Microeconomics 03 Demand & Supply

Microeconomics Ch 03

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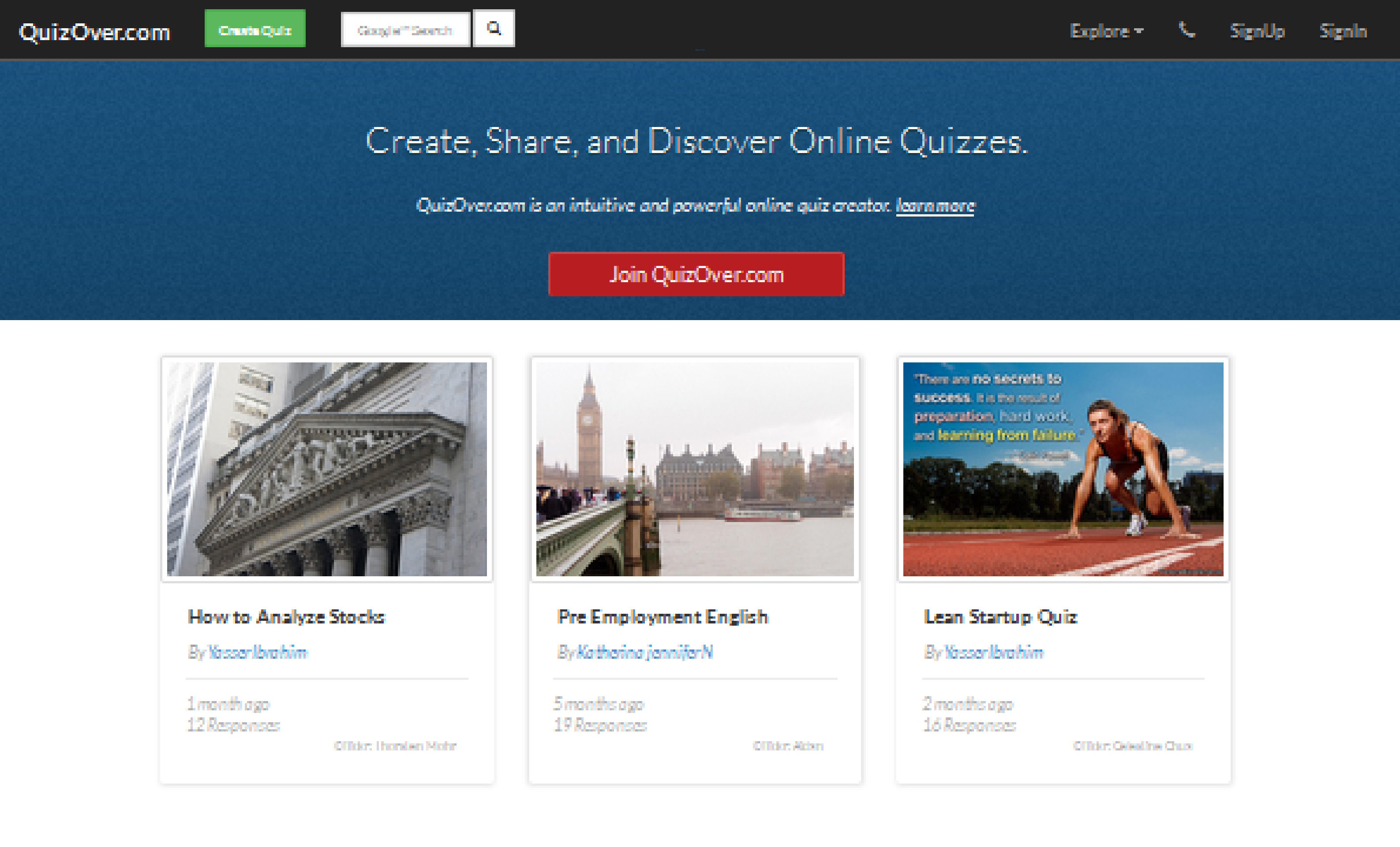

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4. Chapter: Microeconomics 03 Demand & Supply

1. Microeconomics 03 Demand & Supply Questions

4.1.1. Review Figure 3.4. Suppose the price of gasoline is $1.60 per gallo...

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Review Figure 3.4. Suppose the price of gasoline is $1.60 per gallon. Is the quantity demanded higher or lower than at the equilibrium price of $1.40 per gallon? And what about the quantity supplied? Is there a shortage or a surplus in the market? If so, of how much?

- Since $1.60 per gallon is above the equilibrium price, the quantity demanded would be lower at 550 gallons and the quantity supplied would be higher at 640 gallons. (These results are due to the laws of demand and supply, respectively.) The outcome of lower Qd and higher Qs would be a surplus in the gasoline market of 640 - 550 = 90 gallons.

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Question: Review Figure 3.4. Suppose the price of OpenStax College Microeconomics

4.1.2. Why do economists use the ceteris paribus assumption?

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Why do economists use the ceteris paribus assumption?

- To make it easier to analyze complex problems. Ceteris paribus allows you to look at the effect of one factor at a time on what it is you are trying to analyze. When you have analyzed all the factors individually, you add the results together to get the final answer.

4.1.3. In an analysis of the market for paint, an economist discovers the ...

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In an analysis of the market for paint, an economist discovers the facts listed below. State whether each of these changes will affect supply or demand, and in what direction.

a) There have recently been some important cost-saving inventions in the technology for making paint.

b) Paint is lasting longer, so that property owners need not repaint as often.

c) Because of severe hailstorms, many people need to repaint now.

d) The hailstorms damaged several factories that make paint, forcing them to close down for several months.

- a) An improvement in technology that reduces the cost of production will cause an increase in supply. Alternatively, you can think of this as a reduction in price necessary for firms to supply any quantity. Either way, this can be shown as a rightward (or downward) shift in the supply curve.
  b) An improvement in product quality is treated as an increase in tastes or preferences, meaning consumers demand more paint at any price level, so demand increases or shifts to the right. If this seems counterintuitive, note that demand in the future for the longer-lasting paint will fall, since consumers are essentially shifting demand from the future to the present.
  c) An increase in need causes an increase in demand or a rightward shift in the demand curve.
  d) Factory damage means that firms are unable to supply as much in the present. Technically, this is an increase in the cost of production. Either way you look at it, the supply curve shifts to the left.

4.1.4. Many changes are affecting the market for oil. Predict how each of ...

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Many changes are affecting the market for oil. Predict how each of the following events will affect the equilibrium price and quantity in the market for oil. In each case, state how the event will affect the supply and demand diagram.

Create a sketch of the diagram if necessary.

a) Cars are becoming more fuel efficient, and therefore get more miles to the gallon.

b) The winter is exceptionally cold.

c) A major discovery of new oil is made off the coast of Norway.

d) The economies of some major oil-using nations, like Japan, slow down.

e) A war in the Middle East disrupts oil-pumping schedules.

f) Landlords install additional insulation in buildings.

g) The price of solar energy falls dramatically.

h) Chemical companies invent a new, popular kind of plastic made from oil.

- a) More fuel-efficient cars means there is less need for gasoline. This causes a leftward shift in the demand for gasoline and thus oil. Since the demand curve is shifting down the supply curve, the equilibrium price and quantity both fall.
  b) Cold weather increases the need for heating oil. This causes a rightward shift in the demand for heating oil and thus oil. Since the demand curve is shifting up the supply curve, the equilibrium price and quantity both rise.
  c) A discovery of new oil will make oil more abundant. This can be shown as a rightward shift in the supply curve, which will cause a decrease in the equilibrium price along with an increase in the equilibrium quantity. (The supply curve shifts down the demand curve so price and quantity follow the law of demand. If price goes down, then the quantity goes up.)
  d) When an economy slows down, it produces less output and demands less input, including energy, which is used in the production of virtually everything. A decrease in demand for energy will be reflected as a decrease in the demand for oil, or a leftward shift in demand for oil. Since the demand curve is shifting down the supply curve, both the equilibrium price and quantity of oil will fall.
  e) Disruption of oil pumping will reduce the supply of oil. This leftward shift in the supply curve will show a movement up the demand curve, resulting in an increase in the equilibrium price of oil and a decrease in the equilibrium quantity.
  f) Increased insulation will decrease the demand for heating. This leftward shift in the demand for

oil causes a movement down the supply curve, resulting in a decrease in the equilibrium price and quantity of oil.

g) Solar energy is a substitute for oil-based energy. So if solar energy becomes cheaper, the demand for oil will decrease as consumers switch from oil to solar. The decrease in demand for oil will be shown as a leftward shift in the demand curve. As the demand curve shifts down the supply curve, both equilibrium price and quantity for oil will fall.

h) A new, popular kind of plastic will increase the demand for oil. The increase in demand will be shown as a rightward shift in demand, raising the equilibrium price and quantity of oil.

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Question: Many changes are affecting the market for OpenStax College Microeconomics

4.1.5. Let's think about the market for air travel. From 2009 to 2012, the...

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Let's think about the market for air travel. From 2009 to 2012, the price of jet fuel increased roughly 84%. Using the four-step analysis, how do you think this fuel price increase affected the equilibrium price and quantity of air travel?

- Step 1. Draw the graph with the initial supply and demand curves. Label the initial equilibrium price and quantity.
  Step 2. Did the economic event affect supply or demand? Jet fuel is a cost of producing air travel, so an increase in jet fuel price affects supply.
  Step 3. An increase in the price of jet fuel caused an increase in the cost of air travel. We show this as an upward or leftward shift in supply.
  Step 4. A leftward shift in supply causes a movement up the demand curve, raising the equilibrium price of air travel and lowering the equilibrium quantity.

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Question: Let's think about the market for air travel OpenStax College Microeconomics

4.1.6. A tariff is a tax on imported goods. Suppose the U.S. government cu...

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A tariff is a tax on imported goods. Suppose the U.S. government cuts the tariff on imported flat screen televisions. Using the four-step analysis, how do you think the tariff reduction will affect the equilibrium price and quantity of flat screen TVs?

- Step 1. Draw the graph with the initial supply and demand curves. Label the initial equilibrium price and quantity.
  Step 2. Did the economic event affect supply or demand? A tariff is treated like a cost of production, so this affects supply.
  Step 3. A tariff reduction is equivalent to a decrease in the cost of production, which we can show as a rightward (or downward) shift in supply.
  Step 4. A rightward shift in supply causes a movement down the demand curve, lowering the equilibrium price and raising the equilibrium quantity.

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Question: A tariff is a tax on imported goods. OpenStax College Microeconomics

4.1.7. What is the effect of a price ceiling on the quantity demanded of t...

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What is the effect of a price ceiling on the quantity demanded of the product? What is the effect of a price ceiling on the quantity supplied? Why exactly does a price ceiling cause a shortage?

- A price ceiling (which is below the equilibrium price) will cause the quantity demanded to rise and the quantity supplied to fall. This is why a price ceiling creates a shortage.

4.1.8. Does a price ceiling change the equilibrium price?

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Does a price ceiling change the equilibrium price?

- A price ceiling is just a legal restriction. Equilibrium is an economic condition. People may or may not obey the price ceiling, so the actual price may be at or above the price ceiling, but the price ceiling does not change the equilibrium price.

4.1.9. What would be the impact of imposing a price floor below the equili...

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What would be the impact of imposing a price floor below the equilibrium price?

- A price ceiling is a legal maximum price, but a price floor is a legal minimum price and, consequently, it would leave room for the price to rise to its equilibrium level. In other words, a price floor below equilibrium will not be binding and will have no effect.

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Question: What would be the impact of imposing a OpenStax College Microeconomics

4.1.10. Does a price ceiling increase or decrease the number of transaction...

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Does a price ceiling increase or decrease the number of transactions in a market? Why? What about a price floor?

- Assuming that people obey the price ceiling, the market price will be above equilibrium, which means that Qd will be less than Qs. Firms can only sell what is demanded, so the number of transactions will fall to Qd. This is easy to see graphically. By analogous reasoning, with a price floor the market price will be below the equilibrium price, so Qd will be greater than Qs. Since the limit on transactions here is demand, the number of transactions will fall to Qd. Note that because both price floors and price ceilings reduce the number of transactions, social surplus is less.

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Question: Does a price ceiling increase or decrease OpenStax College Microeconomics

4.1.11. If a price floor benefits producers, why does a price floor reduce ...

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If a price floor benefits producers, why does a price floor reduce social surplus?

- Because the losses to consumers are greater than the benefits to producers, so the net effect is negative. Since the lost consumer surplus is greater than the additional producer surplus, social surplus falls.