INTRODUCTION TO ECONOMICS

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WEALTH DEFINITION(ADAM SMITH)

- Definition of economics grown so wide.
- Book :An Inquiry into the Nature and Causes of Wealth of Nations,1776.
- Science of material wealth.Enquires determinants of wealth and its growth.
- Ignores immaterial services like education,health,administration and art for economic growth.

WELFARE DEFINITION(ALFERD MARSHAL)

- **Business of life related with material welfare.**
- **Man's action in earning and spending wealth.**
- **Wealth is not an end but a means of promoting human welfare.**
- **Ignores immaterial services like education,health,administration and art for economic growth.**

SCARCITY DEFINITION(ROBINNS)

- **Science of human behavior as a r/ship b/n endless human wants and finite resources(two facts).**
- **How s/he satisfies her/his wants with scarce resources.**
- **Efficient allocation of resources**
- **The most common way of defining economics in literatures.**

RATIONALE OF ECONOMICS

- **Two facts.**
  1. **Human wants- endless.Two reasons**
     Recurring-the same need reappear again after being satisfied
     Hierarchical-BA MSc PhD
  2. **Resources- finite**
- **How human beings make choices.**

SCOPE OF ECONOMICS

1. **Microeconomics:**
   The analysis of small individual units such as individual consumers,firms and small group of individual units like industries and markets
2. **Macroeconomics:**
   The analysis of the economy as a whole and its large aggregates such as national income,aggregate demand and supply, price level etc.

- **They are interdependent /complemen**

METHOD OF ECONOMIC ANALYSIS

1. **Positive economics: Analysis of facts. It answers what was,is,will be questions.It doesn't judge the system.**
   Examples:
   - **Inflation rate is 5 percent.**
   - **Unemployment is rising.**
   - **Any disagreement on positive statements can be checked by looking into facts.**

METHOD OF ECONOMIC ANALYSIS

1. **Normative economics: It evaluates desirability based on one's value judgment.Can't be proved with references to facts. It answers what should,ought to be questions**
   - **The poor should pay no taxes.**
   - **Female ought to be given job opportunities.**
   - **Any disagreement on positive statements can be solved by voting.**

INDUCTIVE AND DEDUCTIVE REASONING

- **The fundamental objective of economics, like any science, is the establishment of valid generalizations about certain aspects of human behaviour.**

1. **Inductive Approach: Specific to general-deriving a principle or theory by moving from facts. The steps:**
   - **Selecting problem for analysis**
   - **Collection, classification, and analysis of data**
   - **Establish law,theory**

INDUCTIVE AND DEDUCTIVE REASONING

1. **Deductive Approach:General to specific-validating a theory (a theory may agree or disagree with real world)**
   - **Problem identification**
   - **Specification of the assumptions**
   - **Formulating hypotheses**
   - **Testing the validity of the hypotheses**

SCARCITY MEANING

- **Scarcity: resources are finite. Free resource-amount greater than desire of society at zero price eg sunshine.Scarce resource-amount less than wants at zero price.**
- **All resources(labor(wage), land(rent), capital(interest) and entrepreneurship(profit)) are scarce**
- **Shortage when people unable to get the amount they want at on going price.**

CHOICE AND OPPORTUNITY COST MEANING

- Due to scarcity choose what and how much to produce
- Scarcity implies choice
- Choice implies cost
- Whenever choice is made alternative opportunity is sacrificed-Opportunity cost
- Opportunity cost : the value of next best alternative that must be sacrificed in order to

ILLUSTRATING SCARCITY,CHOICE OPPORTUNITY COST USING PRODUCTION POSSIBILITY FRONTIER/CURVE

- **PPC/PPF- shows various possible combinations of goods and services the society can produce given its resources and technology Its Assumptions are.**
  1. **Quantity and quality of resources during the year fixed**
  2. **Two goods/services**
  3. **Full employment**
  4. **Constant technology**

		Production possibilities				
Type	Units	A	B	C	D	E
Food	Tons	500	420	320	180	0
cloth	meter	0	500	1000	1500	2000

Figure: **Hypothetical example**

Exercise

1. Draw PPC
2. Efficient points : within and on ppc
3. Attainable and efficient points:on PPC
4. Attainable and inefficient points-within ppc : due to unemployment and under employment
5. Unattainable points:outside ppc
6. Calculate OC in a movement from A to E and E to A (amount forgone/amount gained): increasing opp.cost (concave PPC)

Inputs/resources are not equally adaptable

Assumption 5

	Efficiency level in food production	Efficiency level in cloth production
X	Best	'Bad'
Y	'Bad'	Best
Z	Better	Not 'bad'

Figure: **resources are not equally adapated**

PPF describes three concepts

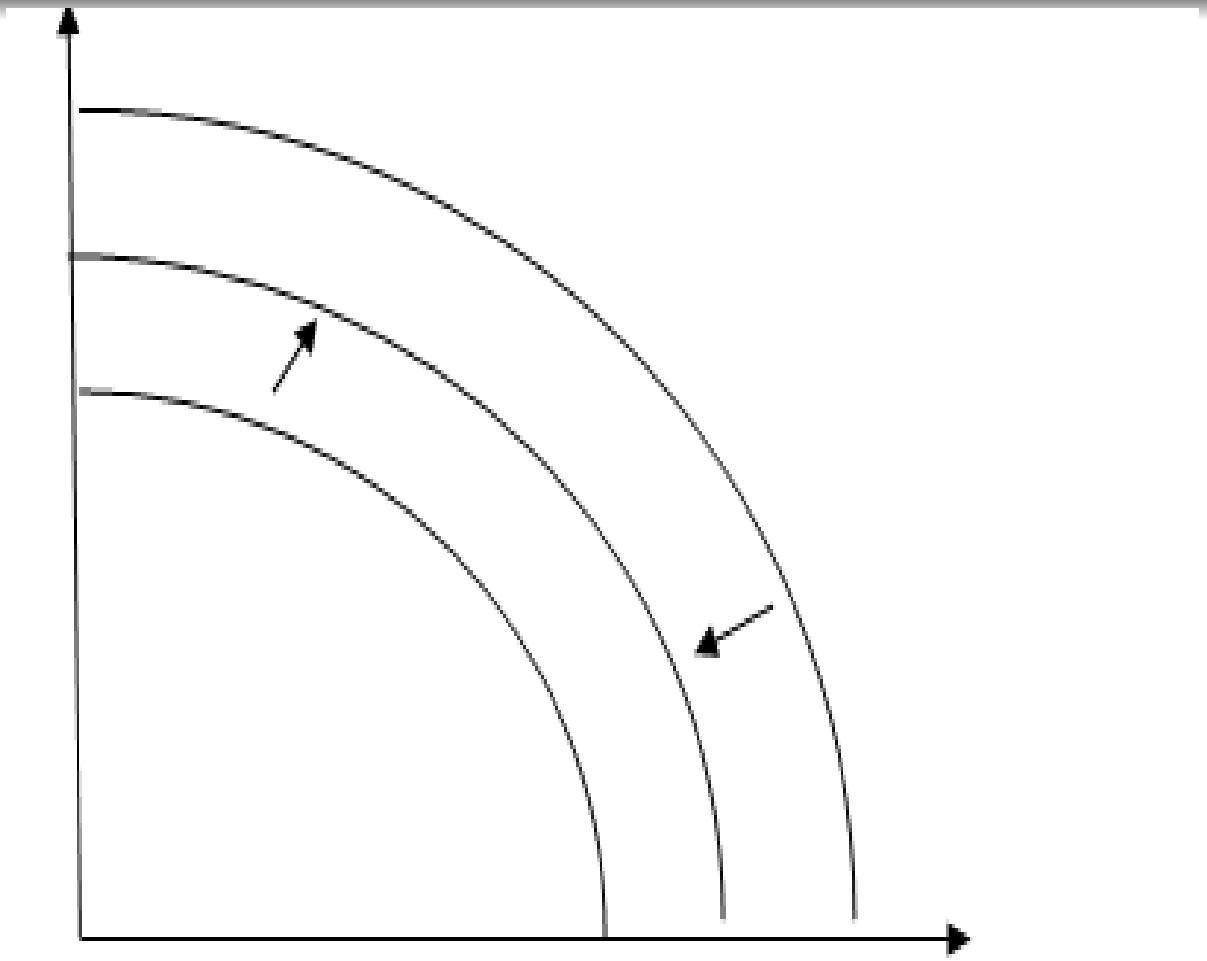
1. **Scarcity:we can not have infinite number of goods even at full employment.**
2. **Choice: a movement along the curve indicates change in choice.**
3. **Opportunity cost:production of more of one good requires sacrificing some of another**

ECONOMIC GROWTH AND PPF/PPC

- SOURCE OF ECONOMIC GROWTH
  1. Increase in quantity and/or quality of resources
  2. Advance in technology
- Shift PPC outward-the reverse is true when low quantity and quality resource ,low technology
- Graphically shown below

CHAPTER ONE : SUBJECT MATTER OF ECONOMICS
CHAPTER TWO :THEORY OF DEMAND AND SUPPLY

DEFINITION,MEANING AND RATIONALE OF ECONOMICS
SCOPE AND METHOD OF ECONOMIC ANALYSIS
SCARCITY,CHOICE AND OPPORTUNITY COST AND PPF/PP
BASIC ECONOMIC QUESTIONS
ECONOMIC SYSTEMS
DECISION MAKING UNITS AND CIRCULAR FLOW MODEL
ASSIGNMENT(10 MARKS) : individual (BA1,BA2,AND B3)

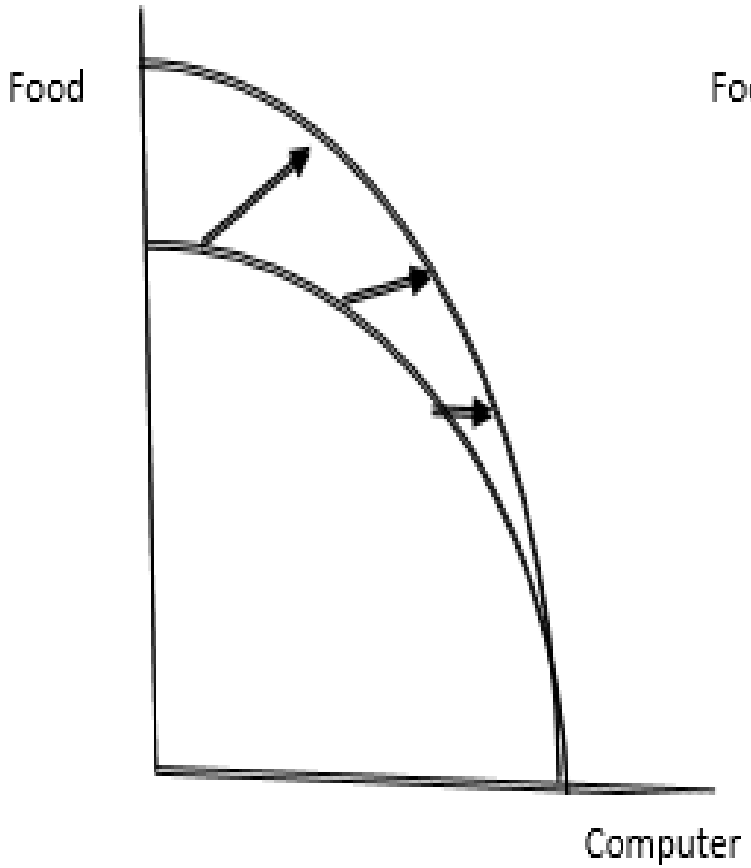


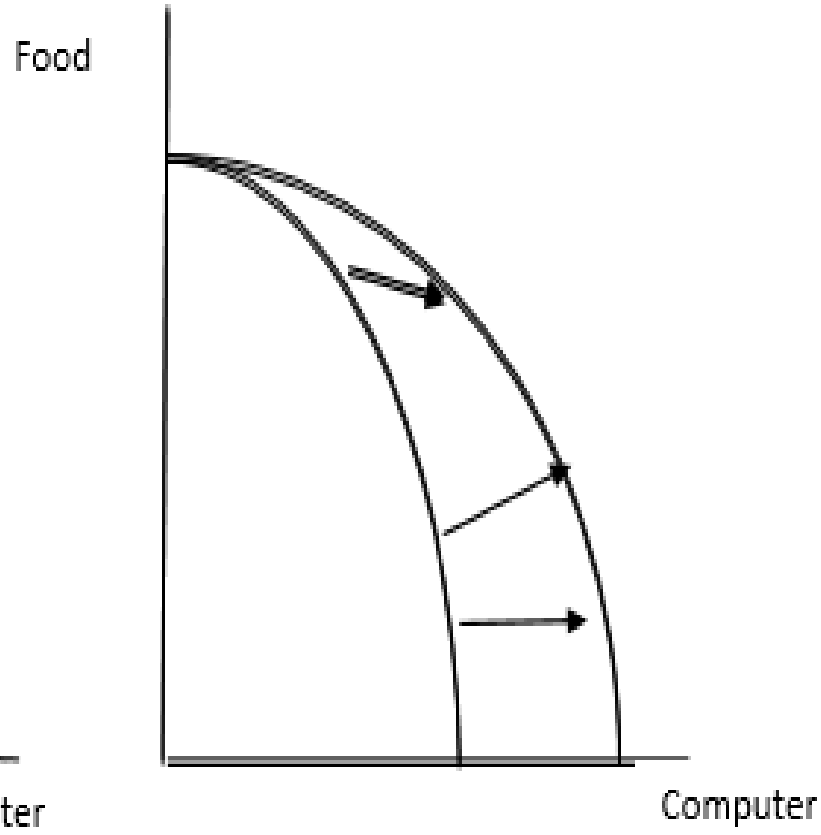
ASYMMETRIC GROWTH

- Due to improvement in technology applied to either food or computer
- Increase in productivity in one sector
- Graphically shown below

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Food
Computer


Food
Computer

BASIC ECONOMIC QUESTIONS

- **ECONOMIC PROBLEMS DUE TO SCARCITY**
  1. **WHAT TO PRODUCE: allocation of resources**
  2. **HOW TO PRODUCE:choice of techniques(capital vs labor intensive technique);choice depends supply and relative price**
  3. **FOR WHOM TO PRODUCE:distribution of output(production for few/mass)**

ECONOMIC SYSTEMS

- **WAY OF ANSWERING THE THREE FUNDAMENTAL QUESTION**
- **An organizational and institutional arrangements established to answer the basic economic questions**
- **Three systems: Capitalism,socialism and mixed**

CAPITALISM/FREE MARKET/LAISSEZ FAIRE ECONOMIC SYSTEM

- FEATURES OF CAPITALISM
  1. **PRIVATE OWNERSHIP OF RESOURCES**:
  2. **CONSUMER SOVEREIGNTY**:can buy their tastes , producer can produce in accordance with consumers' preferences
  3. **PROFIT MOTIVE**: productive activities guided by profit motive
  4. **COMPETITION**:among seller,among laborers,among employers
  5. **PRICE MECHANISM**: The price(DD,SS)

- FEATURES OF CAPITALISM ...
  1. **MINOR ROLE OF GOVERNMENT: maintain peace and order**
  2. **SELF INTEREST: desire for economic gain**
  3. **INCOME INEQUALITY: productive activities guided by profit motive**
  4. **NEGATIVE EXTERNALIZES: harm,cost,inconvenience suffered by third party. eg music sound from neighbors,air ,water pollution from factories**

- ADVANTAGES OF CAPITALISM
  1. **FLEXIBLE AND ADAPTS TO CHANGING ENVIRONMENT:**
  2. **DECENTRALIZATION OF ECONOMIC POWER: market mechanism**
  3. **HIGHER STANDARD OF LIVING AND PER CAPITA INCOME: growth in production**
  4. **VARIETY OF GOODS: more goods to choose from**
  5. **GROWTH OF ENTREPRENEURSHIP: due to profit motive**
  6. **OPTIMUM UTILIZATION OF RESOURCES: due to innovation and technology**

- DISADVANTAGES OF CAPITALISM
  1. **INCOME INEQUALITY: social imbalance**
  2. **UNBALANCED ECONOMY: in terms of geographical regions or sector of the economy or section of society**
  3. **LABOR EXPLOITATION: in terms of low wage**
  4. **NEGATIVE EXTERNALITIES:**

SOCIALISM / COMMAND ECONOMIC SYSTEM

- FEATURES OF SOCIALISM
  1. **COLLECTIVE OWNERSHIP OF RESOURCES**: **society as a whole own resources**
  2. **CENTRAL PLANNING**:
  3. **STRONG GOVERNMENT ROLE**: **on economic activities**
  4. **MAXIMUM SOCIAL WELFARE**: **doesn't allow labor exploitation**
  5. **RELATIVE INCOME EQUALITY**:no

- ADVANTAGES OF SOCIALISM
  1. **ABSENCE OF WASTEFUL COMPETITION:**
  2. **BALANCED GROWTH:**
  3. **ELIMINATE PRIVATE MONOPOLIES AND INEQUALITIES:**

- DISADVANTAGES OF SOCIALISM
  1. **ABSENCE OF AUTOMATIC PRICE MECHANISM:**
  2. **ABSENCE OF INCENTIVES FOR HARD WORK AND EFFICIENCY:**
  3. **LACK OF ECONOMIC FREEDOM:**
  4. **RED-TAPISM:BEUROCRATIC PROCEDURES**

MIXED ECONOMIC SYSTEM

- FEATURES OF MIXED ECONOMIC SYSTEM
  1. **Co-existence of public and private sectors**: big invt by public, consumer goods industry by private
  2. **Economic welfare**: govt control over private sector leads welfare
  3. **Economic planning**:
  4. **Price mechanism**: operate for goods in private sector but not public sector
  5. **Economic equality**:rules prevent concentration of wealth eg progressive

- ADVANTAGES OF MIXED ECONOMY
  1. **Private property, profit motive and price mechanism:**
  2. **Adequate freedom:**
  3. **Rapid and planned economic development:**
  4. **Social welfare and fewer economic inequalities**

- DISADVANTAGES OF MIXED ECONOMY
  1. **Ineffectiveness and inefficiency**:lack of incentive and responsibility(public sector),government regulation and control(private sector)
  2. **Economic fluctuations**: if not properly controlled -economic fluctuation,unemployment can occur
  3. **Corruption and black markets**:

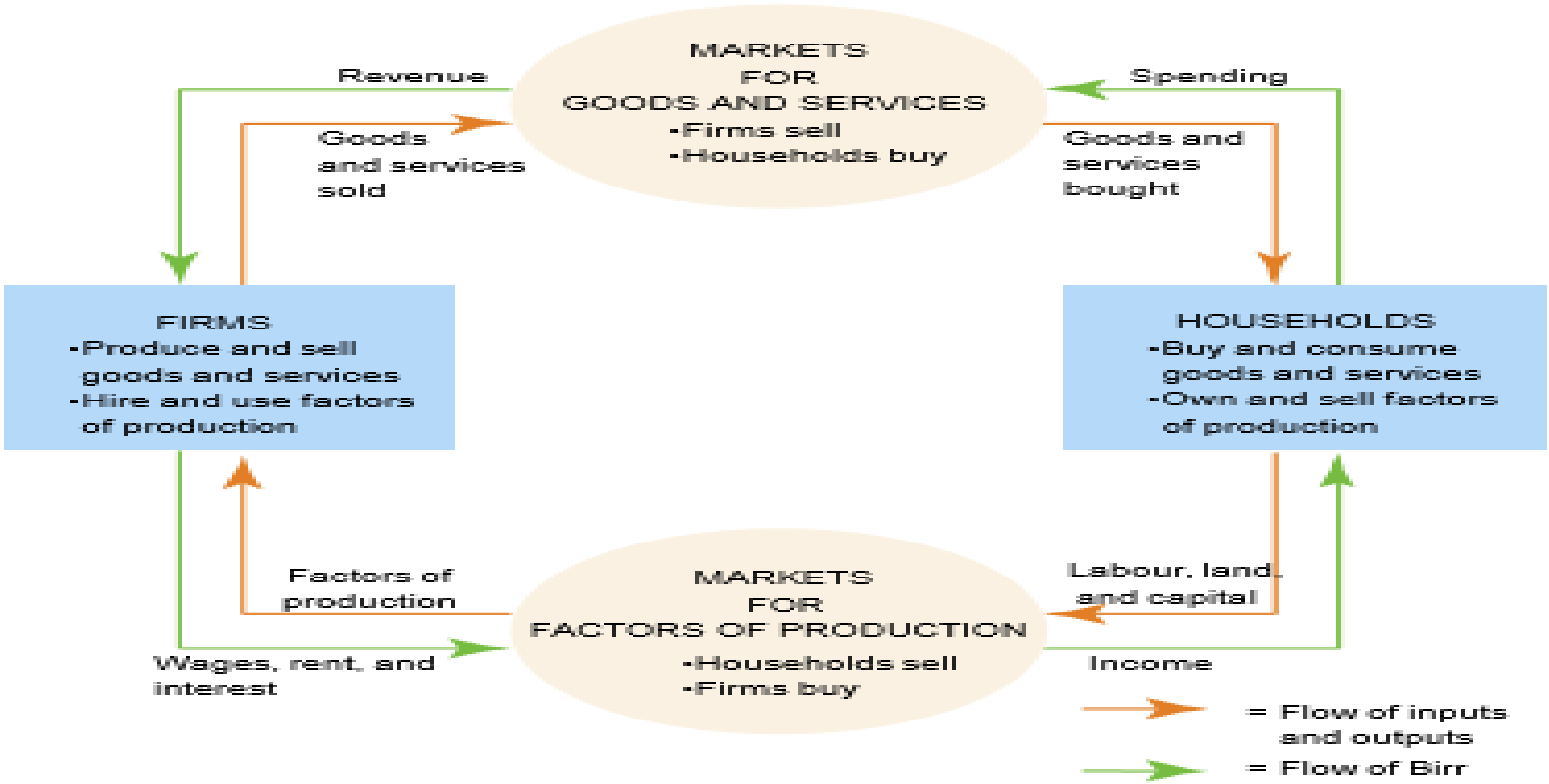
DECISION MAKING UNITS

- HOUSEHOLD,FIRM,GOVERNMENT,FOREIGNERS INTERACT IN TWO MARKETS
  1. **PRODUCT MARKET:**
  2. **FACTOR MARKET:**
  3. **CIRCULAR FLOW MODEL/DIAGRAM - model that shows how money (Birr), economic resources and goods and services flows through markets among the decision making units:**
  4. **Two sector model and three sector model**

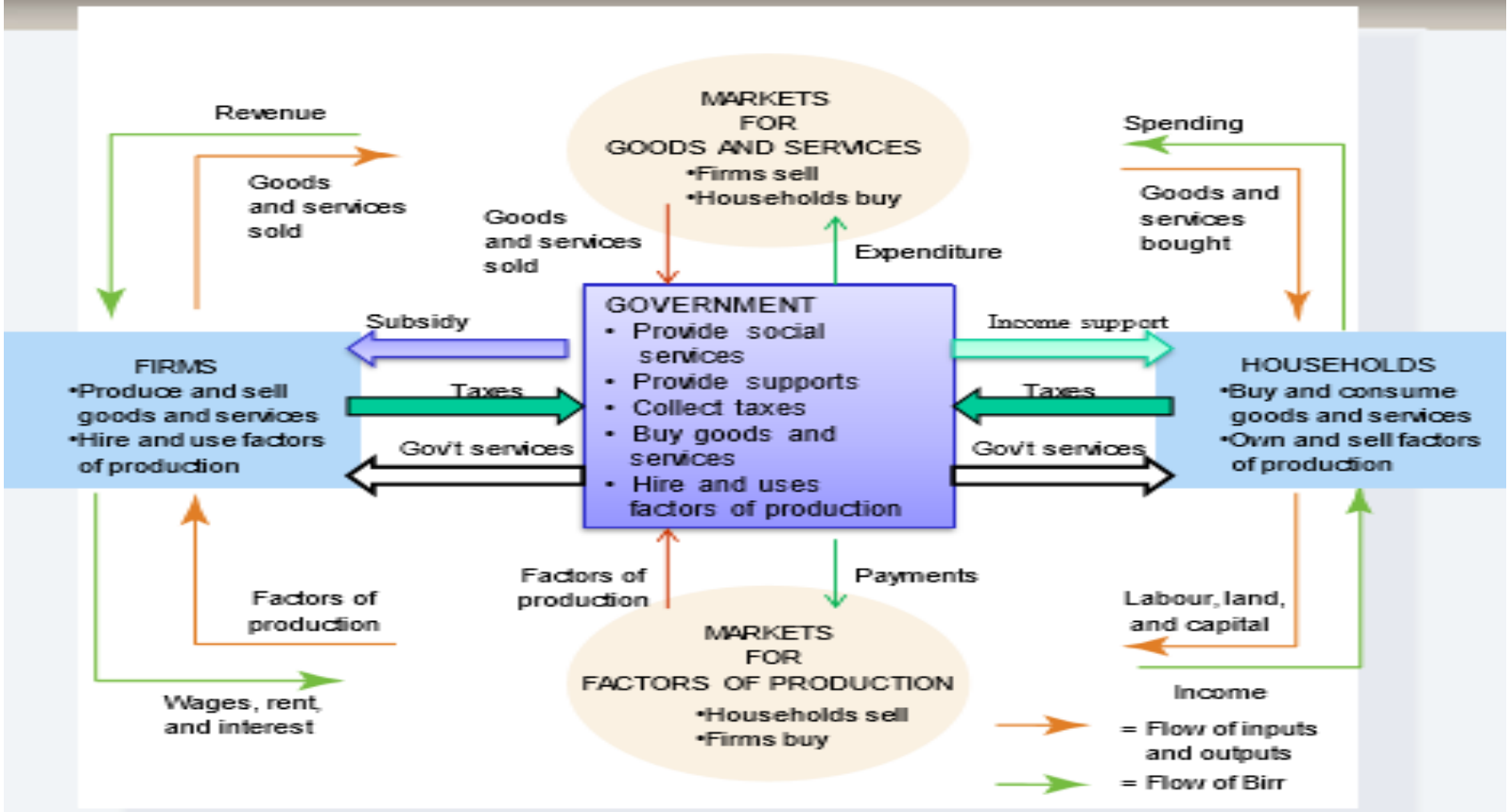
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A Two sector model



A Three sector model



PRODUCTION POSSIBILITY FRONTIER AND CIRCULAR FLOW MODEL

- **Relax the two goods assumption to three goods assumptions of PPC and try to see what happens to PPC?(1 points)**
- **By relaxing the fifth assumption(inputs are equally adapted) (6 points)**
  1. **Draw PPC,concave,convex or linear?**
  2. **Identify opportunity cost of more cloth, and or more food? increasing ,decreasing or constant?**

PRODUCTION POSSIBILITY FRONTIER AND CIRCULAR FLOW MODE

- **Develop four sector circular flow model? Show detail interactions with concrete examples(3 points)**
- **Submission date : Dec 11,2019**

DEMAND DEFINED AND LAW OF DEMAND

- Wish/Want vs Demand.
- Day to day life meaning : A desire of a person to purchase a commodity or service
- Economics meaning : Willing and able to purchase the commodity
- Demand refers to various quantities that a consumer would purchase at a given time at various prices, given other things unchanged (ceteris paribus).

DEMAND SCHEDULE, CURVE AND FUNCTION

- Law of demand expressed using table,graph and equation
- Once we have a schedule can derive a graph and equation
- Once we have equation can derive schedule and graph
- Go from one way of expression to the other/s.

Combinations	A	B	C	D	E
Price per kg	5	4	3	2	1
Quantity demand/week	5	7	9	11	13

Figure: **Demand schedule**

EXERCISE

1. Draw the demand curve?
2. Find the demand function
3. Prove/disprove law of demand
4. Convert the demand function to schedule and graph.

MARKET DEMAND

- **Horizontal summation of Qd of all buyers at each price**
  1. **Consider three buyers in the market**
  2. **Draw the market demand curve**
  3. **Find the market demand function**

Price	Individual demand			Market demand
	Consumer-1	Consumer-2	Consumer-3	
8	0	0	0	0
5	3	5	1	9
3	5	7	2	14
0	7	9	4	20

Figure: **Market demand schedule**

MARKET DEMAND FUNCTION FROM INDIVIDUAL DEMAND FUNCTIONS

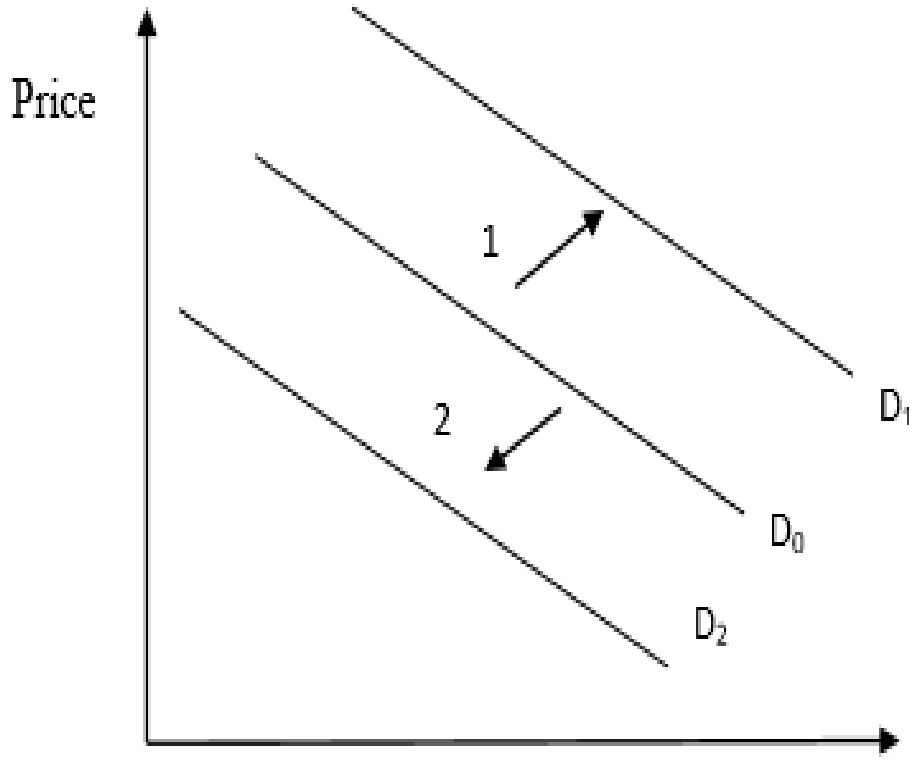
- Identical buyers and if unidentical:first get '**quantity as function of price**'
  1. Consider individual function : P=10-0.5Q Derive market demand function of 100 identical buyers
  2. Consider two individuals : P=10-0.5Q for buyer 1 and P=5-Q for buyer 2 Derive market demand function, curve?
  3. TRY this: three buyers QA = 40 – 2P ,QB = 25.5 – .75P and QC = 36.5 – 1.25P

When do we purchase more/less?

- Determinants of demand
  1. Price of the product
  2. Taste or preference of consumers
  3. Income of the consumers
  4. Price of related goods
  5. Consumers expectation of income and price
  6. Number of buyers in the market
  7. (2-6)shifter while 1 cause only a movement along the same curve

CHANGE IN DEMAND VS CHANGE IN QUANTITY DEMAND

1. **CHANGE IN DEMAND: When (2-6) changes**
   - **If buyers choose to purchase more at any price , demand curve shifts rightward—an increase in demand**
   - **If buyers choose to purchase less at any price,demand curve shifts leftward—a decrease in demand.**
   - **Graphically shown below**
2. **CHANGE IN QUANTITY DEMAND: Wh**



When demand increases, demand curve shifts upward (D_1) while a decrease in demand shifts demand curve downwards (D_2).

Figure: **Shift in demand**

DETERMINANTS OF DEMAND EXPLAINED

1. **Taste or preference**
   - Due to change in fashion
   - Pressure of advertisements
   - Take Malta Guiness with huge marketing campaign recently
2. **Income of the consumer**
   - Demand for meat when income rises?
   - Demand for 'shiro' when income rises?
   - Normal Goods whose demand increases as income increase, while inferior goods demand

DETERMINANTS OF DEMAND EXPLAINED...

1. **Price of related goods**
   - Demand for pepsi when price of coffee rise?
   - Demand for tea when price of sugar rise?
   - **Substitute goods** goods which satisfy the same desire of the consumer **complementary goods** goods which are jointly consumed
2. **Consumer expectation of income and price**
   - Will you spend more if you expect a higher future price?
   - Will you spend more if you expect a higher

DETERMINANTS OF DEMAND EXPLAINED...

1. **Number of buyer in the market**
   - **An increase in the number of buyers(due to like migration, population growth) will increase demand**

What kind of information does it include??

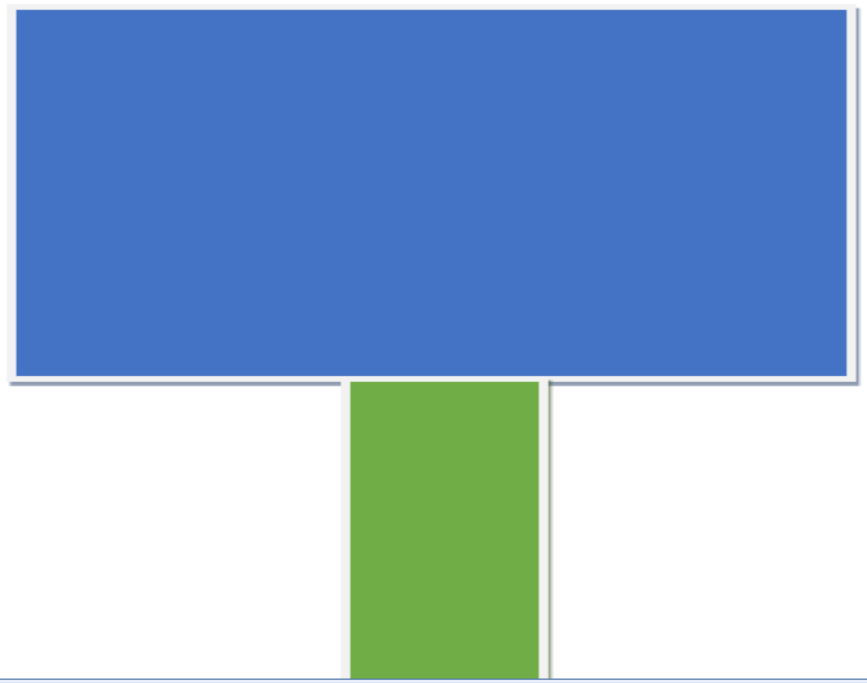


Figure: **Information pole**

LAW OF DEMAND ,SLOPE AND ELASTICITY DIFFERENCE

- The pole misses two important info: direction and Magnitude
- **Law of demand** : only show direction of changes in P,Qd
- **Slope** : shows both direction and magnitude but unit interpretation.
- **Elasticity** : degree of sensitivity /responsiveness to changes in price or income or price of other goods(both direction and

ELASTICITY OF DEMAND

- Slope can't be used to compare demand for different goods.
- Along the linear demand curve slope constant while elasticity varies.
- Elasticity best measure b/c create a measure independent of units-gives us a uniform scale for different goods
- Elasticity can be used to compare goods measured in different units ,bn countries with different currencies.It embodied slope, indeed

ELASTICITY OF DEMAND

1. PRICE ELASTICITY
2. INCOME ELASTICITY
3. CROSS ELASTICITY

PRICE ELASTICITY OF DEMAND

- Degree of sensitivity /responsiveness to changes in price.
  (How consumers react to changes in price?
  Greater-more elastic, the lesser-less elastic)
- Reaction to changes in price of Cloth vs Salt?

1. POINT PRICE ELASTICITY(AT A GIVEN POINT)
2. ARC PRICE ELASTICITY(B/N TWO POINTS)

POINT PRICE ELASTICITY OF DEMAND

1. Derive the formula
2. Point elasticity of demand on a straight line is different at every point.
3. There are five types of elasticity(inelastic,elastic,unitary elastic,perfectly inelastic and perfectly elastic)
4. The shape incudes vertical ,horizontal and downward slope curves.

POINT PRICE ELASTICITY EXAMPLES

- **Given :(P=10-0.5Q)**

1. **Calculate point price elasticity , when price is 5 ,4,3,2,1**
2. **Identify type of elasticity**
3. **Interpret**
4. **Prove Point elasticity of demand on a straight line is different at every point.**
5. **Prove elasticity decrease as price falls in linear curve?**

STEPS
DEMAND FUNCTION CASE

1. **Check the form : if it is inverse demand function convert it to normal demand function**
2. **Get coefficients of P or slope in linear demand function.**
3. **Get initial price and quantity demand**
4. **Apply the formula (slope)times(initial price divided by initial quantity)**

POINT PRICE ELASTICITY EXAMPLES

- When price increase from 4 birr to 5 birr ,ceteris paribus quantity demand for a good decrease from 10kg to 2kg

1. Calculate point price elasticity
2. Identify type of elasticity
3. Interpret the results
4. Prove Point elasticity of demand at P=4 is different from P=5

STEPS TO CALCULATE POINT PRICE ELASTICITY DEMAND SCHEDULE OR CURVE CASE

1. Calculate change in change in quantity demand
2. Calculate change in price
3. Get initial quantity demand
4. Get initial price
5. Divide step 1 by step 3
6. Divide step 2 by step 4

POINT PRICE ELASTICITY CLASS WORK

- Given Q=5-P (Class work)

1. Calculate point price elasticity , when price is 5 ,4,3,2
2. Identify type of elasticity
3. Interpret the results
4. Prove Point elasticity of demand on a straight line is different at every point.
5. Prove elasticity decreases as price falls in linear curve.

POINT PRICE ELASTICITY CLASS WORK

- When price decrease from 10 birr to 5 birr,ceteris paribus quantity demand increase from 100kg to 200kg(class work)

1. Calculate point price elasticity
2. Identify type of elasticity
3. Interpret the results
4. Prove Point elasticity of demand at P=10 is different from P=5

Elasticity in absolute value	Description of the type of elasticity	implication
>1	Elastic	%ΔQd> %ΔP
=1	Unitary	%ΔQd=%ΔP
<1	Inelastic	%ΔQd<%ΔP
=0	Perfectly inelastic	%ΔQd=0
?	Perfectly elastic	%ΔP=0????

Figure: **Types of elasticity**

INTERPRETATION OF PERFECTLY ELASTIC AND PERFECTLY IN ELASTIC

1. **Perfectly inelastic whatever the price, quantity demanded remains unchanged. eg. demand of insulin for acute diabetic patient.**
2. **Perfectly elastic : A small reduction in price would cause the buyers to increase the quantity demanded from zero to all they could obtain. A small rise in price of the product will cause quantity demanded to falls zero.**

ARC PRICE ELASTICITY OF DEMAND

1. **Used when big gaps in price as well as the quantity demanded(if the change in price is substantially large-greater than 5 percent)**
2. **Mid-point - measures the average responsiveness bn two points, ceteris paribus.**
3. **Derive the formula**

ARC PRICE ELASTICITY EXAMPLES

1. **Given : P=10-0.5Q**
2. **Calculate arc elasticity when price fall from 5 birr to 1 birr**
3. **Interpret the result**

ARC PRICE ELASTICITY EXAMPLES

1. When price increase from 4 birr to 5 birr ,ceteris paribus quantity demand for a good decrease from 10kg to 2kg
2. Calculate arc elasticity
3. Interpret the result

STEPS TO CALCULATE ARC PRICE ELASTICITY
DEMAND FUNCTION CASE

1. Check the form : if it is inverse demand function convert it to normal demand function
2. Get coefficients of p or slope in linear demand function.
3. Get midpoint price and quantity demand
4. Apply the formula (slope)times(midpoint price /midpoint quantity)

STEPS TO CALCULATE ARC PRICE ELASTICITY

DEMAND SCHEDULE OR CURVE CASE

1. Calculate change in quantity demand
2. Calculate change in price
3. Calculate midpoint quantity demand
4. Calculate midpoint price
5. Calculate step 1 divided by step 3
6. Calculate step 2 divided by step 4
7. Calculate step 5 divided by step 6

VIOLATION OF LAW OF DEMAND

1. Elasticity of demand is usually a negative number because of the law of demand.
2. If the price elasticity of demand is positive the product is Giffen good
3. How ? Discuss the case of Giffen good

ELASTICITY AND LINEAR DEMAND CURVE

1. Above midpoint -elastic
2. At midpoint of curve -unitary elastic(prove???)
3. Below mid point-inelastic
4. Elasticity decrease as price falls.

Figure 5.3 shows that the elasticity decreases along a linear demand curve as the price falls.

1. At any price above the midpoint, demand is elastic.
2. At the midpoint, demand is unit elastic.
3. At any price below the midpoint, demand is inelastic.

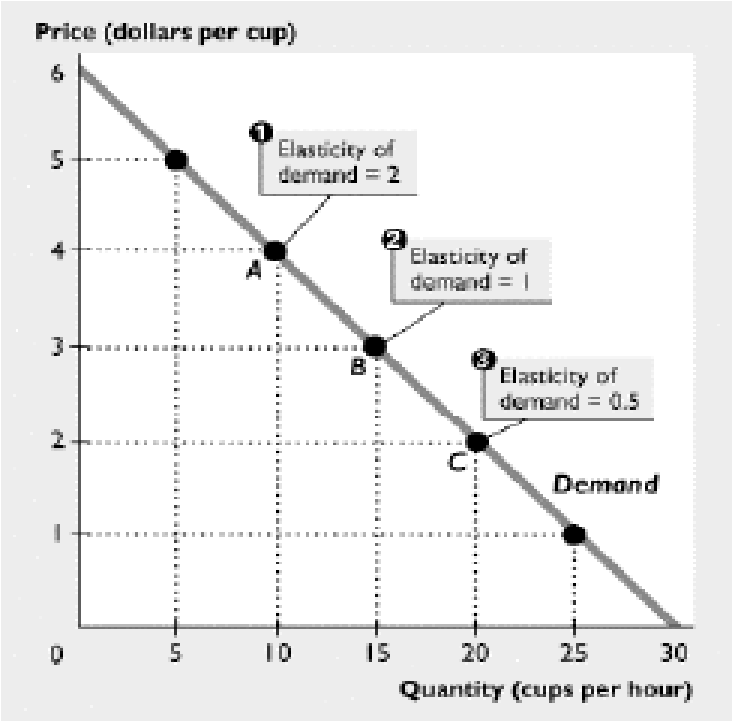


Figure: **Elasticity and linear demand curve**

DEMAND,LAW OF DEMAND AND MARKET DEMAND
DETERMINANTS OF DEMAND
ELASTICITY OF DEMAND
DETERMINANTS OF PRICE ELASTICITY DEMAND
SUPPLY,LAW OF SUPPLY AND MARKET SUPPLY
DETERMINANTS OF SUPPLY
ELASTICITY OF SUPPLY
MARKET EQUILIBRIUM
EFFECTS OF SHIFT IN DEMAND AND SUPPLY ON EQUILIBRI
ASSIGNMENT(10 MARKS) : individual (BA4,BA6,AND BK6)

DETERMINANTS OF PRICE ELASTICITY DEMAND

1. The availability of substitutes :more substitutes, the more elastic..
2. Time: In the long- run, elastic. Because: :
   - More substitute goods could be produced and people adjust consumption pattern
3. The proportion of income spend :the smaller the proportion , the less elastic
4. The importance of the commodity in the consumers' budget :Luxury goods(gold) more

INCOME ELASTICITY OF DEMAND

1. Luxury :if income elasticity is greater than 1.
2. Necessity : if income elasticity is positive but less than 1.
3. Inferior good : if income elasticity is negative
4. EI=0, means consumption of the good does not vary with income, e.g. salt
5. NORMAL GOOD(LUXURY AND NECESSITY)

INCOME ELASTICITY EXAMPLES

1. **Given :If income double ,the quantity demand for a good increases 100 percent,ceteris paribus**
2. **Calculate Income elasticity(use point formula)**
3. **Identify the good**
4. **Interpret**

CROSS PRICE ELASTICITY OF DEMAND

1. **The cross – price elasticity of demand for substitute goods is positive.**
2. **The cross – price elasticity of demand for complementary goods is negative.**
3. **The cross – price elasticity of demand for unrelated goods is zero.**

CROSS PRICE ELASTICITY EXAMPLES

1. **Given :When price X increase from 10 birr to 1 birr, quantity demand for Y rises from 100 to 200units,ceteris paribus**
2. **Calculate cross elasticity(use point formula)**
3. **Identify the goods**
4. **Interpret**

SUPPLY,LAW OF SUPPLY AND MARKET SUPPLY

1. **Supply indicates various quantities of a product that sellers (producers) are willing and able to provide at different prices in a given period of time, other things remaining unchanged.**
2. **The law of supply: states that, ceteris paribus, a positive relationship between price and quantity supplied**
3. **Supply schedule, curve and function**

WHEN DO FIRMS PROVIDE MORE/LESS?

- Determinants of supply
  1. Price of inputs (cost of inputs) : Inverse relationship - leftward shift ss.
  2. Technology : Direct relationship - shifts outward.
  3. Prices of related goods
  4. Sellers‘ expectation of price of the product
  5. Taxes and subsidies
  6. Number of sellers in the market
  7. Weather : Good weather boost supply-outward shift

ELASTICITY OF SUPPLY

- **It is the degree of responsiveness of the supply to change in price.**
  1. **POINT ELASTICITY**
  2. **ARC ELASTICITY**
  3. **Try different examples by your own?**

MARKET EQUILIBRIUM

- When market demand equals market supply-market clears
- The price equates quantity demanded and quantity supplied - equilibrium price
- The quantity of the good which is purchased and sold at this equilibrium price is called equilibrium amount.
  1. Given market demand: Qd= 100-2P, and market supply: P =(Qs /2) + 10
  2. Calculate the market equilibrium price and

STEPS TO IDENTIFY MARKET EQUILIBRIUM

- These are the steps we need to follow to get equilibrium point
  1. Check the form: If it is inverse demand function convert it to normal demand function
  2. Equate quantity demand with quantity supply(i.e Qd=Qs)
  3. Find the price
  4. Find the quantity at price found in step 3 either in demand for supply function and interpret

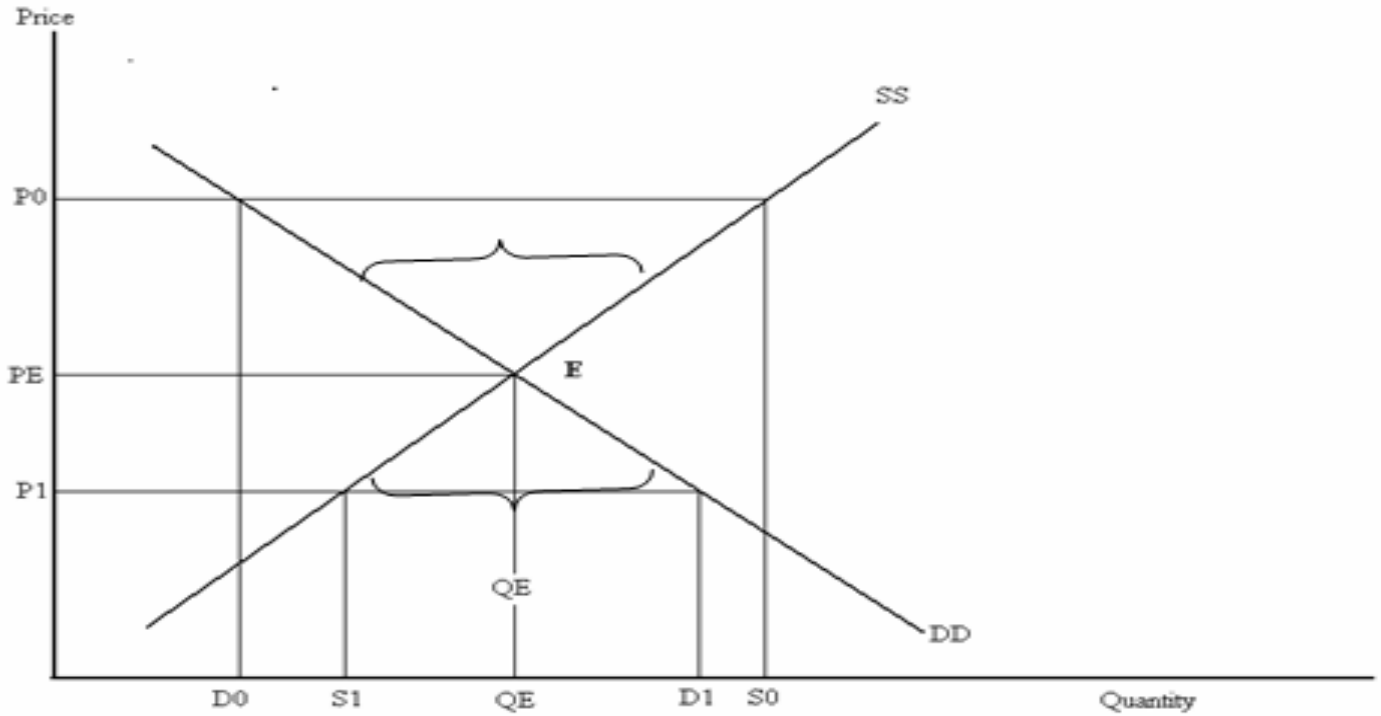


Figure: **Market equilibrium**

MARKET SITUATION :EXCESS DEMAND,EXCESS SUPPLY,EQUILIBRIUM

- MARKET SITUATION AND PRICE MECHANISM
  1. At price = Po, quantity supplied larger than demanded
  2. Excesses supply-the whole will not be sold
  3. Sellers compete with each other to win a demand for their product. How do they compete?
  4. Lower price of the product till point E is attained

MARKET SITUATION:EXCESS DEMAND,EXCESS SUPPLY,EQUILIBRIUM

- MARKET SITUATION AND PRICE MECHANISM
  1. At price = P1, quantity supplied less than demanded
  2. Excesses demand-the whole consumers will not get the product
  3. Buyers compete with each other to get it. How do they compete?
  4. Able buyers pay higher price till point E is attained

WHEN DEMAND SHIFT WHILE SUPPLY CONSTANT

- **WHEN DEMAND INCREASE AND SUPPLY CONSTANT**
  1. **Demand increase-right side shift**
  2. **Supply constant- no shift**
  3. **Both equ P and Q rises**
  4. **Graphically given below**
  5. **Try when DD decrease while supply constant**

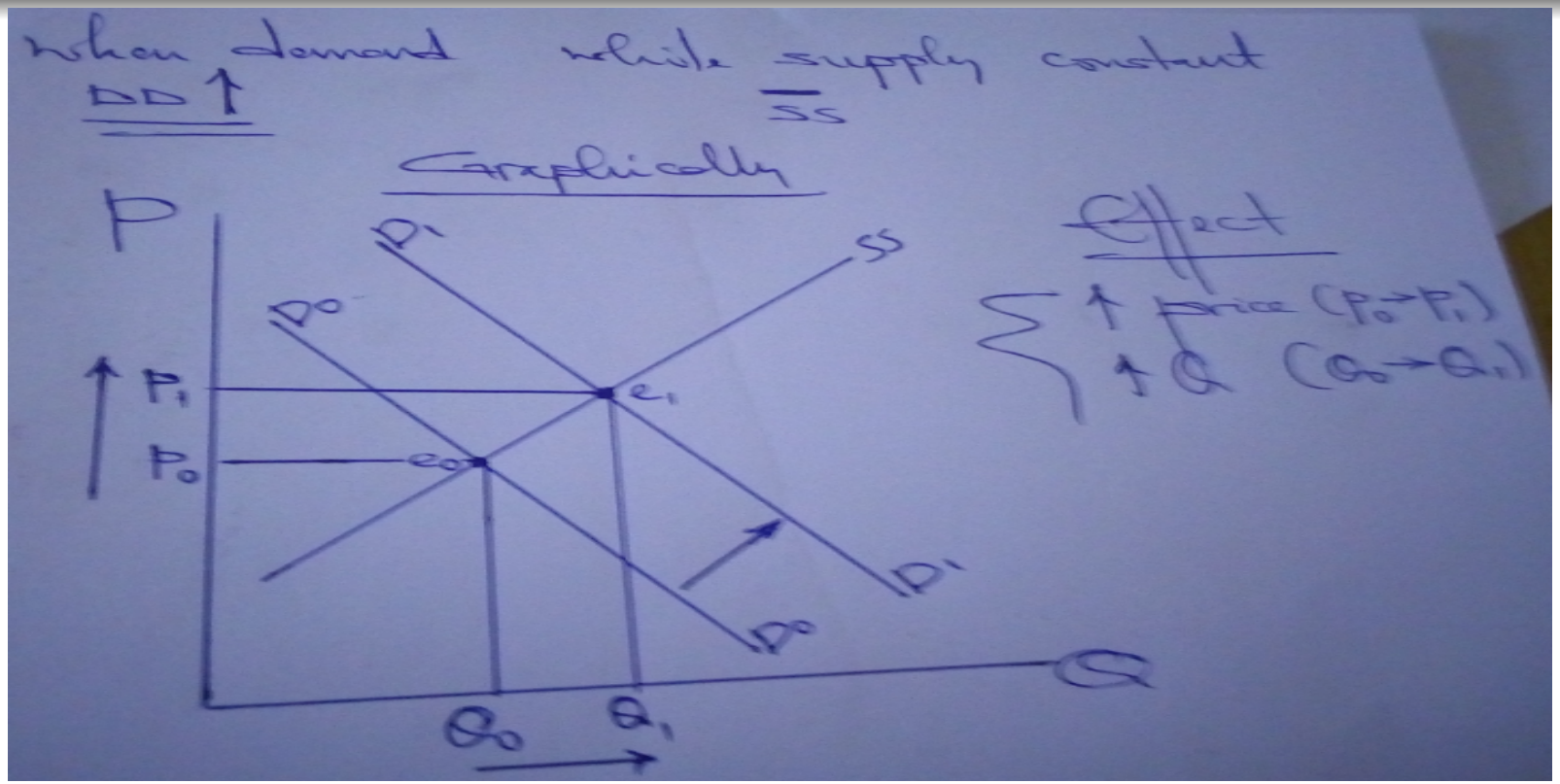


Figure: **Effect of an increase in DD while SS constant**

WHEN DEMAND CONSTANT WHILE SUPPLY SHIFT

- **WHEN DEMAND CONSTANT AND SUPPLY INCREASE**
  1. **Supply increase-right side shift**
  2. **Demand constant- no shift**
  3. **Equilibrium P falls but Q rises**
  4. **Graphically given below**
  5. **Try when SS decrease while DD constant**

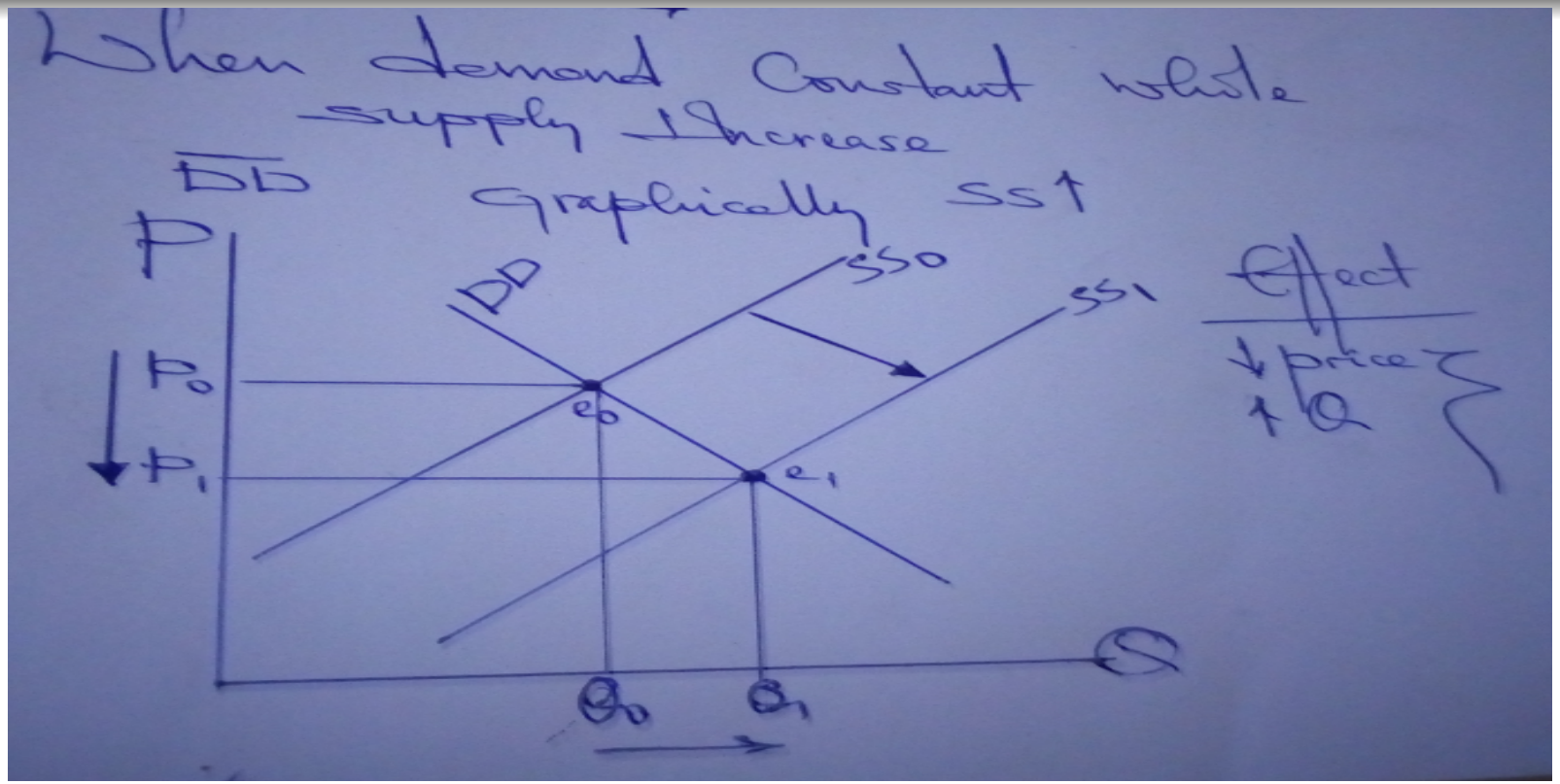


Figure: **Effect of an increase in SS while DD constant**

WHEN DEMAND AND SUPPLY SHIFT

- **WHEN DEMAND INCREASE AND SUPPLY INCREASE**
  1. **Supply increase-right side shift**
  2. **Demand increase- right shift**
  3. **Equilibrium P indeterminate but Q rises by larger**
  4. **Graphically given below**
  5. **Try when SS and DD decrease?**

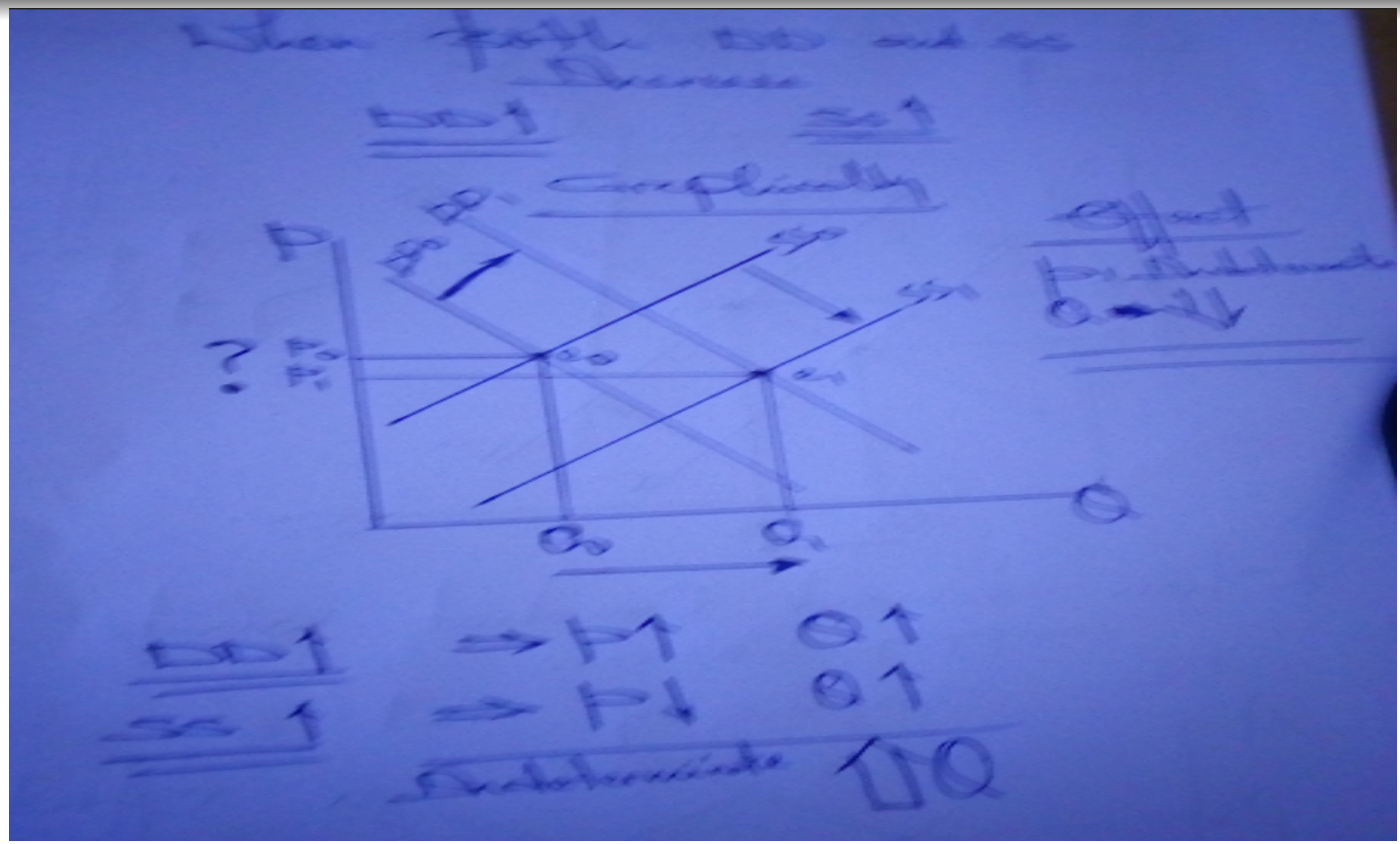


Figure: **Effect of an increase in both SS and DD**

WHEN DEMAND AND SUPPLY SHIFT

- **WHEN DEMAND INCREASE AND SUPPLY DECREASE**
  1. **Supply decrease-left side shift**
  2. **Demand increase- right shift**
  3. **Equilibrium P increase by larger but Q indeterminate**
  4. **Graphically given below**
  5. **Try when SS increase and DD decrease?**

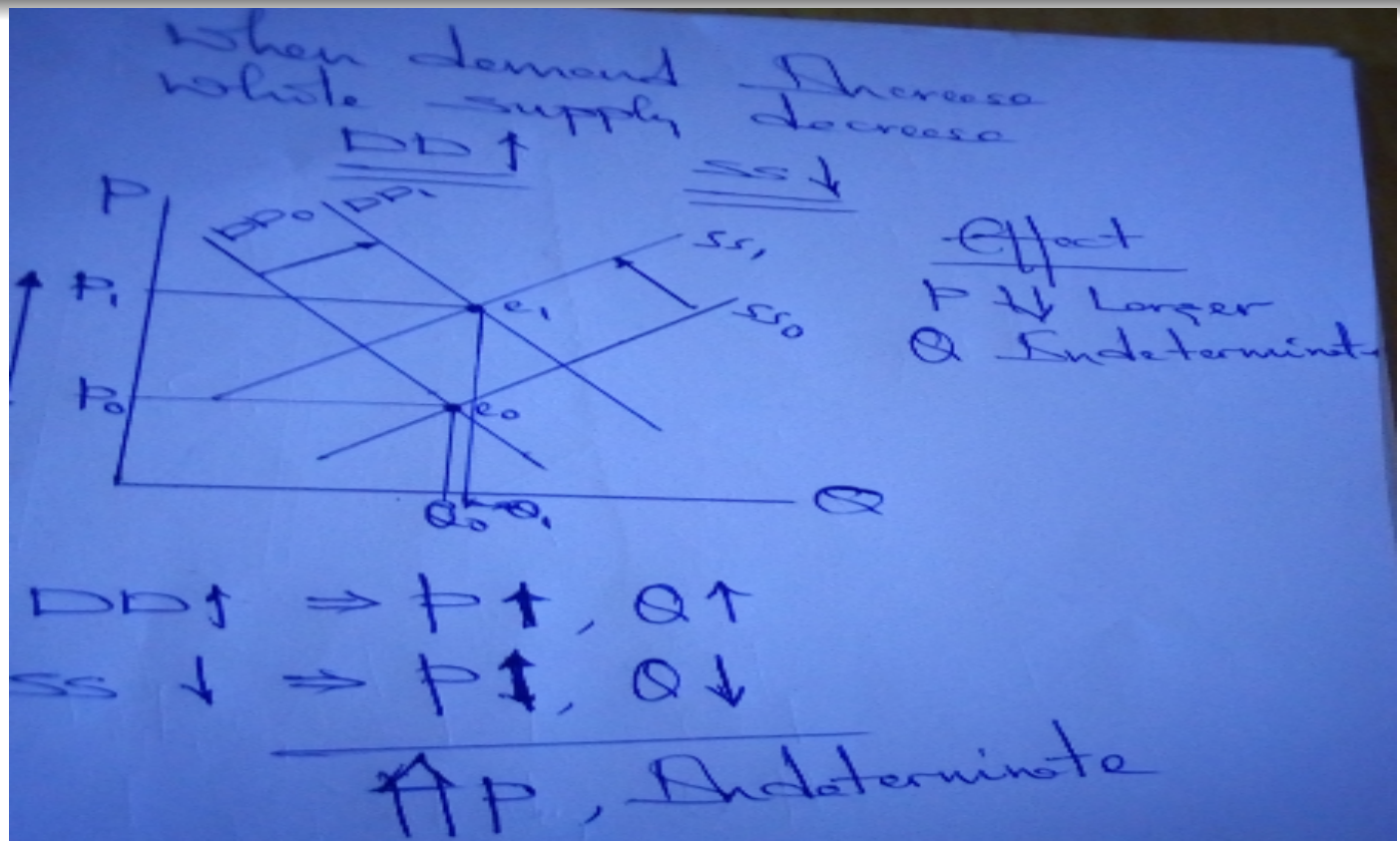


Figure: **Effect of an increase in DD while SS decrease**

THEORY OF DEMAND AND SUPPLY

1. Given Q=100-5P, quantity a consumer willing and able to purchase at price equal zero is 100. Do you think this is against human wants are endless? Do you think the demand curve touches quantity axis?(1 points)
2. What is Giffen good.Discuss Giffen good with examples(2 points).
3. Prove price elasticity at midpoint of linear demand curve is unitary. Below midpoint inelastic and above elastic(2 points)

THEORY OF DEMAND AND SUPPLY

- The effect of change in demand and supply in equilibrium price and output(5 points)
  1. When supply increase while the vertical demand curve is constant
  2. When perfectly elastic supply curve decrease while the vertical demand curve is constant
  3. When perfectly inelastic demand curve decrease while the perfectly elastic supply curve is constant
- Submission date Dec 15,2019

GET READY FOR TEST ONE (10 POINTS)

1. READ THE FIRST CHAPTER OF THE COURSE
2. READ THE SECOND CHAPTER OF THE COURSE