Econ 1115: Principles of Macroeconomics

Lecture 5: Markets and the Government

Rizwanur Rob

rob.r@husky.neu.edu

302 Holmes Hall
Department of Economics
Northeastern University

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Outline

Shift vs Movement along the curve

For example, if it becomes more expensive to import avocados from Mexico, then sellers may raise the price of avocados. This leads to a rise in the price, a **fall in quantity demanded**.

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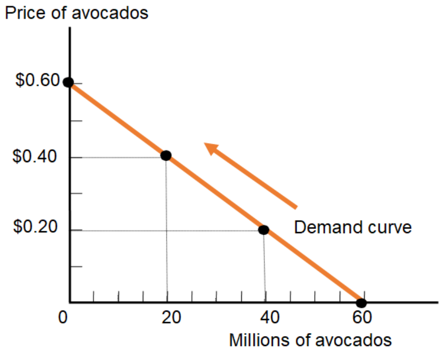
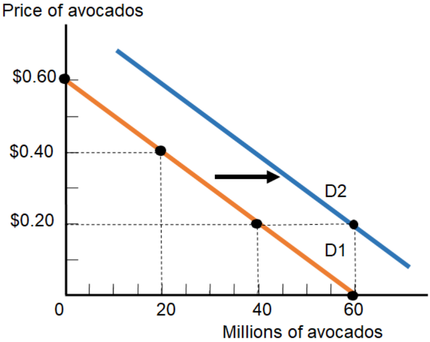


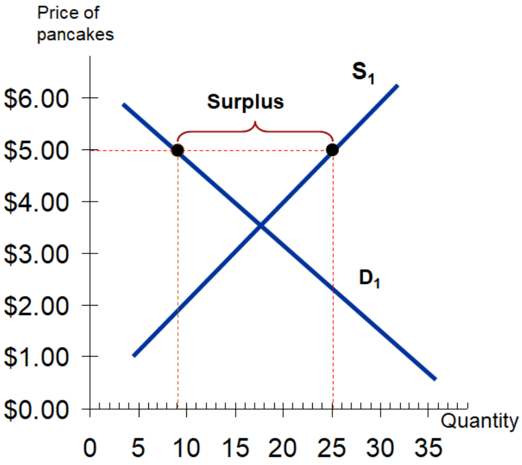
Shift vs Movement along the curve

However if a new fad for avocado toast and guacamole changes the taste for avocado among millenials, this shifts the demand curve to the right.

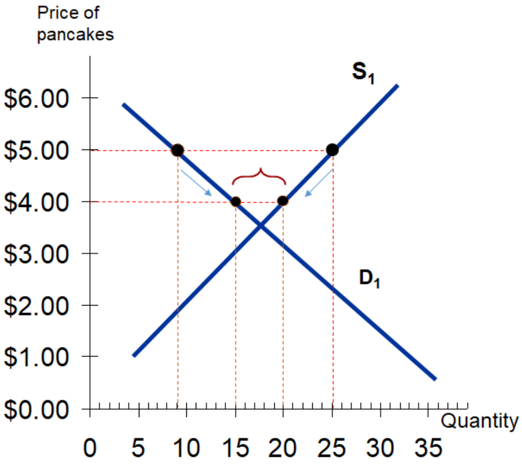


- Demand and supply curves together = market
- Equilibrium = where demand and supply intersect
- Market clears, there is no surplus nor a shortage.
- Quantity demanded = Quantity supplied

Surplus


Price of pancakes
$6.00
$5.00
$4.00
$3.00
$2.00
$1.00
$0.00
Surplus
S_1
D_1
0
5
10
15
20
25
30
35
Quantity

Surplus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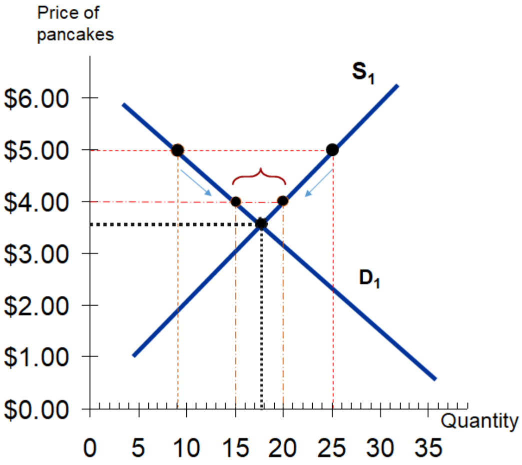
Surplus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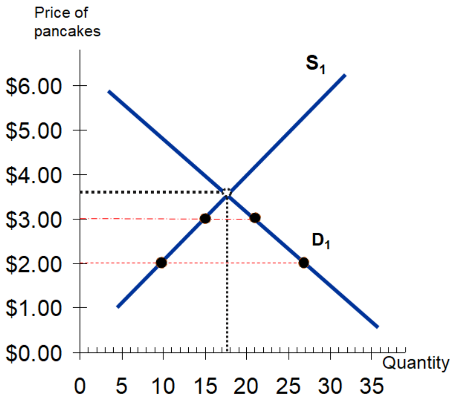
Shortage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Quantity

Outline

1. Review
2. Markets
3. Price and Efficiency

Equilibrium

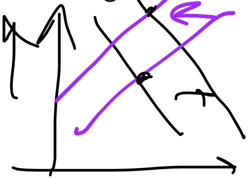
What will happen to the equilibrium price of new textbooks if more students attend college, paper becomes cheaper, and fewer used textbooks are sold?

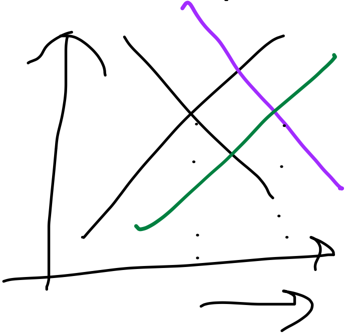
a. Price will rise.

b. Price will fall.

c. Price will stay exactly the same.

d. The price change will be ambiguous.





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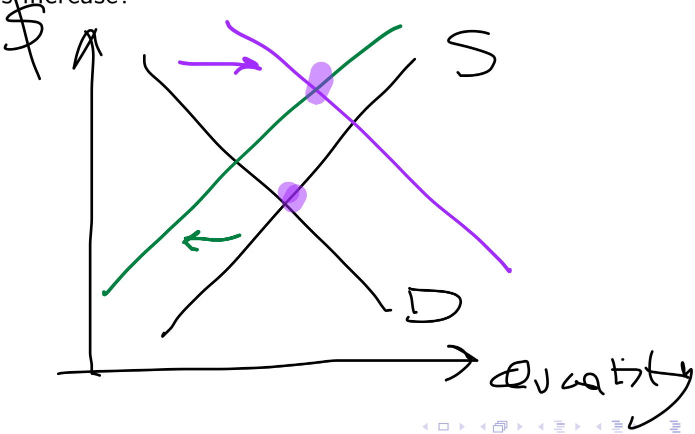
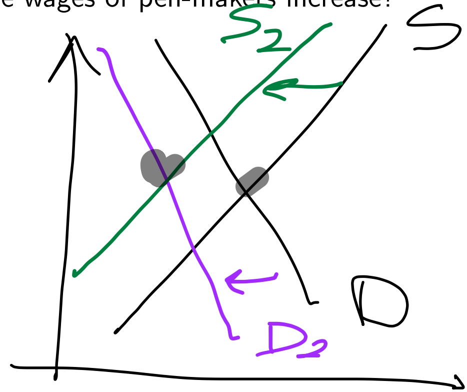
Answer: d. The price change will be ambiguous

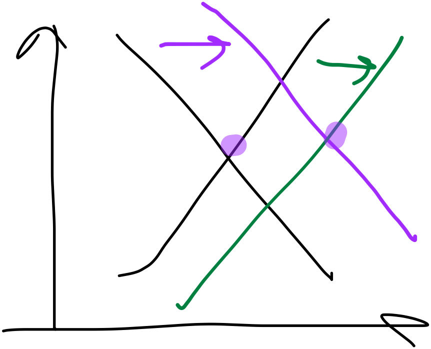
If pens are normal goods, what will happen to the demand and supply of pens if the price of pencils rises and the wages of pen-makers increase?



Instead what would happen if consumers experience a decrease in income and the wages of pen-makers increase?



Lastly, what will happen to the equilibrium price of pens if consumers experience an increase in income and more firms start producing pens?



Equilibrium price must increase when demand

a. increases and supply does not change, when demand does not change and supply decreases, and when demand decreases and supply increases simultaneously.

b. increases and supply does not change, when demand does not change and supply decreases, and when demand increases and supply decreases simultaneously.

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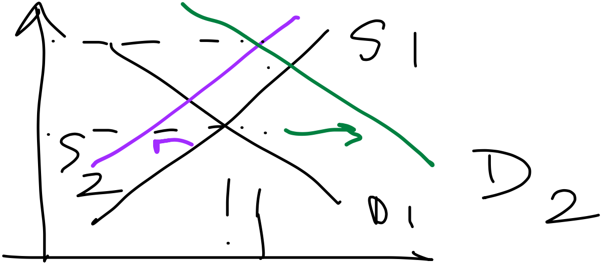
Answer: b.

Identify what is changing, which curve should shift and graph what happens to the equilibrium in the relevant markets:

- In the market for oak tables, if the price of maple tables rises, the price of oak wood rises, and the price of the glue used in the production of the new oak tables increased?



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- If public transportation (the T) is an inferior good, what happens to the equilibrium price and quantity, if the price of gasoline falls, average incomes rise, and transportation union workers negotiate higher wages?

Structure of Market

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- Oligopolies: Only a few large firms and significant market power

Definition of the market

How you define a market matters!

Whether you define it broadly or narrowly they have important economic analyses and legal consequences

For example, if you are looking at soda, i.e. carbonated beverages, should you define the market for every type of soda together, or each type of brand separately?

Or the other example from homework, do you define traditional taxi cabs and Uber and Lyft as the same market, or each of them separately, or taxi cabs as one market, and Uber and Lyft as the rideshare market?

Outline

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- Allocates scarce resources
- Determines **who** produces, **what** and **how** much.

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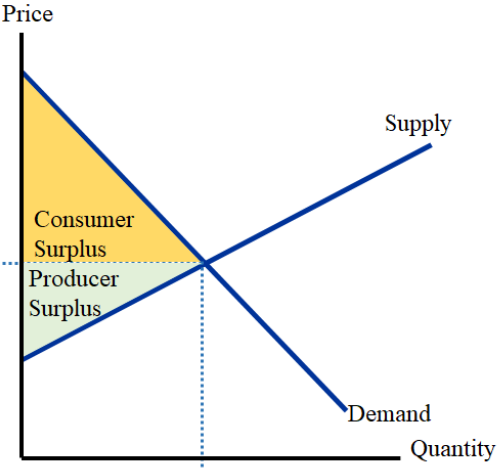
- Misallocation of resources when prices are regulated/controlled for example a price floor, or price ceiling.

Productive Efficiency vs Allocative Efficiency

- Productive Efficiency: Produce goods at the lowest cost (fewest inputs). Anyone (or any country) producing on the PPC achieves productive efficiency.
- Allocative Efficiency: Requires price set such that it maximizes total surplus and resources are optimally allocated.

  This happens when P=MC. The goods are consumed by the buyers who value them most highly, and the goods are produced by the producers with the lowest costs.

Consumer and Producer Surplus



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- It is defined as the difference between the total amount that consumers are willing and able to pay for a good or service (the demand curve) and the total amount that they actually do pay (the market price).
- Consumer surplus is shown by the area under the demand curve and above the price.

Producer Surplus

- Producer surplus is a measure of producer welfare.

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- Producer surplus is measured as the difference between what producers are willing and able to supply a good for (the supply curve) and the price they actually receive (the market price).

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- Price ceiling
- Price floor
- Does it bind?

Efficiency, Price gouging and Uber surge pricing in Massachusetts

- Prices in the free market adjust to clear the market, allocate scarce resources and is efficient. But is it always fair? What about when a disaster hits?

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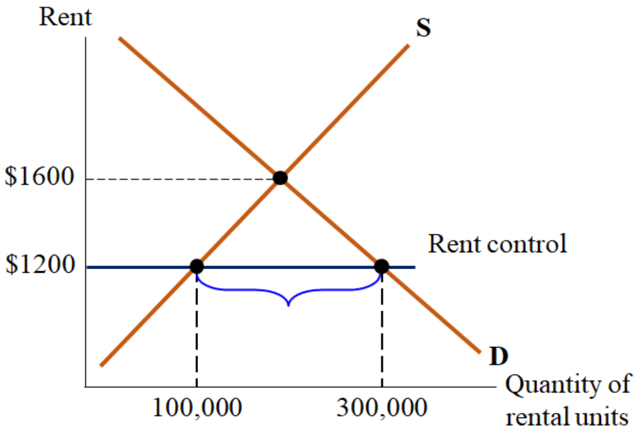
- Prices in the free market adjust to clear the market, allocate scarce resources and is efficient. But is it always fair? What about when a disaster hits?
- Surge pricing and Uber
- Mass state laws passed forbid driving up prices during a declared state of emergency
- Thus Uber is being investigated for surge pricing during the last snowstorm in March

Other applications

- Rent control
- Minimum wages
- Turing Pharmaceuticals and the Pharma Bro

Rent control



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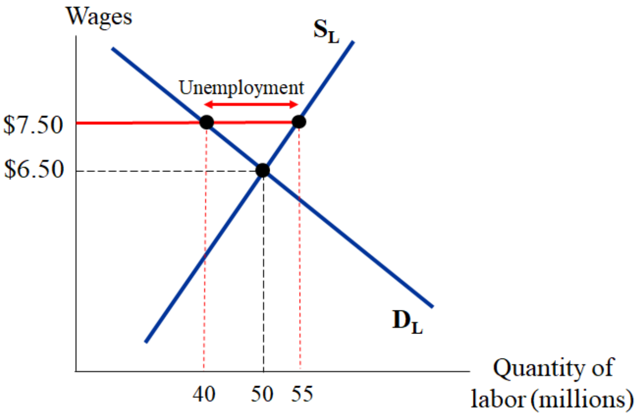
Minimum wages



Minimum wage law

- Price floor

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- May create more unemployment
- Conflicting research results, and many economists still support minimum wage laws.

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- Raises price of antiparastic drug Daraprim, from \$13.50 to \$750
- Patents give a legal monopoly, but even with exclusive licensing (without a patent) you can create a monopoly.

Price controls are usually enacted

a. as a means of raising revenue for public purposes.

b. when policymakers believe that the market price of a good or service is unfair to buyers or sellers.

c. when policymakers tax a good.

d. all of the above are correct.

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Answer: b. when policymakers believe that market prices of a good or service is unfair to buyers or sellers.

The particular price that results in quantity supplied being equal to quantity demanded is the best price because it

a. maximizes costs of the seller.

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c. maximizes the combined welfare of buyers and sellers.

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Answer: c. maximizes the combined welfare of buyers and sellers.