Microeconomics (Advanced Level).d

1. Economics proceeds by making … of social phenomena, which are simplified representations of reality.
2. In this task, economists are guided by the … , which states that people typically try to choose what's best for them, and by the equilibrium principle, which says that prices will adjust until demand and supply are equal.
3. The demand curve measures how much people wish to demand at each price, and the supply curve measures how much people wish to supply at each price. An … is one where the amount demanded equals the amount supplied.
4. The study of how the equilibrium price and quantity change when the underlying conditions change is known as … .
5. An economic situation is … if there is no way to make some group of people better off without making some other group of people worse off. The concept of Pareto efficiency can be used to evaluate different ways of allocating resources.
6. The movement from one equilibrium to another can take a substantial amount of … , and questions about how such movement takes place can be very interesting and important.
7. Economists call a person's maximum willingness to pay for something that person's … .
8. An economist would describe the distinction between the prices of the two kinds of apartments in this model by saying that the price of the outer-ring apartments is an exogenous variable, while the price of the inner-ring apartments is an … .
9. People try to choose the best patterns of consumption that they can afford. This is known as:
10. Prices adjust until the amount that people demand of something is equal to the amount that is supplied. This is known as:
11. The … consists of all bundles of goods that the consumer can afford at given prices and income. We will typically assume that there are only two goods, but this assumption is more general than it seems.
12. The … is written as $p1x1+p2x2 = m$. It has a slope of $-p1/p2$, a vertical intercept of $m/p2$, and a horizontal intercept of $m/p1$.

13. Increasing income shifts the budget line … . Increasing the price of good 1 makes the budget line steeper. Increasing the price of good 2 makes the budget line flatter.
14. Taxes, subsidies, and rationing change the slope and position of the budget line by changing the … paid by the consumer.
15. The economic theory of the consumer is very simple: economists assume that consumers choose the … bundle of goods they can afford.
16. We say that good 2 represents a … that stands for everything else that the consumer might want to consume other than good 1.
17. Economists sometimes say that the slope of the budget line measures the … of consuming good 1.
18. The budget line is defined by two prices and one income, but one of these variables is … .
19. Governments also sometimes impose … . This means that the level of consumption of some good is fixed to be no larger than some amount. For example, during World War II the U.S. government rationed certain foods like butter and meat.
20. Households with … incomes had to pay more for their allotment of food stamps. Thus the slope of the budget line would become steeper as household income increased.
21. Economists assume that a consumer can rank various consumption possibilities. The way in which the consumer ranks the consumption bundles describes the consumer's … .
22. Indifference curves can be used to depict different kinds of … .
23. Well-behaved preferences are monotonic (meaning more is better) and … (meaning averages are preferred to extremes).
24. The … measures the slope of the indifference curve. This can be interpreted as how much the consumer is willing to give up of good 2 to acquire more of good 1.
25. We call the objects of consumer choice … bundles.
26. Two goods are … if the consumer is willing to substitute one good for the other at a constant rate.
27. … complements are goods that are always consumed together in fixed proportions.
28. A … is a neutral good if the consumer doesn't care about it one way or the other.

29 A … is a commodity that the consumer doesn't like.

30 The slope of an indifference curve is known as the … .

31 A utility function is simply a way to represent or summarize a … ordering. The numerical magnitudes of utility levels have no intrinsic meaning.

32 Thus, given any one … function, any monotonic transformation of it will represent the same preferences.

33 The …, can be calculated from the utility function via the formula MRS = Δx2/Δx1 = −MU1/MU2.

34 The theory of … has been reformulated entirely in terms of consumer preferences, and utility is seen only as a way to describe preferences.

35 A utility function is a way of assigning a number to every possible … bundle such that more-preferred bundles get assigned larger numbers than less-preferred bundles.

36 There are some theories of utility that attach a significance to the magnitude of utility. These are known as cardinal utility theories.

37 In mathematics, the set of all (x1, x2) such that u(x1, x2) equals a constant is called a absolute set.

38 When the utility function is linear in good 2, but (possibly) nonlinear in good 1; hence the name quasilinear utility, meaning «partly linear» utility.

39 Consider a consumer who is consuming some bundle of goods, (x1, x2). How does this consumer's utility doesn't change as we give him or her a little more of good 1? This rate of change is called the marginal utility with respect to good 1.

40 Utility functions are basically ways of describing choice behavior.

41 The optimal choice of the consumer is that bundle in the consumer's budget set that lies on the … indifference curve.

42 Typically, the optimal bundle will be characterized by the condition that the slope of the indifference curve (the MRS) will equal the slope of the … line.

43 If we observe several … choices it may be possible to estimate a utility function that would generate that sort of choice behavior. Such a utility function can be used to predict future choices and to estimate the utility to consumers of new economic policies.

44 If everyone faces the same prices for the two goods, then everyone will have the … marginal rate of substitution, and will thus be willing to trade off the two goods in the same way.

45 The optimal choice of goods 1 and 2 at some set of prices and income is called the consumer’s … bundle.

46 The demand function is the function that relates the optimal choice—the quantities demanded—to the different values of prices and incomes.

47 Quantity tax is a tax on the amount consumed of a good, like a gasoline tax of 15 cents per gallon.

48 An income tax is just a tax on Expenses.

49 The Cobb-Douglas consumer always spends a fixed fraction of his income on each good. The size of the fraction is determined by the exponent in the Cobb-Douglas function.

50 The basic procedure will be the same for each example: plot the indifference curves and inverse the budget line and find the point where the lowest indifference curve touches the budget line.

51 The consumer’s … function for a good will in general depend on the prices of all goods and income.

52 A … good is one for which the demand increases when income increases. An inferior good is one for which the demand decreases when income increases.

53 An ordinary good is one for which the demand … when its price increases. A Giffen good is one for which the demand increases when its price increases.

54 If the demand for good 1 … when the price of good 2 increases, then good 1 is a substitute for good 2. If the demand for good 1 decreases in this situation, then it is a complement for good 2.

55 The inverse demand function measures the price at which a given quantity will be demanded. The … of the demand curve at a given level of consumption measures the marginal willingness to pay for an additional unit of the good at that consumption level.

56 The consumer’s demand functions give the optimal amounts of each of the goods as a function of the prices and income faced by the consumer.

57 Studying how a choice responds to changes in the economic environment is known as comparative statics.

58 We would normally think that the demand for each good would increase when income increases. Economists, with a singular lack of imagination, call such goods normal goods.

59 The income offer curve is also known as the income expansion path.

60 The Engel curve is a graph of the demand for one of the goods as a function of income, with all prices being held constant.

61 The market demand curve is simply the sum of the individual … curves.

62 The … price measures the price at which a consumer is just indifferent between purchasing or not purchasing a good.

63 The demand function measures quantity demanded as a function of price. The … demand function measures price as a function of quantity. A given demand curve can be described in either way.

64 The elasticity of demand measures the responsiveness of the quantity demanded to … . It is formally defined as the percent change in quantity divided by the percent change in price.

65 If the absolute value of the elasticity of demand is … than 1 at some point, we say that demand is inelastic at that point. If the absolute value of elasticity is greater than 1 at some point, we say demand is elastic at that point. If the absolute value of the elasticity of demand at some point is exactly 1, we say that the demand has unitary elasticity at that point.

66 If demand is elastic at some point, then an increase in quantity will result in a reduction in revenue.

67 The marginal revenue is the extra revenue one gets from increasing the quantity sold. The formula relating marginal revenue and elasticity is $MR = p[1 + 1/E\ ] = p[1 - 1/|E\ |]$.

68 If the inverse demand curve is a linear function $p(q) = a - bq$, then the marginal revenue is given by $MR = a - 2bq$.

69 Price elasticity measures the responsiveness of the quantity demanded to income. It is formally defined as the percent change in quantity divided by the percent change in income.

70 A normal good is one for which an increase in income leads to an increase in demand; so for this sort of good the income elasticity of demand is positive.

71 We can use the … set and indifference curve apparatus developed earlier to examine the choice of how much money to invest in risky and riskless assets.

72 The marginal rate of substitution between … and return will have to equal the slope of the budget line. This slope is known as the price of risk.

73 The amount of … present in an asset depends to a large extent on its correlation with other assets. An asset that moves opposite the direction of other assets helps to reduce the overall risk of your portfolio.

74 The amount of risk in an asset relative to that of the market as a whole is called the … of the asset.

75 The fundamental equilibrium condition in asset markets is that risk adjusted returns have to be the … .

76 Counterparty risk, which is the risk that the other side of a transaction will not pay, can also be an important risk factor.

77 A closely related measure is the standard deviation, denoted by σw, which is the square root of the variance.

78 Suppose that you can invest in two different assets. One of them, the risk-free asset, always pays a different rate of return, rf. This would be something like a Treasury bill that pays a different rate of interest regardless of what happens.

79 We can call this slope the price of risk since it measures how risk and return can be traded off in making portfolio choices.

80 Financial institutions loan money only to individuals but to each other.

81 In the case of a … good and quasilinear utility, the utility associated with the consumption of n units of the discrete good is just the sum of the first n reservation prices.

82 This sum is the gross benefit of consuming the good. If we … the amount spent on the purchase of the good, we get the consumer’s surplus.

83 The change in … surplus associated with a price change has a roughly trapezoidal shape. It can be interpreted as the change in utility associated with the price change.

84 In general, we can use the compensating variation and the equivalent variation in income to measure the monetary impact of a … change.

85 If utility is … , the compensating variation, the equivalent variation, and the change in consumer’s surplus are all equal.

86 In the case of supply behavior we can define a producer’s surplus that measures the net benefits to the supplier from producing a given amount of output.

87 The term v(n) − pn is called consumer’s surplus.

88 If a single consumers is involved we can add up each consumer’s surplus across all the consumers to create an aggregate measure of the consumers’ surplus.

89 This is called the equivalent variation in income since it is the income change that is opposite to the price change in terms of the change in utility.

90 the area above the supply curve is known as producer’s surplus.

91 The … curve measures how much people will be willing to supply of some good at each price.

92 An … price is one where the quantity that people are willing to supply equals the quantity that people are willing to demand.

93 The study of how the equilibrium price and quantity change when the underlying demand and supply curves change is another example of … statics.

94 When a good is taxed, there will always be two prices: the price paid by the demanders and the price received by the suppliers. The difference between the two represents the amount of the … .

95 How much of a tax gets passed along to consumers depends on the relative steepness of the demand and supply curves. If the supply curve is horizontal, all of the tax gets passed along to consumers; if the supply curve is vertical, … of the tax gets passed along.

96 The deadweight loss of a tax is the net loss in consumers’ surplus plus producers’ surplus that arises from imposing the tax. It measures the value of the output that is not sold due to the presence of the tax.

97 A situation is Pareto efficient if there is no way to make some group of people better off without making some other group worse off.

98 The Pareto efficient amount of output to supply in a single market is that amount where the demand and supply curves cross, since this is the only point where the amount that demanders are willing to pay for an extra unit of output equals the price at which suppliers are willing to supply an extra unit of output.

99 If we have a number of independent suppliers of this good, we can add up their individual supply curves to get the market demand curve.

100 A market where each economic agent takes the market price as outside of his or her control is called a super market.