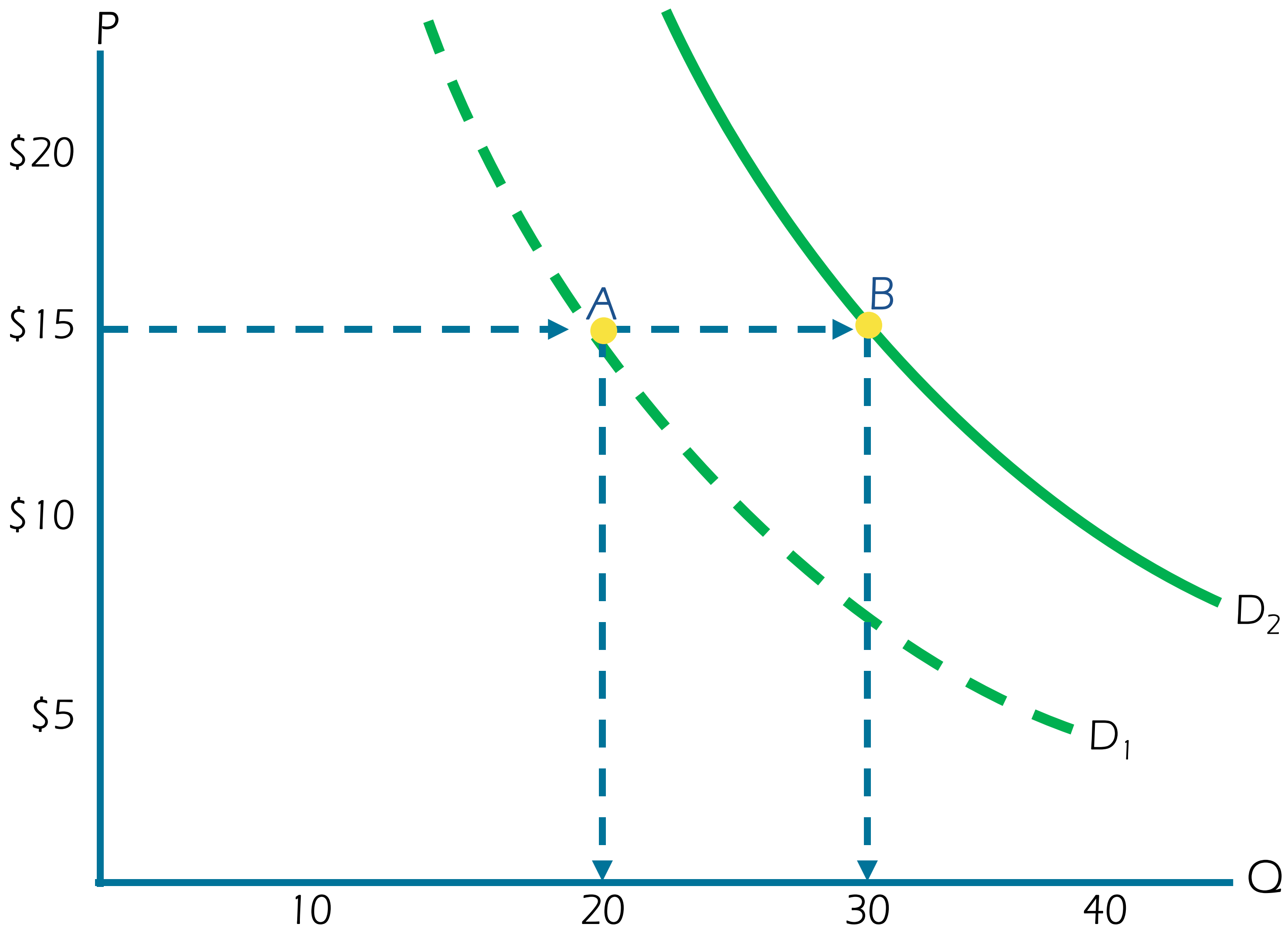


What happens when something other than price changes?

When something other than price changes, the whole curve shifts … there is a *change in demand*.

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

Chart: Change in Demand



What can cause a shift in the demand curve?

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

- number of buyers in the market
- tastes and preferences
- income
- expectations of consumers
- prices of related goods

What does a direct relationship between price and quantity mean?

A *direct* relationship between price and quantity means the two move in the same direction.

When one goes up, the other goes up.

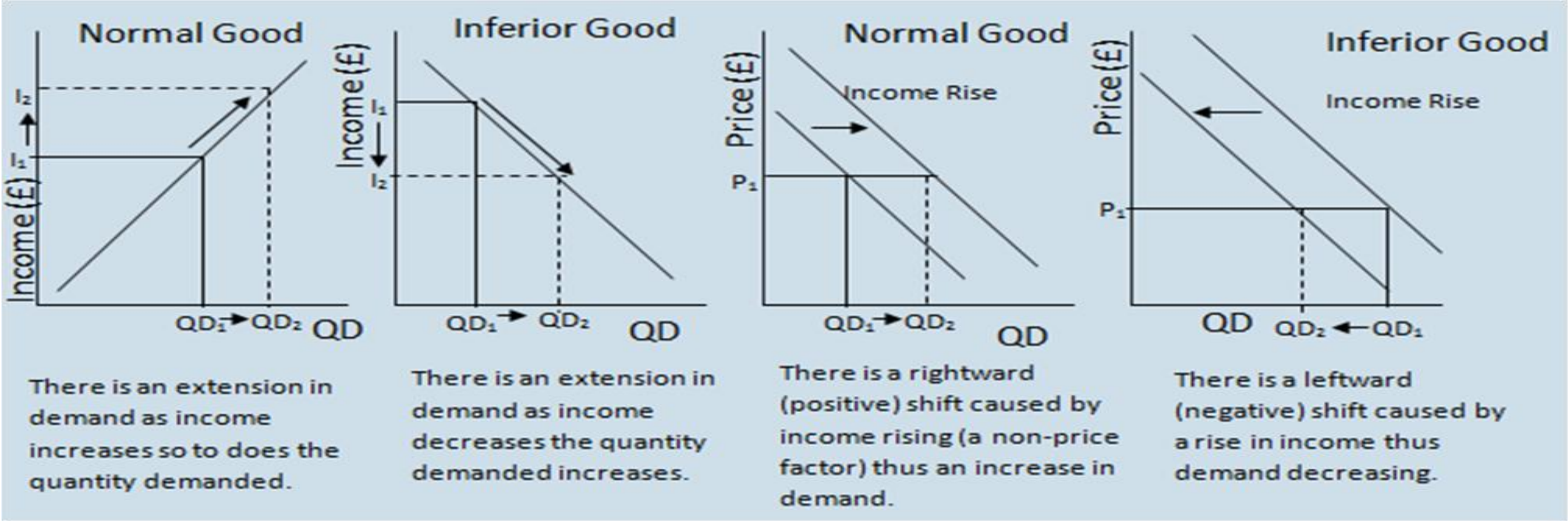
When one goes down, the other goes down.

By contrast, an *inverse* relationship means the two move in opposite directions.

What is a normal good?

A normal good is any good for which there is a direct relationship between changes in income and its demand curve.

If income increases, demand for normal goods increases.



What is an inferior good?

An inferior good is any good for which there is an inverse relationship between changes in income and its demand curve.

As buyers' incomes increase, demand for inferior goods decreases.

What are substitute goods?

Substitute goods are goods that compete with one another for consumer purchases.

If a product's price begins to increase, the demand for similar but less expensive products (substitutes) will increase.

Complements (coffee and doughnuts)	
↓ *Reducing* the price of one...	↑ *increases* the demand for the other.
↑ *Increasing* the price of one...	↓ *reduces* the demand for the other.

Substitutes (coffee and tea)	
↑ *Increasing* the price of one...	↑ *increases* the demand for the other.
↓ *Reducing* the price of one...	↓ *reduces* the demand for the other.

What are complementary goods?

Complementary goods are goods that are jointly consumed with another good – coffee and cream, peanut butter and jelly, printer ink and paper.

As a product's price increases, the demand for that product and for its compliments decrease.

What is supply?

Supply represents the choice-making behavior of sellers.

The law of supply says there is a direct relationship between the price of a good and the quantity sellers are willing to offer for sale in a defined time period, *ceteris paribus.*

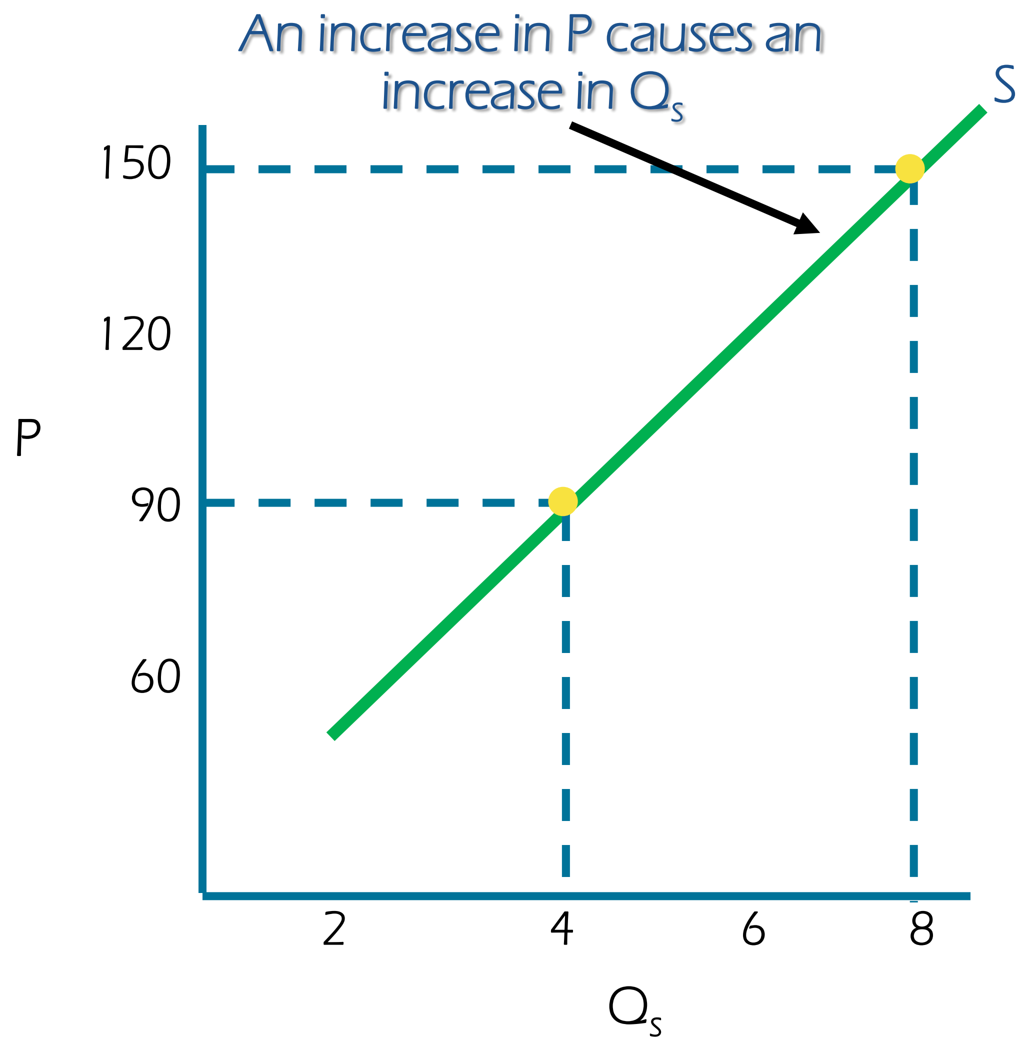
We use a supply schedule to show the relationship between the price and the quantity supplied on a supply curve.

Why do supply curves have a positive slope?

Supply curves have a positive slope because only at a higher price will it be profitable for sellers to incur the higher opportunity cost associated with supplying a larger quantity.

Table and Chart: Quantity Supplied (Q_s)

P	Q_s
$150	8
120	6
90	4
60	2



CONTINUED IN TEST YOURSELF: CORE CONCEPTS PART III