# UNIT 3: MICROECONOMICS

**SSEF5; SSEMI1; SSEMI2; SSEMI3**

In this unit, you will demonstrate your knowledge of microeconomic concepts. You will learn what motivates trade and why businesses and individuals specialize in a specific skill. You will learn how decisions made by one person, business, or group affect others and how scarcity drives decision-making. You will also learn that many people or parties respond predictably to both positive and negative incentives.

## KEY IDEAS

- Desire to trade/voluntary exchange (SSEF3b)
- Circular flow diagram (SSEMI1a)
- Role of money as it facilitates the circular flow (SSEMA2a)
- Law of supply and law of demand (SSEMI2a)
- Role of prices as incentives (SSEF2c)
- Role of profit as incentive (SSEF1c)
- Determinants of supply and demand (SSEMI2e, f)
- Equilibrium (SSEMI2c)
- Disequilibrium caused by price controls—price floors and price ceilings (SSEMI2g)
- Competition and market structures (SSEMI3b)
- Deciding on a business organizational structure (SSEMI3a)
- Externalities, market failures and government intervention (SSEF5a, b)

## KEY TERMS

**Microeconomics:** the study of people and businesses within a single market. This small focus—on only one particular market—is one way microeconomics (literally "small economics") is different from **macroeconomics** ("large economics").

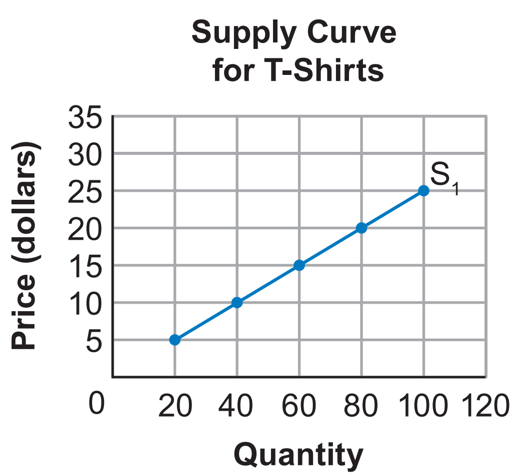
**Law of supply:** an economic principle stating that as price rises, the quantity a seller is willing and able to sell increases. (SSEMI2a)

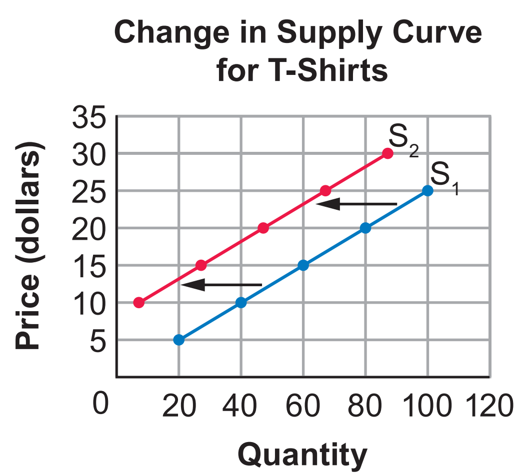
**Law of demand:** an economic principle stating that as the price of a good rises, the quantity of the good consumers are willing and able to buy decreases. (SSEMI2a)

Prices are rarely stable over a long period of time. Many factors can affect the supply or demand curves within a market. Here are some of the factors that can affect the price and quantity of a good.

## Determinants (Shifters) of Supply

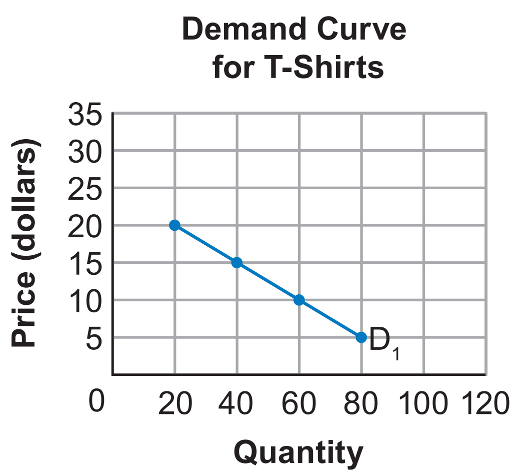
- **Changes in . . .**
  - Costs of productive resources—When input prices rise, producers must spend more of their revenue to buy the inputs and therefore are forced to reduce their supply of the good because of the greater expense associated with the input. When input prices become cheaper, sellers can increase their supply because it is cheaper to produce their product.
  - Government regulations—If more taxes are imposed, most businesses will not be willing to supply as much as before.
  - Number of sellers—The supply of a particular good may increase or decrease because of change in the number of sellers in the market for a good.
  - Producer expectations—When sellers believe the price for a good will go lower in the future and they can increase their supply now, they will sell all they can before the price decreases. If they believe prices will go up in the future and they can delay the sale of their goods, they will supply less of the good now and wait for the price increase.
  - Technology—Technological improvements in the tools or processes used to make goods and services increase the supply of those goods and services. New technology eventually makes production cheaper.
  - Education—A better-educated and better-trained workforce should be able to produce more goods in less time. This should lower costs and increase supply.
- A shift of the supply curve to the left indicates a decrease in supply. A shift of the supply curve to the right indicates an increase. (SSEMI2e)

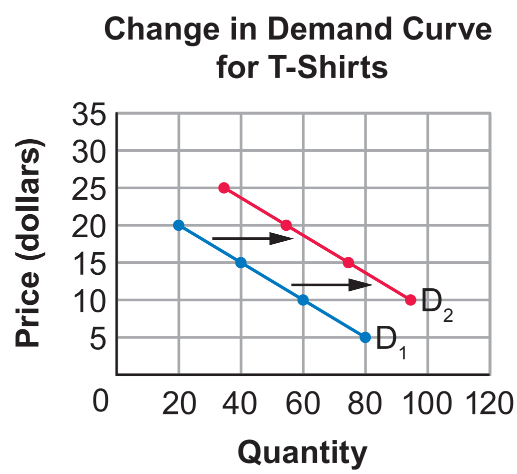


## Determinants (Shifters) of Demand

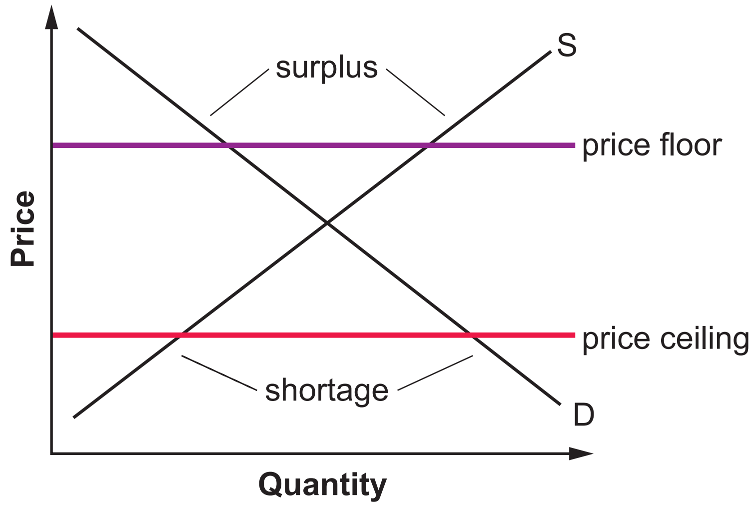
- **Changes in . . .**
  - Related goods—Based on the law of demand, we know that when the price of a good rises, consumers will buy less of that good. If the price of a complementary or related good changes, this could change the demand curve.
  - Income—When a large number of consumers in the market for a good experience a change in income, the entire demand curve may shift.
  - Consumer expectations—When consumers believe a change in price will occur, they may hold off on purchasing the good until the price drops or buy more of the good before the price rises.
  - Preferences/tastes—When a large number of consumers experience a change in preference toward or away from a good, the demand will change.
  - Number of consumers—The demand for a good may increase or decrease depending on the number of people in the market for the good.
- A shift of the demand curve to the left indicates a decrease. A shift of the demand curve to the right indicates an increase. (SSEMI2f)



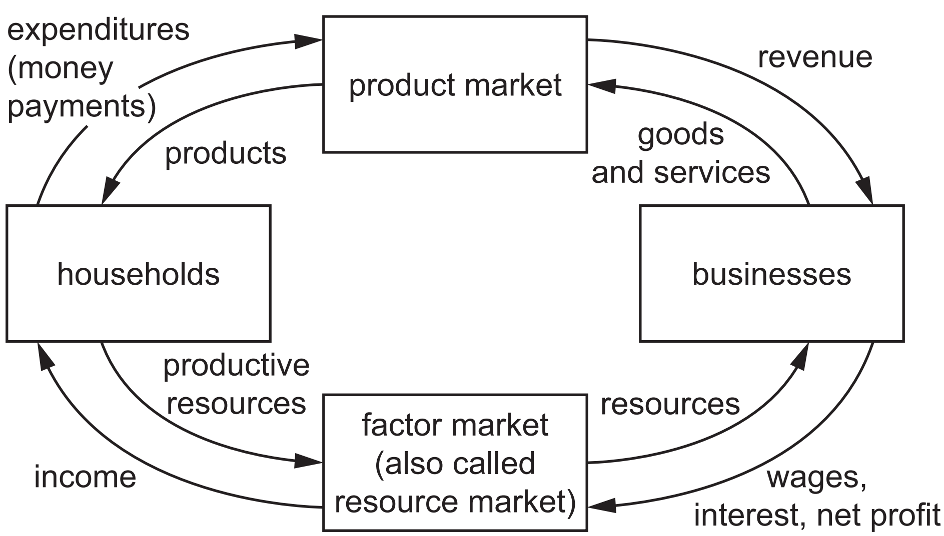

**Equilibrium price** or **market clearing price** is found at the intersection of the market demand and supply curves. It is the point at which the quantity demanded by consumers is equal to the quantity supplied by producers. (SSEMI2c)

A government may set a price floor or price ceiling on a good or service. A **price floor** sets a minimum price for which a product can be sold. Price floors often lead to a surplus of a good. An example of a price floor is a minimum wage. A **price ceiling** sets a maximum price at which a good can be sold. A price ceiling often leads to a shortage. An example of a price ceiling would be rent control. (SSEMI2g)




When buyers and sellers freely and willingly engage in market transactions, it is known in economics as **voluntary exchange.** The transactions are made in such a way that both the buyer and seller benefit from the exchange. (SSEF3b)

The **circular flow diagram** shows the interactions between buyers and sellers in different markets. Here is one example of a circular flow diagram.




**Households in the factor market** own productive resources. They sell land, labor, and capital to businesses in the factor market in exchange for **income. Households in the product market** are the consumers of goods and services. They use their income to buy goods and services from businesses. **Businesses (firms) in the factor market** consume productive resources (land, labor, capital, and entrepreneurship). **Businesses (firms) in the product market** produce the goods and services purchased by households. The money received by businesses from households is revenue. (SSEMI1a, b)

There are many different types of business organizations, and each type has its advantages and disadvantages.

1. **Sole proprietorship:** A sole proprietorship has a single owner. (SSEMI3a)
2. **Partnership:** A partnership divides up the risk and reward among a group of people. (SSEMI3a)
3. **Corporations:** Corporations issue stock, and anyone who owns stock in the corporation owns a portion of that corporation. (SSEMI3a)

**Monopoly:** a market structure in which a commodity is supplied by one firm. (SSEMI3b)

**Oligopoly:** a market structure of imperfect competition in which an industry is dominated by a small number of suppliers. (SSEMI3b)

**Monopolistic competition:** a market structure in which there are a large number of sellers who are supplying goods that are close, but not perfect, substitutes. Sellers have a degree of control over price. There are few long-term barriers of entry and exit. (SSEMI3b)

**Pure (perfect) competition:** a market structure in which there are a large number of sellers who are supplying goods but not a large enough number to set the price of the goods. There are no barriers of entry and exit. (SSEMI3b)

Governments in the United States provide **public goods and services** only when there is a reason that the private market is unable to provide that good or service at a level that would benefit society. Public goods and services are usually paid for through the collection of taxes. Public goods are "shared consumption" goods. This means that when one person uses the good it does not lessen the value of the good for another person. They also are non-exclusionary. This means that it is difficult to prevent someone from enjoying the benefit from that good even though they are unwilling to pay for that good. (SSEF5a)

Sometimes governments choose to **redistribute income**. This means using the tax money from one group and giving it to other groups. Social welfare payments and unemployment compensation are examples of the government redistributing income. (SSEF5a)

The government is also responsible for the protection of **private property rights**. If consumers or businesses are uncertain that they will be able to hold on to their physical or intellectual property, they are less likely to purchase goods or invest in or expand their business. Private property rights are protected by intellectual property laws, such as patents and copyright laws. Deeds for property and titles for cars are examples of how physical property is protected by the government. (SSEF5a)

**Market failures** occur when the private market is unable to produce goods and services in a way that the marginal benefit to society from the production of the good is equal to or greater than the marginal cost to society for producing the good. **Externalities** are a type of market failure. They occur when a third party other than the consumer or producer of a good is hurt or benefits from the production or consumption of that good. Another type of market failure is **market power**. Market power refers to a market failure resulting from the formation of monopoly and oligopoly market structures. (SSEF5a)

**Government regulation** takes many forms. Some regulations protect citizens from corporate abuse. Other government regulations help businesses recover from external problems by offering money to help offset an unforeseen disaster. **Deregulation** is the reduction or elimination of government power in an industry. Deregulation may help increase competition, which could improve business profits and reduce costs for consumers. (SSEF5b)

## SAMPLE ITEMS

### Item 4

**Selected-Response**

**Which of these describes a characteristic of a monopoly?**

**A.** few barriers of entry
**B.** rarely affected by government regulations
**C.** strong control over price
**D.** face strong competition for customers

### Item 5

**Selected-Response**

**Read the scenario.**

| |
|---|
| Juanita and Sarah made 100 T-shirts with a picture of their school's basketball team to celebrate winning the division championship. They initially sold the T-shirts for $5 each. The T-shirts began selling quickly. Juanita and Sarah realized that $5 a shirt would not cover their costs, so they raised the price to $8 a shirt. As a result, sales declined and they had 20 unsold T-shirts at the end of the year. |

**Which term BEST describes what happened when Juanita and Sarah raised the price of the T-shirts?**

**A.** law of supply
**B.** law of demand
**C.** opportunity cost
**D.** comparative advantage

### Item 6

**Selected-Response**

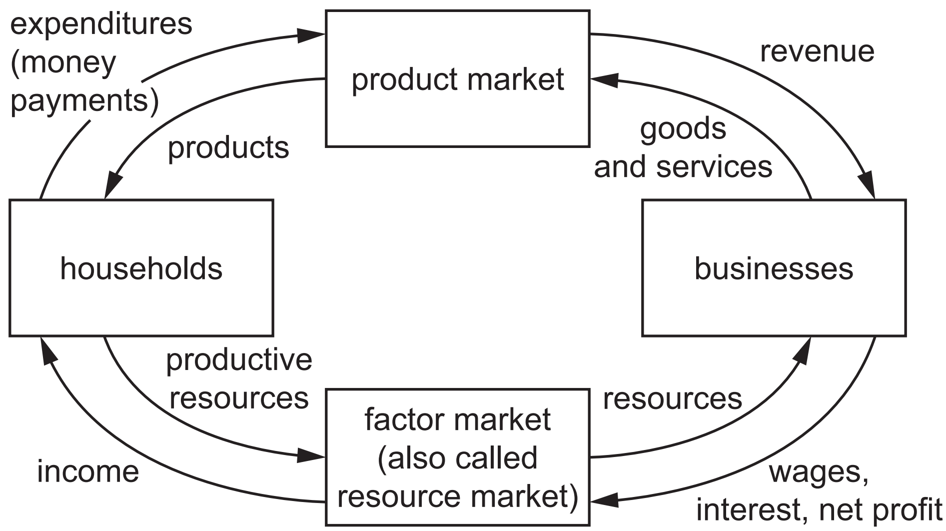
**In the U.S. economy, a few firms dominate the wireless telephone provider industry. Which type of market structure does this represent?**

**A.** oligopoly
**B.** monopoly
**C.** pure competition
**D.** monopolistic competition

## Item 7

**Multi-Part Technology-Enhanced**

**Use the diagram to answer the questions.**




**Part A**

**What benefit do households provide for businesses?**

**A.** They supply consumers and workers.
**B.** They dictate the supply of certain goods.
**C.** They develop scarce resources for business use.
**D.** They help businesses save money by looking for bargains.

**Part B**

**Which interaction illustrates the flow of services between a household and a business?**

**A.** A city operates and maintains public parks.
**B.** A discount store establishes a clearance aisle.
**C.** A disabled worker draws benefits from the government.
**D.** A pizza business provides delivery for an additional fee.

## Item 8

**Selected-Response**

**Which statement BEST describes the role of the government in a mixed economic system?**

**A.** It dictates what is to be produced.
**B.** It determines for whom goods are to be produced.
**C.** It restricts the industrial purchases of raw materials.
**D.** It monitors the safety of goods and services through regulatory agencies.

## ACTIVITY

**Supply and Demand**

**Standard:** SSEMI2

To better understand the laws of supply and demand, you will create a graph showing supply and demand for a product using the supply and demand schedules below. After you have created your graph, use your graph to explain to a classmate, friend, or family member how the shifters of supply and demand will affect the curves.

Step 1: Plot the data from the supply schedule below on a graph. The supply schedule shows the quantity available at each price. Supply curves are always upward sloping because when prices are higher, firms produce more goods. The *y*-axis is price, and the *x*-axis is quantity.

Step 2: Connect the plots to see your supply curve.

Step 3: Add the demand schedule below to the graph on which you plotted the supply curve. The demand schedule shows the quantity that will be demanded at every price level. Demand curves are always downward sloping because consumers buy less as the price goes up.

Step 4: Connect the plots to see your demand curve.

**Supply Schedule for T-Shirts**

| Quantity | Price ($) |
|---|---|
| 0 | 0 |
| 20 | 5 |
| 40 | 10 |
| 60 | 15 |
| 80 | 20 |
| 100 | 25 |

**Demand Schedule for T-Shirts**

| Quantity | Price ($) |
|---|---|
| 100 | 0 |
| 80 | 5 |
| 60 | 10 |
| 40 | 15 |
| 20 | 20 |
| 0 | 25 |

Step 5: Now share your graph with someone you know. First, select a determinant of supply (i.e., changes in costs of productive resources, government regulations, number of sellers, producer expectations, technology, or education) and explain how the determinant of supply will affect the supply curve. Be sure to include what will make the supply curve shift to the left and to the right. Now, select a determinant of demand (i.e., changes in related goods, income, consumer expectations, preferences/tastes, or number of consumers) and explain how the determinant of demand will affect the demand curve. Be sure to include what will make the demand curve shift to the left and to the right.