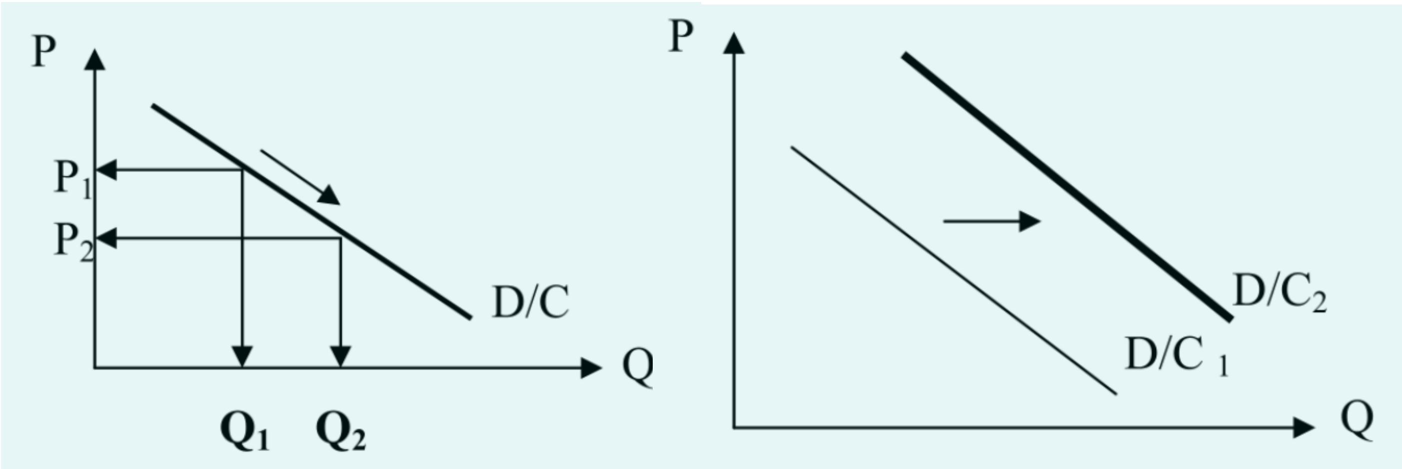
Diagrams Revision Sheet

1. Distinguish between a movement along the demand curve and a shift in the demand curve.

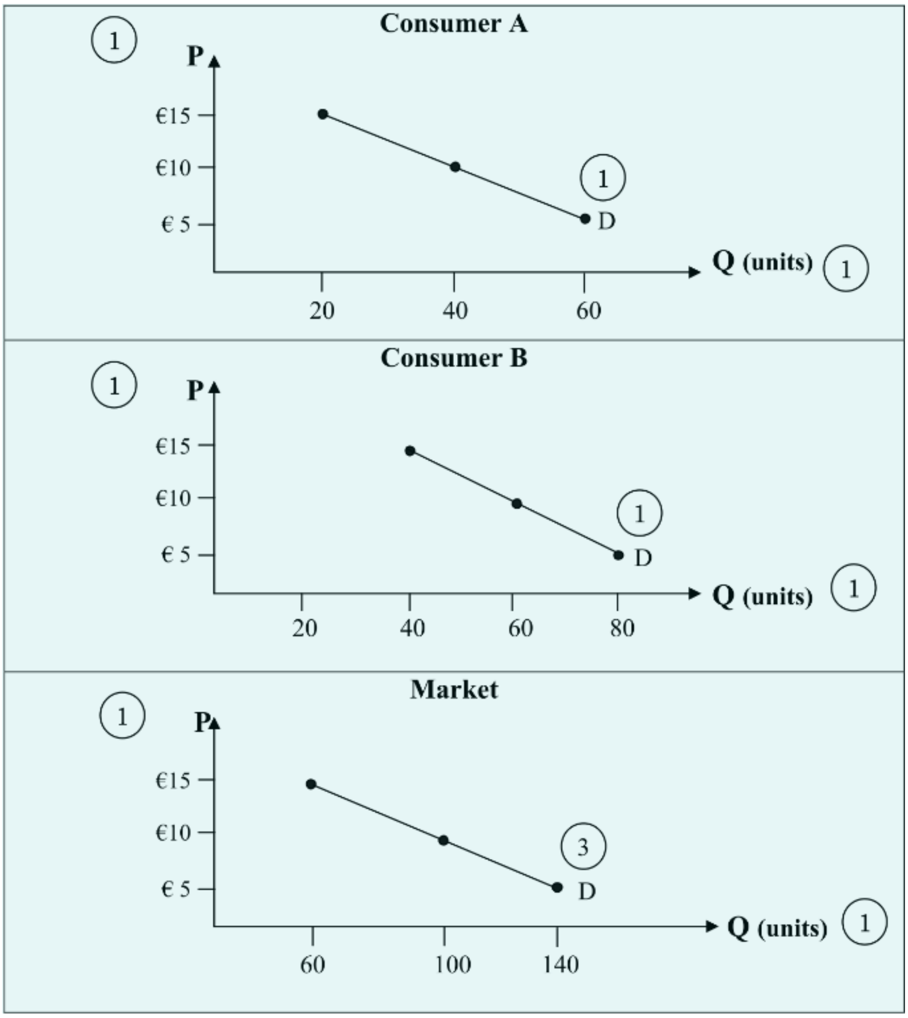


A movement along the demand curve is caused by a change in the price of the good itself (all else being equal)
Referred to as a change in the quantity demanded

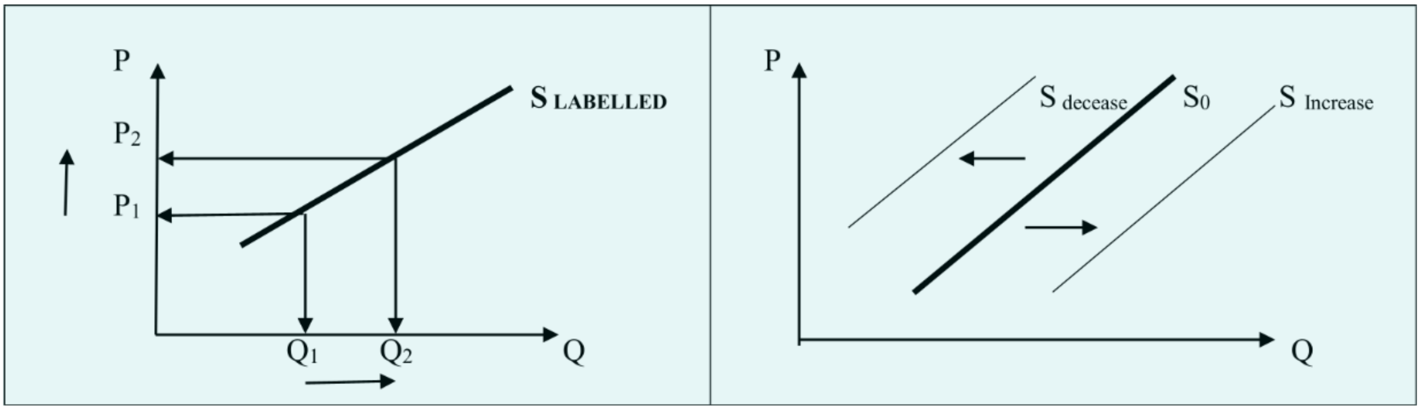
A shift in the demand curve is caused by a change in any non-price determinant of demand
Referred to as a change in demand at any given price

2. Explain the relationship between individual demand and aggregate/market demand.

To get the market demand, we add the quantity demanded by each individual consumer at each price to calculate the overall quantity demanded by the market at each price



3. Distinguish between a movement along the supply curve and a shift in the supply curve.

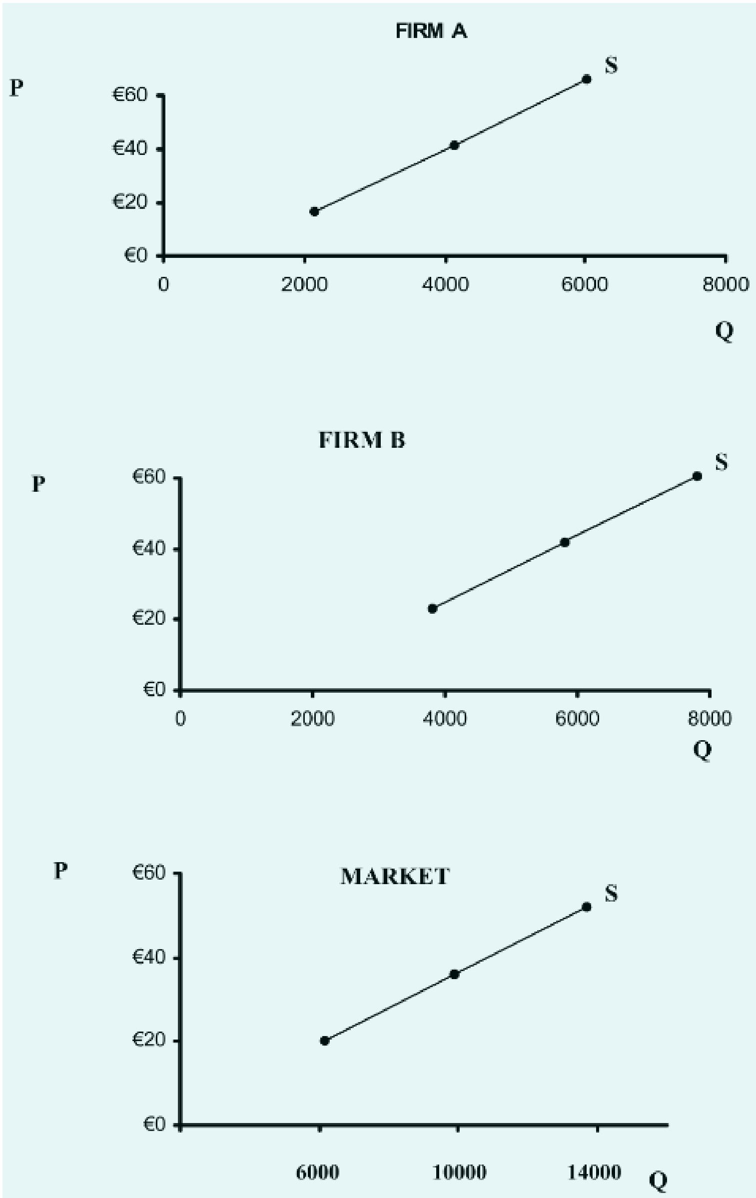


A movement along the supply curve is caused by a change in the price of the good itself
Referred to as a change in supply

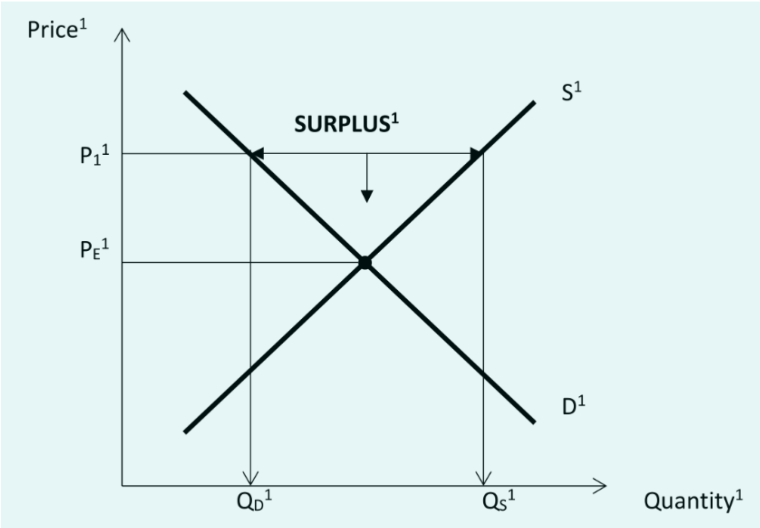
A shift in the supply curve is caused by a change in any non-price determinant of supply.
Referred to as a change in supply at all prices

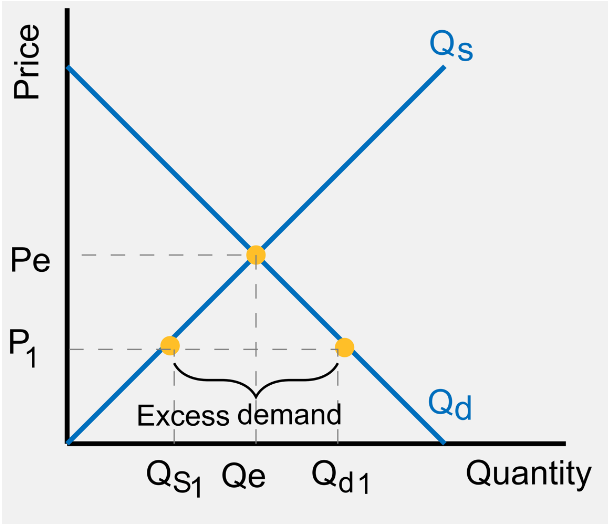
4. Explain the relationship between individual supply and aggregate/market supply.

To get the market supply,
we add the quantity supplied
by each individual firm at
each price to calculate the overall
quantity supplied by the market
at each price



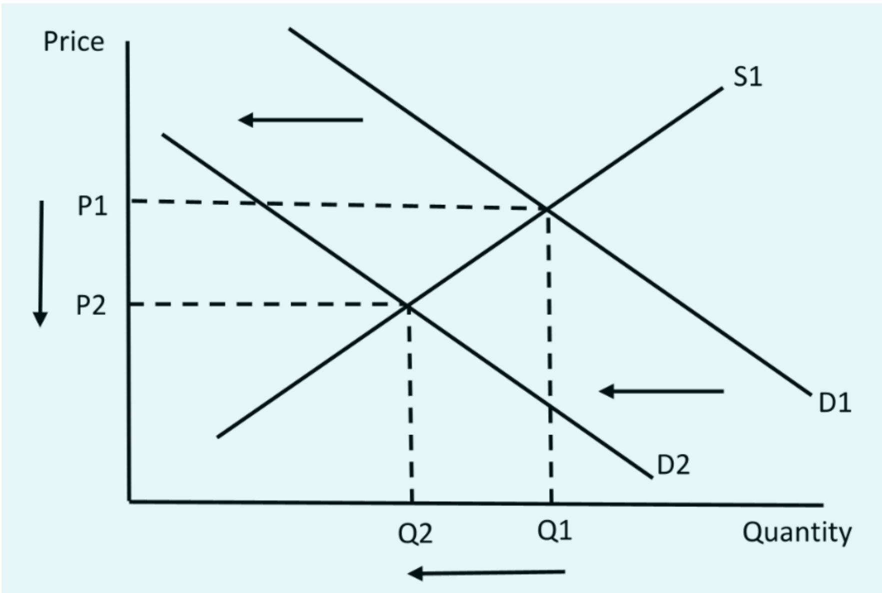
5. Explain how a market would return to equilibrium following excess supply/excess demand.





- If the market price is too high, there is excess supply and suppliers are unable to sell all they want.
- Sellers respond by cutting their prices to clear stocks
- As price falls some suppliers will reduce supply and consumers will demand more (movement along the curve)
- The price will continue to fall until equilibrium is reached and QD = QS

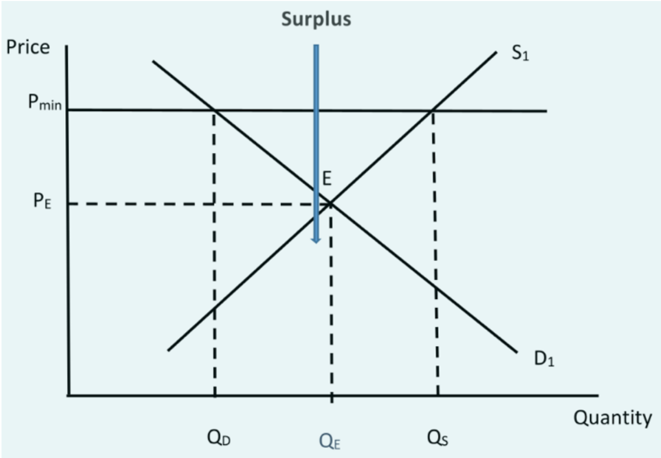
6. Assume the market for X is in equilibrium, explain how the following will affect the market…

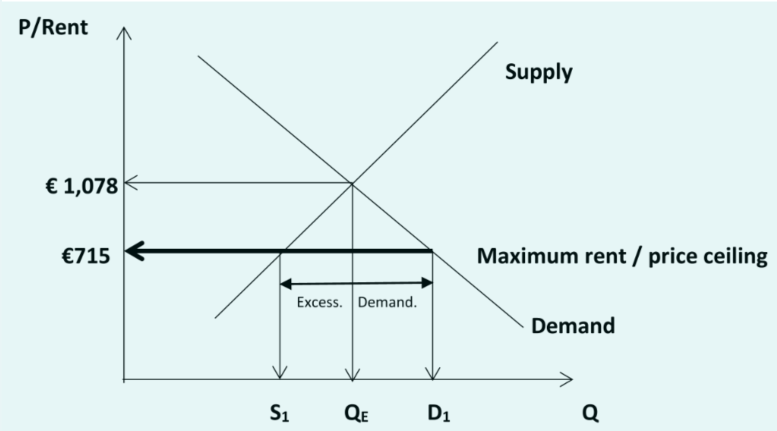


E.g. Assume the market for electric cars is in equilibrium. What will happen if the government increases subsidies on public transport, reducing prices for its commuters?

1. What factor is affecting the demand/supply?
   The fall in the price of a substitute (public transport) causes the demand for electric cars to fall.
2. What kind of shift will there be in the demand/supply curve?
   This causes the demand curve to shift left.
3. Will there be excess supply or excess demand?
   This creates excess supply.
4. What will happen to the price?
   This causes equilibrium price to fall from P1 to P2
5. What will happen to the quantity?
   Equilibrium quantity will fall from Q1 to Q2.

7. Explain the impact that a minimum/maximum price would have on the market.





A minimum price would legally force the price upwards from PE to Pmin.
This increased price will cause a fall in demand from QE to QD.
This will result in excess supply between QD and QS as the price cannot return to equilibrium.

8. Distinguish between elastic, unit elastic, and inelastic demand.

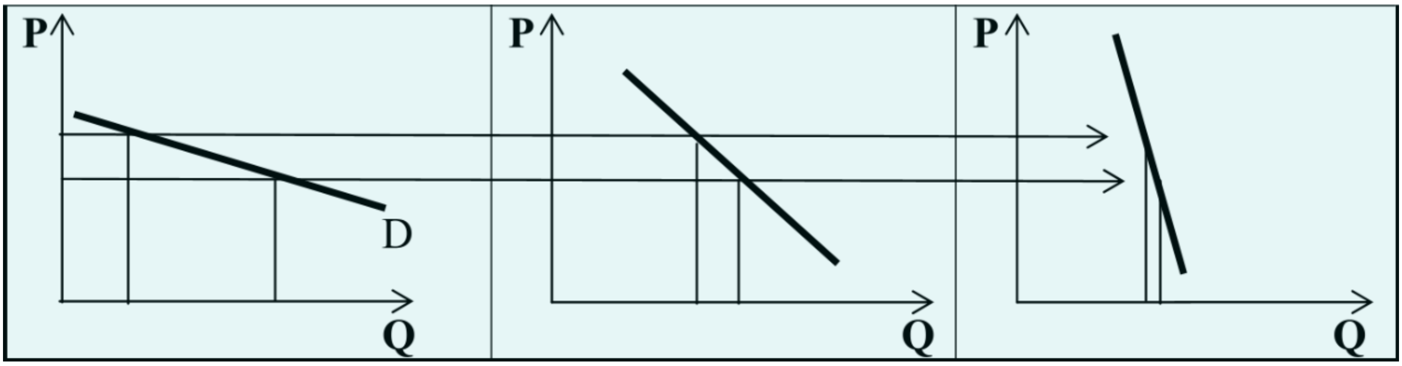


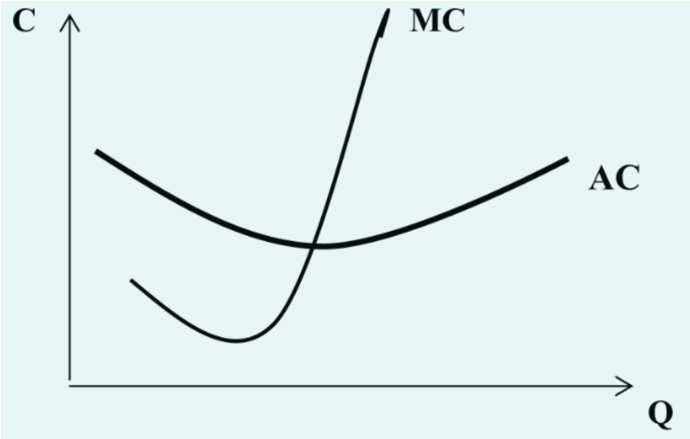
Diagram 1
PED is elastic. PED > 1. A percentage change in price causes a greater percentage change in quantity demanded.

Diagram 2
PED is unit elastic. PED = 1. A percentage change in price causes an equal percentage change in quantity demanded.

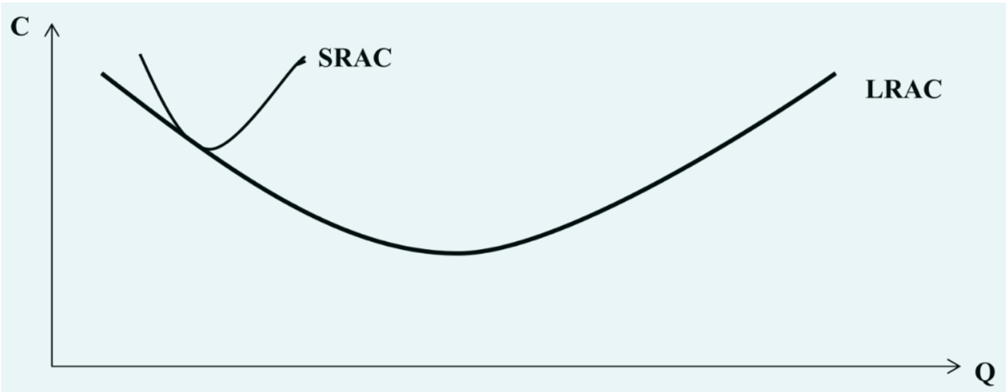
Diagram 3
PED is inelastic. PED < 1. A percentage change in price causes a smaller percentage change in quantity demanded.

9. Explain the relationship between the marginal cost curve and the short run average cost curve.

When MC < AC, AC is falling
When MC > AC, AC is rising
When MC = AC, AC is at its minimum.
MC always cuts AC at its lowest point

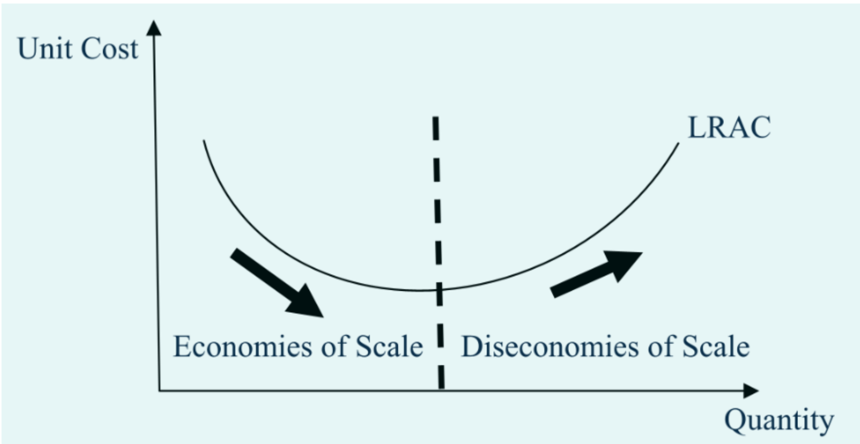


10. Explain the relationship between the short run average cost curve and the long run average cost curve.



Each SRAC curve represents a different size of the firm
The LRAC curve is made up of all the lowest points on the SRAC curves

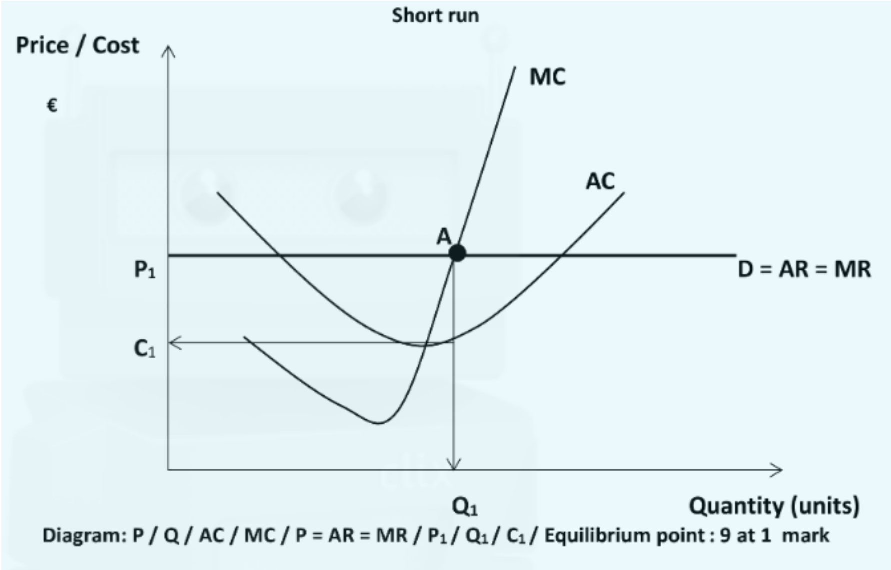
11. Explain the shape of the long run average cost curve.



The LRAC slopes downwards due to increasing returns to scale
Economies of scale are dominant over this range of output

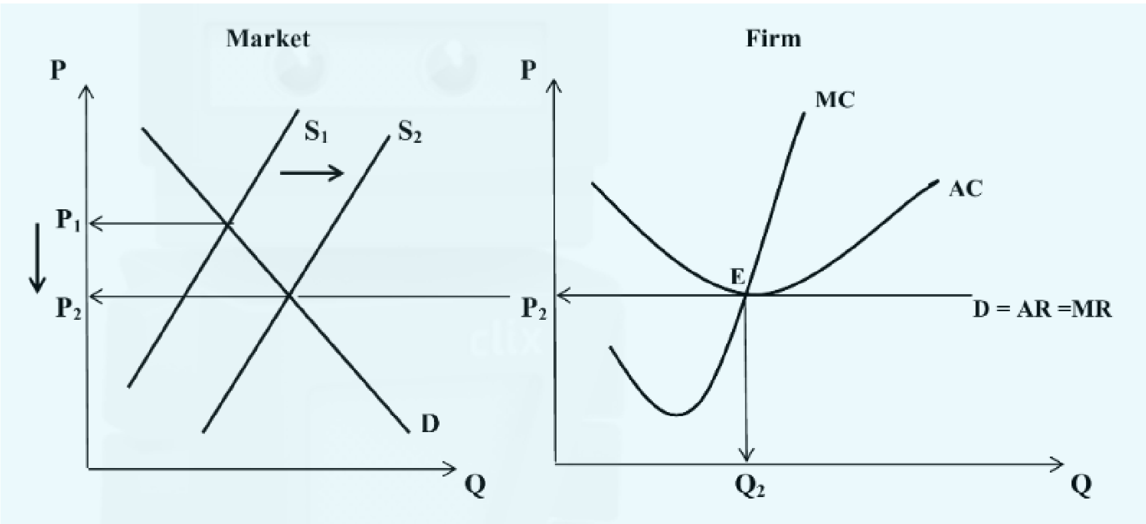
The LRAC slopes upwards due to decreasing returns to scale
Diseconomies of scale are dominant over this range of output

12. Explain the short run equilibrium position of a firm in perfect competition.



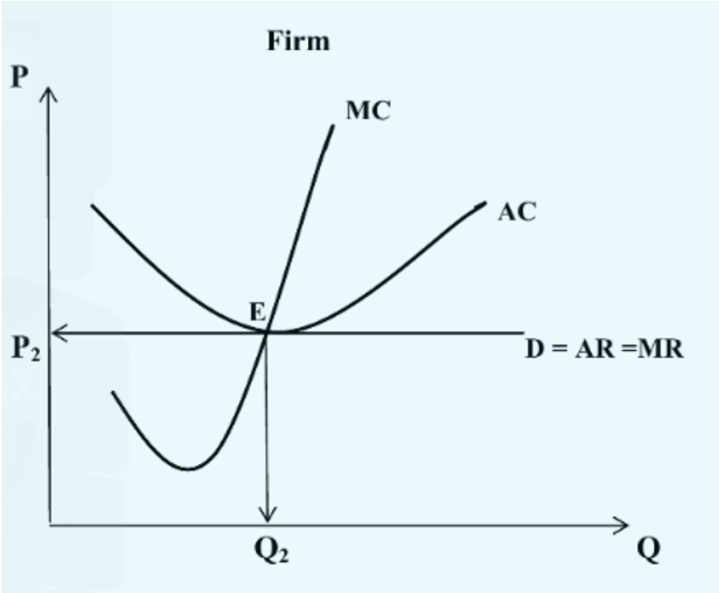
E : Equilibrium occurs at E, where MC = MR and MC is rising
P : The firm produces quantity Q and sells it at price P
C : The cost of production is at point C.
S : The firm is earning supernormal profits, as AR > AC
S : The firm is not making efficient use of their scarce resources as they are not producing at the lowest point of the AC curve

<u>13. Explain the impact that new firms entering the market has on the market equilibrium and the equilibrium of the firm.</u>



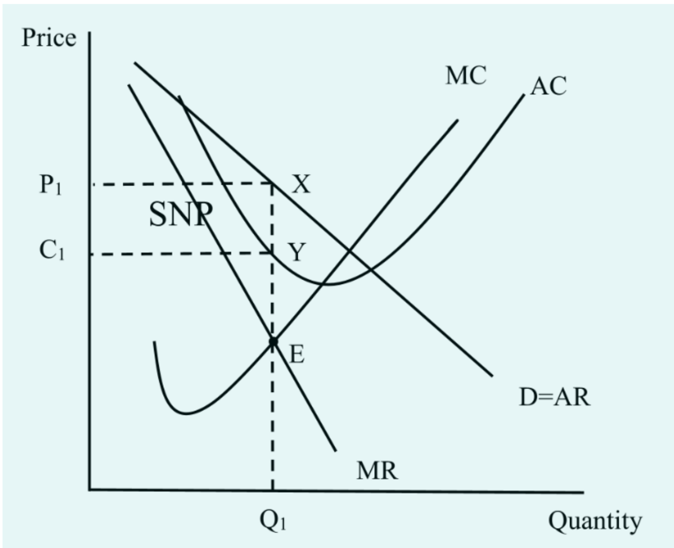
The market supply curve shifts to the right as more firms enter the market
The market price falls
The individual firm's demand curve falls
Firms will now produce a smaller quantity
The amount of SNP's earned will fall and may be eliminated

<u>14. Explain the long run equilibrium position of a firm in perfect competition.</u>



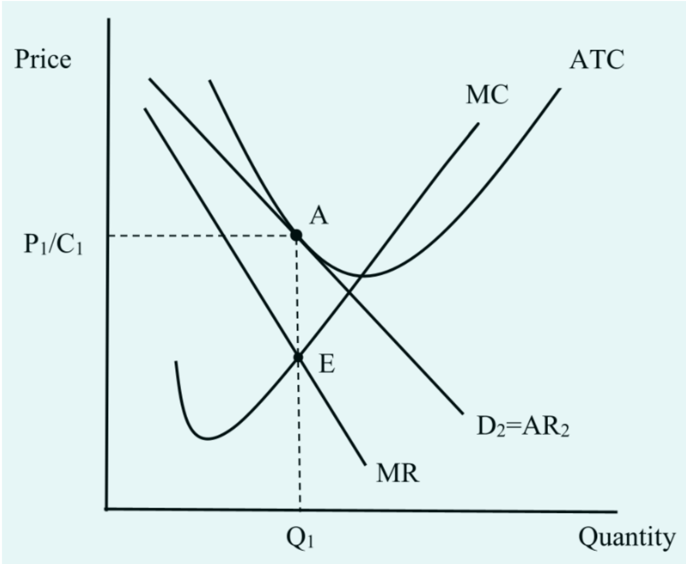
E : Equilibrium occurs at E, where MC = MR and MC is rising
P : P is the selling price and Q is the quantity produced
C : The cost of production is at point C.
S : SNP are not earned, as AR = AC. Normal profit is earned as firms enter the market due to no barriers to entry.
S : The firm is making efficient use of their scarce resources as they are producing at the lowest point of the AC curve

15. Explain the short run equilibrium position of a firm in monopolistic competition.



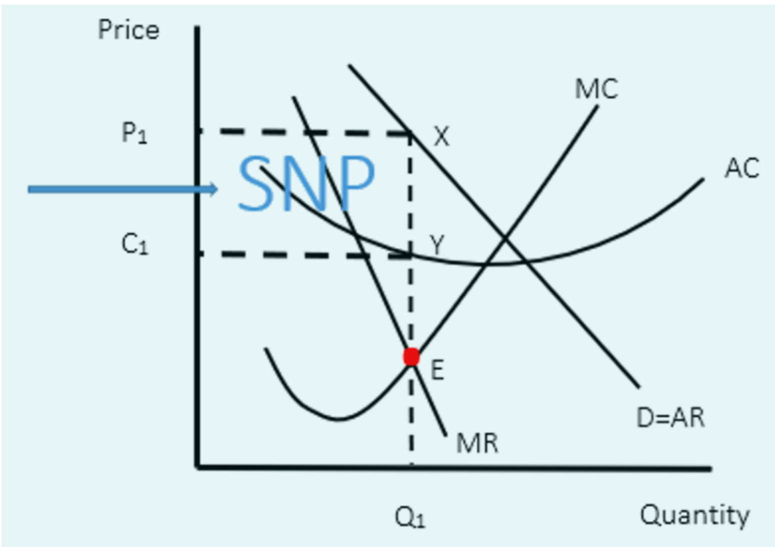
E : Equilibrium occurs at E, where MC = MR and MC is rising
P : The firm produces quantity Q and sells it at price P
C : The cost of production is at point C.
S : The firm is earning supernormal profits, as AR > AC
S : The firm is not making efficient use of their scarce resources as they are not producing at the lowest point of the AC curve. This is due to advertising costs as the firm seeks to differentiate their product

16. Explain the long run equilibrium position of a firm in monopolistic competition.



E : Equilibrium occurs at E, where MC = MR and MC is rising
P : The firm produces quantity Q and sells it at price P
C : The cost of production is at point C.
S : The firm is earning normal profits, as AR = AC
S : The firm is not making efficient use of their scarce resources as they are not producing at the lowest point of the AC curve. This is due to advertising costs as the firm seeks to differentiate their product

17. Explain the long run equilibrium position of a firm in monopoly. *(same as short run monopolistic competition)*



E : Equilibrium occurs at E, where MC = MR and MC is rising
P : The firm produces quantity Q and sells it at price P
C : The cost of production is at point C.
S : The firm is earning supernormal profits, as AR > AC. They can continue earning SNP due to the existence of barriers to entry.
S : The firm is not making efficient use of their scarce resources as they are not producing at the lowest point of the AC curve.

18. Explain the shape of the demand curve a firm faces in oligopoly./Explain the rationale for price rigidity.

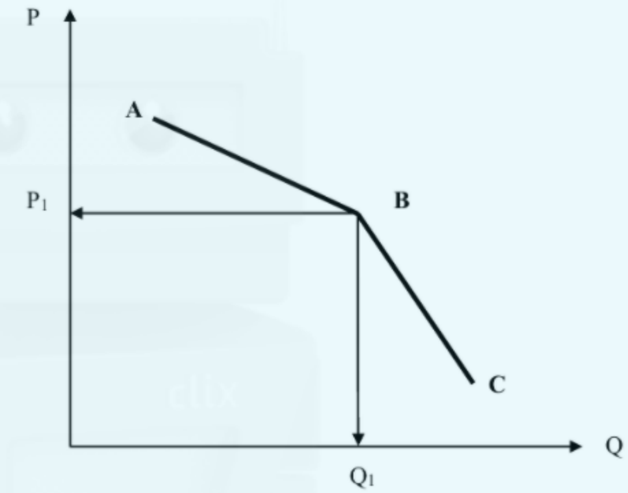


Diagram: P, Q, AB, BC, P_1 : 5 x 1 marks = 5 marks

Overall Demand Curve

The overall demand curve is ABC
It is kinked at point B

Demand Curve AB

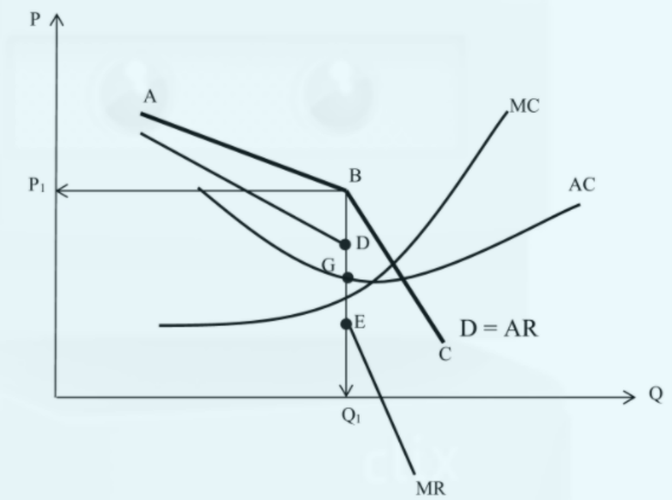
This portion of the demand curve is elastic.
The firm would fear increasing its price as other firms will leave their prices unchanged
So this firm will lose many customers

Demand Curve BC

This portion of the demand curve is inelastic.
The firm does not lower its price as it believes other firms will match this price decrease
So the firm will gain few additional customers and this could lead to a price war

19. Explain the long run equilibrium position of a firm in oligopoly.

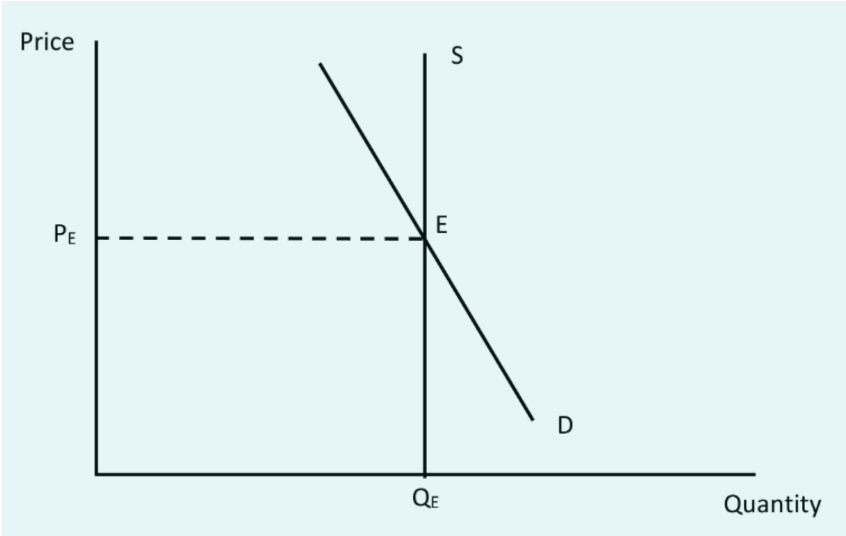
Diagram:



Price axis / Quantity axis / Kinked D/C / Distinct MR / MC / AC / P_1 / Q_1 / Point G

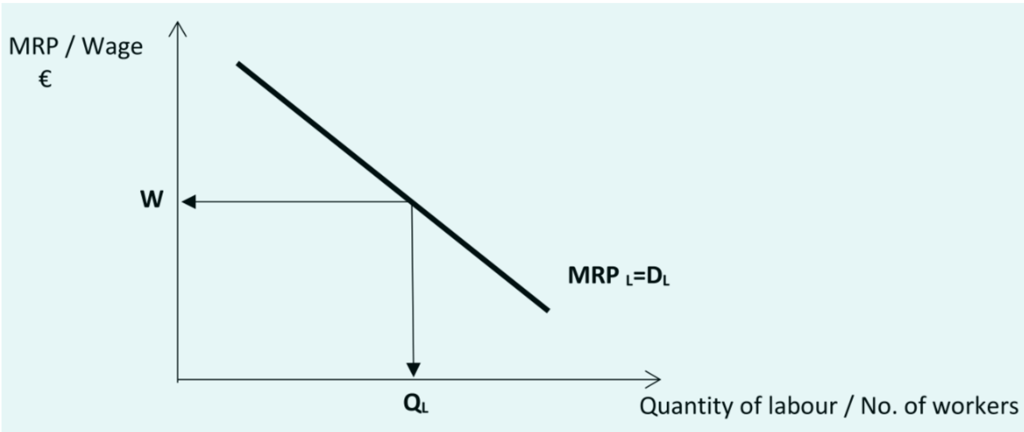
E : Equilibrium occurs at E, where MC = MR and MC is rising
P : The firm produces quantity Q and sells it at price P
C : The average cost of production is at point C. Should costs rise between points F and G, then the market price should remain constant at P due to price rigidity.
S : The firm is earning supernormal profits, as AR > AC. They can continue earning SNP due to the existence of barriers to entry.
S : The firm is not making efficient use of their scarce resources as they are not producing at the lowest point of the AC curve. This is due to advertising costs as firms attempt to differentiate their products

20. Explain how the equilibrium price of land is determined.



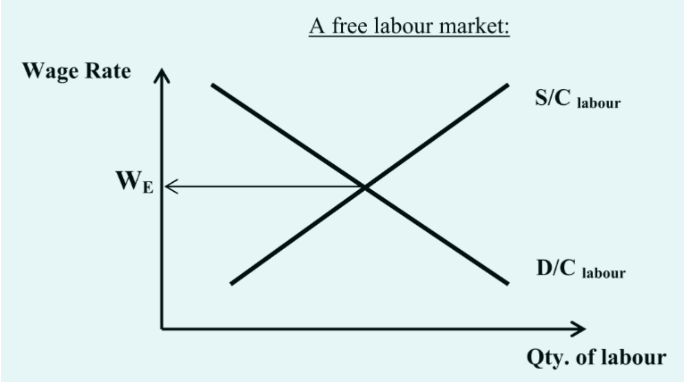
The supply of land is fixed in quantity S.
The demand for land is downward sloping from left to right – D.
The equilibrium price PE is established where D is equal to S.

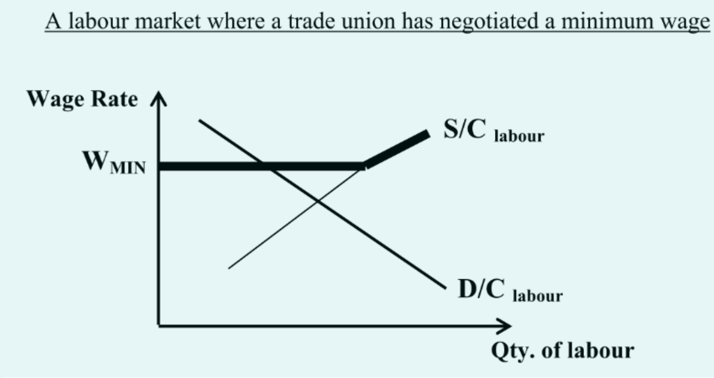
21. Explain the Marginal Revenue Product of labour (MRP of labour).



A profit maximising firm will hire the number of workers where the MRP of the last worker is equal to the wage rate
Therefore the downward sloping section of the MRP curve = the demand curve for labour as it shows the number of workers hired at each wage rates

22. Explain how the equilibrium wage rate is determined in a free labour market and a labour market where a trade union has negotiated a minimum wage.





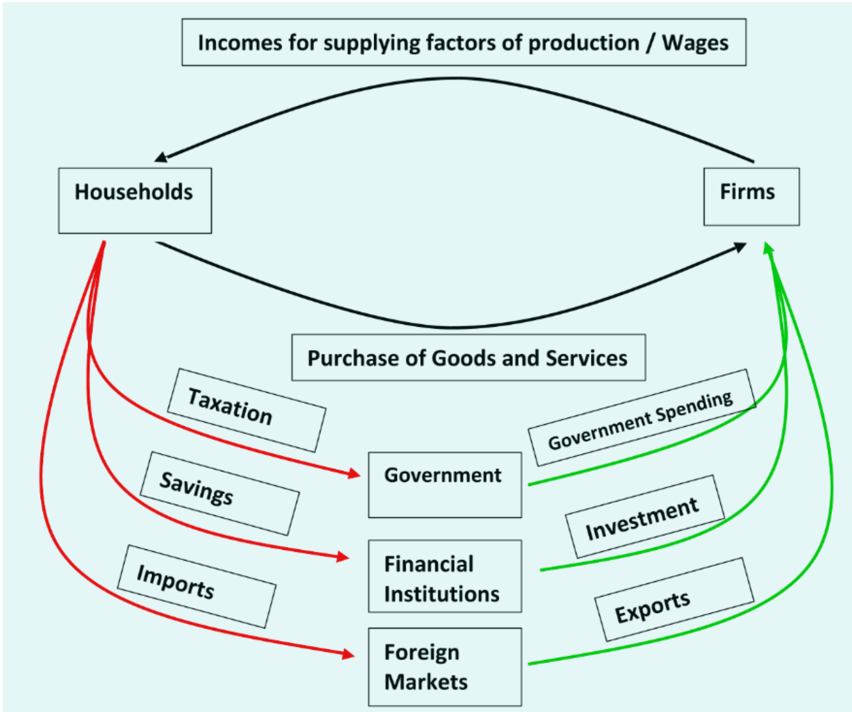
Free Labour Market

There are no restrictions on the demand or supply of labour
The equilibrium wage rate is set where the demand for labour meets the supply of labour

Minimum Wage

The trade union would negotiate a minimum wage rate, set at Wmin
No workers will be supplied below Wmin.

23. Explain the circular flow of income in an open economy.



Households supply the factors of production to firms who, in turn, pay households for these factor inputs (wages, rent, profit and interest).
Firms produce goods and services from the factors of production and households spend income on these goods and services.
Not all income is spent, some is saved. Households save money with financial institutions and these institutions lend money back for investment purposes.
Governments spend money on goods and services and also on transfer payments. Its expenditure is financed by raising revenue through both direct and indirect taxation.
Finally firms export to the rest of the world and firms and households import from the rest of the world.