

Micro Rules & Relationships Summary

When the effect on a bystander is adverse = negative externality

When the effect on a bystander is beneficial = positive externality

Market equilibrium = not efficient in the presence of externalities

In the absence of government intervention the price adjusts to balance supply and demand

In the presence of a negative externality, social cost is higher than the private cost. The socially desirable quantity produced at the optimum is thus smaller than the market equilibrium quantity.

Cost to society = greater than the benefit to society in the presence of a negative externality

Intersection of the social cost curve and demand curve determines the optimal amount of a product to produce from the standpoint of society as a whole (including bystanders)

Equilibrium quantity = larger than socially desirable quantity

Internalising an externality = using a corrective tax to give buyers and sellers an incentive to take into account the external effects of their actions on bystanders

Achieve optimum outcome by implementing a tax on producers which shifts the supply curve upwards by the size of the tax

Positive externalities = social cost is less than private cost

In the presence of a positive externality, the socially optimum quantity is larger than the equilibrium quantity

Corrective subsidy to internalise positive externalities

In the case of negative consumption externalities, the social value is less than the private value and the socially optimal quantity is smaller than the quantity determined by the private market

Positive consumption = social value greater than private value and socially optimal quantity is greater than the quantity determined by the private markets

Negative = Tax, positive = subsidy to move the market equilibrium closer to the social optimum

If benefit to both parties exceeds cost, then a private solution may resolve externalities

An ideal corrective tax would equal the external cost from an activity with externalities and an ideal corrective subsidy would equal the benefit from activity with positive externalities

Total revenue = the quantity of output the firm produces times the price at which it sells its output

Opportunity cost = things that must be forgone to acquire another item

Total cost of a business = implicit + explicit costs

Implicit = costs that do not require an outlay of money by the firm

Explicit = costs that require an outlay of money by the firm

Economists measure economic profit as the firm's total revenue minus all opportunity costs (implicit and explicit) of producing the goods and services sold

Relationship between workers and output is called the production function

Marginal product of any input is the increase in the quantity of the output contained from each additional unit of that input (labour)

As number of workers increases, the marginal product declines = diminishing marginal product

As workers increase, production function = flatter

Total cost curves get steeper as the amount produced rises

Fixed costs do not vary with the quantity of output produced, they remain the same

Variable costs change as the firm alters the quantity of the output produced

Total cost = Fixed + Variable costs

Total cost/Q = average total cost

Amount that total cost rises when a firm increases production by one unit of output is known as the marginal cost (change in TC/change in Q)

MC rises as the quantity of output produced increases = positive relationship

Upward slope reflects the properties of diminishing marginal product

When quantity of output produced is already high, marginal product (benefit) of an extra worker is low and marginal cost is high.

When quantity of output is low, the marginal product of an extra worker is high and the marginal cost is low

Average Fixed Costs always declines as output rises because the fixed cost is getting spread over a larger number of units (negative)

AVC rises as output increases because of diminishing marginal product (positive)

Bottom of the U shape occurs at the quantity that minimises ATC called the efficient scale of the firm

When MC is less than ATC, ATC is falling

When MC is greater than ATC, ATC is rising

The MC and ATC intersect at its minimum