

# Snazzlefrag's Macroeconomics CLEP Study Notes

Contact: <http://www.degreeforum.net/members/snazzlefrag.html>

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**Allocative Efficiency:** Resources are used for society's most desired goods. ( $P=MC$ ).  
**Perfect Competition.**

Monopolistic Competition, Oligopolies, Monopolies. ( $P>MC$ ).

**Comparative Advantage:** Lower Opportunity Cost (better use of resources).  
Specialize.

**Economic Efficiency:** Full employment and full production (assuming the right goods are produced)

**Fallacy of Composition:** Mistaken assumption that what applies in one case will apply in other cases.

**Lorenz Curve:** / Measures distribution of a populations Income

**Normative Analysis:** "What ought to be" (passes judgement). Cigarette Tax.

**Positive Analysis:** "What if". Theories/models to Predict the impact of choices.

**Productive Efficiency:** Least costly method of production is being used to produce goods/services.

**Scarcity:** Resources = Land, Labour, Capital (plant & equipment), Entrepreneurial Ability

**Slope:** Rise over run (y-vertical divided by x-horizontal)

Sherman Antitrust Act (1890): Price fixing, attempts to monopolize.

Clayton Antitrust Act (1914): Prevent monopolies through mergers.

Price Discrim, Interlocking, Tying, Exclusive Deals (labor unions exempt).

Federal Trade Commission Act (1914): FTC enforces Sherman & Clayton Acts.

Approve Mergers, False Advertizing.

**Opportunity Costs:** Cost of goods sacrificed to produce an alternative good.

**Production Possibilities Curve:** (opportunity cost - Concave graph=Increasing Opportunity Costs)

**Graph: Inefficient < ) > Unattainable** (as you buy more of one, you have to sacrifice another).

1) Full Production/Full Employment (5%). 2) Fixed Resources. 3) Fixed Technology. 4) Only two products.

**Shift: Left** = Economic Decline. **Right** = Economic Growth (invest in capital goods/new technology).

**Supply: /** The amount of goods or service producers plan to sell in a given period. **Price up=Supply up.**

**Shift in supply other than prices = Shift in curve. Decreased Supply = < / > =**

**Increased supply.**

1) Technology. 2) Resource Price. 3) Taxes. 4) Related Goods Price. 5) Expected Price. 6) # of sellers.

Tax increase: Lowers supply. **Perfectly Inelastic Supply = Seller Bears Tax Burden.**

**Demand:** \ The amount of goods or service consumers plan to buy in a given period.  
**Price up=Demand down.**

**Shift** in demand other than prices = Shift in curve. **Lower Demand = < \ > = Higher demand.**

1) Prices. 2) Related Goods Price. 3) Expected Price. 4) Income. 5) Population. 6) Preferences.

**Substitute Effect:** High prices = choose cheaper alternatives.

**Income Effect:** Low prices = buy more AND buy alternatives.

**Price UP:** Demand down/Supply up. **Demand UP:** Price up/Supply up. **Supply Up:** Price down/Demand up.

**Increase in supply:** price will decline & quantity will rise

**Increase in demand:** price & quantity will increase

**Decrease in demand:** price & quantity will decrease

**Decrease in supply:** price rises & quantity declines

**Elastic (>1):** Change in price makes a **big difference**. **Perfect Elastic Demand = Horizontal line** (P=MR) Infinity.

1 = Unit Elastic: Price increase = Demand decreases, No change in revenue. 1:1 ratio, change in price:revenue

>1 = Elastic: Price increase = Demand decreases, Revenue decreases

**Inelastic (<1):** Change in price makes **no difference**. **Inelastic = steeper slope (Price/Quantity).**

0 = Perfectly Inelastic: Price increase = No change in demand, Revenue increases **Vertical Line.**

<1 = Inelastic: Price increase = Demand decreases slightly, Revenue increases

**Price Elasticity of Demand:** \ **%Change in Q / %Change in P.**

**Change in Quantity=** $Q_2 - Q_1 / Q_2 + Q_1$ . **Change in Price=** $P_2 - P_1 / P_2 + P_1$ .

**Price Elasticity of Supply:** / **%Change in S / %Change in P.**

**Cross-price Elasticity of Demand:** **%Change in Q(of item1) / %Change in P(of item2)**. Comp=Neg, Substit=Pos.

**Utility:** (satisfaction) (Eg, 1st@\$2.75, 2nd@\$2, 3rd@\$1, 4th@25c).

**Marginal Utility:** Additional utility from buying one more. Less and less (=actual price. MU of 2nd=\$2).

When MU is zero, TU is at its highest (consuming more will not increase satisfaction/utility).

**Marginal Utility Per Dollar:** **MU / P.** As price increases, MU per dollar decreases.

**Total Utility:** Add up all the marginal utility of all items bought so far. (TU of 2nd=\$2.75+\$2=\$4.75).

**Consumer Surplus:** Difference b/n what you paid, and what you would have been willing to pay.

3@\$1=\$3. But you would have been willing to pay (TU) \$5.75. Consumer Surplus = \$2.75.

**As prices decrease, Consumer Surplus increases.**

**Compliment Goods:** If Price of Y goes up, demand for X goes down (Milk expensive=won't buy Cornflakes)

**Inferior Goods:** If income goes up, demand goes down.

**Normal Goods:** If income goes up, demand goes up.

**Substitute Goods:** If Price of Y goes up, Demand for X goes up (because it's cheaper).

**Veblen Goods:** Status Symbol (Higher the price, higher the Demand).

**Giffen Goods:** If price of Bread rises, poor people have less money for meat, so they buy MORE bread.

**Average Fixed Cost (AFC):**  $\backslash \quad FC / Q$ . Decreases as Output increases. Down to zero in long-run.

**Average Total Costs (ATC):** U  $TC / Q$ . Down=EofS, Up=DofS. ATC rises as rising AVC overcomes falling AFC

**Average Variable Costs (AVC):** /  $VC / Q$ .

**Average Revenue:** Shown as Demand Curve.

**Fixed Costs (FC):** — Horizontal. Fixed Cost per unit of Output.

**Variable Cost (VC):** / Variable Cost per unit of Output.

**Marginal Cost (MC):** /  $Change\ in\ Total\ Costs / Change\ in\ Output$ . Cost of producing one extra unit of output.

ALWAYS intersects with ATC at its lowest point.

**Marginal Revenue (MR):**  $Change\ in\ TR / Change\ in\ Q$ . (actual increase in total revenue). Same as Demand.

**Marginal Revenue Product (MRP):**  $\backslash$  Profit from hiring 1 more worker. Hire until  $MRP=Wages$  (MRP=ME).

**Total Variable Cost (TVC):** /  $VC * Q$ .

**Total Cost (TC):** /  $FC + VC$ .

**Total Profit:**  $(P-ATC)*Q$ .

**Total Revenue (TR):**  $P*Q$ .

**Short-run:** Shut down/Cease Operations or continue to operate (fixed costs = can't go out of business).

**Operate:** If Sales  $TR (P*Q) > VC$ . Or if  $P > AVC$ . (Operate if price is **above shutdown** point).

**Shutdown:** If  $VC > TR (P*Q)$ . Or if  $AVC > P$ . (Shutdown if price is **below shutdown** point).

**Short-run Shutdown Point (Efficient Output)**=lowest point of **AVC** curve (where MC intersects AVC).

**Long-run:** Stay in business or go out of business. Monopoly=highest LR Price. PerfComp=highest LR Quantity.

**Stay in business:** If Sales  $TR (P*Q) > TC (FC+VC)$ . (Stay in Business if price is **above breakeven** point).

**Go out of Business:** If  $TC > TR$  (sales).

**Short-run Breakeven Point (Most Profitable)**=lowest point on **ATC** curve (where MC intersects ATC)

**Minimum Efficient Scale:** When output cost per unit is at its lowest.

In LR competitive firms have ZERO Economic Profit (except for monopolies).

**Maximum Profit:** When  $MR \backslash = MC /$ . Perfect quantity (output). **Not enough output < X**  
**> Too much output.**

Increasing Quantity makes MR go down, and MC go up.  
If MR exceeds MC, keep increasing Q until  $MR=MC$  (maximum profit). If MC exceeds MR, profit decreases.

**Perfect Competition:** — Many sellers (no price influence), **same product**, free entry. Price Taker ( **$P/D/MR=Horizontal$** ) <--- Perfectly Elastic Demand.  
SR Profit:  **$MC=MR$**  or  $TR=TC$ . Big vertical difference b/n TR & TC curve = Maximum Profits.

Short Run:  **$P=MC=MR$** . **Long Run:** All firms breakeven/zero economic profit ( **$P=ATC$** )

**Monopolistic Competition** (99%): Many sellers (no price influence), **differentiated product**, free entry.

**Maximized Profit:**  $MC=MR$  then find the Demand Curve. Elastic demand curve (substitutes). Shallow slope.

**Long-run:** Breakeven/zero economic profit.

**Oligopoly: Few sellers** (Mutual Interdependence/can influence price), same/different product, entry is difficult.

Restrict Output = Higher Prices. **High Concentration Ratio.**

**Long-run AND Short-run:** Firm makes an economic profit.

Kinked Demand Curve: Firms follow price cuts but not price increases. Price stays at the kink.

Cartel -> Collusion/Cooperation -> Price Leadership --> Mild Competition -> Cutthroat Competition

**Monopoly:** \ One seller, no substitutes, no entry (economies of scale, economies of being established).

Control of Essential Resource, Govt Franchise, First There.

**Maximised Profit:**  $MC=MR$  then find the Demand Curve.

**Short Run:**  **$P>MC$** . **Long Run AND Short Run:** Firm makes an economic profit.

MC curve is the Supply curve (starting above breakeven point).

**Concentration Ratio:** 4 Largest Firms in an industry.  $10\%+8\%+7\%+5\%=30$  (80% is high).

Herfindahl Index: 10,000 = monopoly, 0 = perfect competition. Sum of Squares of Market Shares.

**Diseconomies of Scale:** / Increasing Output = Rising LR ATC. (decreasing return to scale).

**Economies of Scale:** \ Increasing Output = Declining LR ATC. (increasing return to scale).