

Instructions

Here are some slides to review topic areas for TEST #3.

For each area, there is a slide of review questions followed by a slide with the correct answers.

Try to answer each slide's questions on your own, before consulting with the answer slide that follows.

Review: Utility

- 1) What measure of utility generally rises with consumption?**
- 2) What measure of utility generally falls as consumption rises?**
- 3) What is the limit to one's buying power known as?**
- 4) What is the condition for Utility Maximization?**
- 5) What is another name for this condition?**
- 6) What is meant by the phrase "pricing is done at the margin" ?**

Answers: Utility

- 1) Total Utility rises with consumption
- 2) Marginal Utility falls as consumption rises
- 3) Budget Constraint
- 4) Condition for **Utility Maximization**:
$$\text{MU1/P1} = \text{MU2/P2} = \dots\dots\dots\text{MUn/Pn}$$
- 5) also called Condition for **Consumer Optimization**
- 6) It means that prices in competitive markets are set in proportion to the marginal utility of the last item consumed in those markets

Review: Consumers' Surplus

- **Given: $Q = 16 - 2P$**
- **And assuming supply crosses demand at the midpoint**
 - 1) **At equilibrium, what is total revenue?**
 - 2) **At equilibrium, what is the consumers' surplus?**
 - 3) **At equilibrium, what would consumers be willing and able to pay?**
 - 4) **What technique would producers likely attempt that would lead to a reduced consumers' surplus?**
 - 5) **What economic conditions are necessary for this strategy to be employed?**
 - 6) **What is the area above the supply curve but below the equilibrium price called?**

Answers: Consumers' Surplus

- 1) Total Revenue = 32
- 2) Consumers' Surplus = 16
- 3) Willing & Able to spend = 48
- 4) Technique known as **Price Discrimination**
- 5) 2 economic conditions necessary:
 - a) must be able to distinguish subgroups
 - b) resale among groups must be difficult
- 6) Area is known as **Producers' Surplus**

Review: Production

- 1) Under what conditions does maximum production lead to maximum profit?**
- 2) How does diminishing marginal utility differ from diminishing marginal product?**
- 3) When total product is maximized, what is true of marginal product?**
- 4) When average product is maximized, what is true of marginal product?**
- 5) What is the ratio of marginal to average product called?**
- 6) Which stage of production should generally be avoided?**

Answers : Production

- 1) 2 conditions: all costs are fixed costs and price stability
- 2) DMU refers to the **demand side** of the market....as one consumes more, the extra satisfaction declines....DMR refers to the **supply side** of the market....as one adds variable inputs to at least one fixed input, extra product declines
- 3) If TP is MAX, then $MP = 0$
- 4) If AP is MAX, then $MP = AP$
- 5) **Elasticity of Production** = MP/AP
- 6) Avoid Stage 3

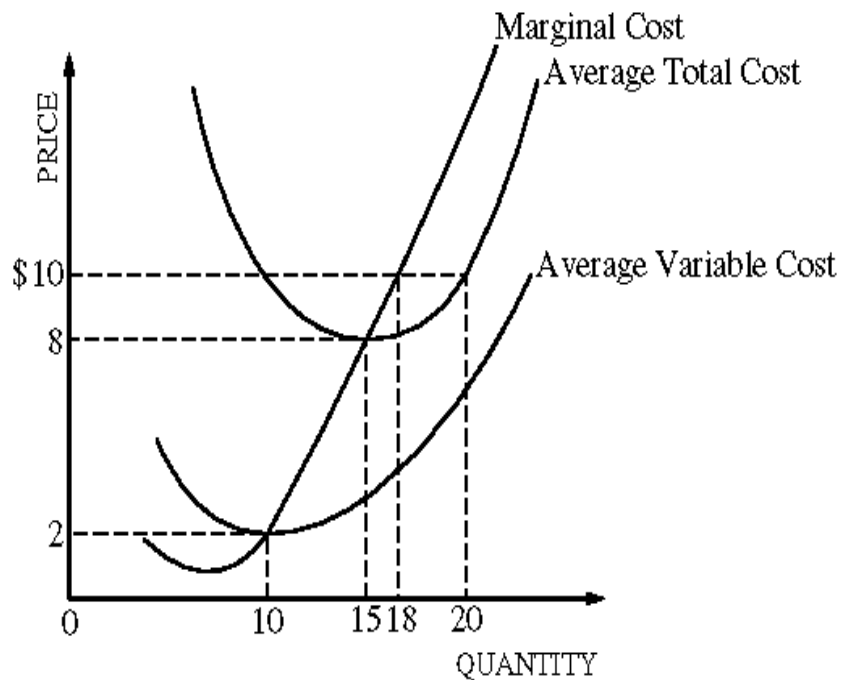
Review: Costs

- 1) Which measure of cost never changes?**
- 2) Which measure of cost rises with output?**
- 3) Which total cost measures are affected by marginal costs?**
- 4) At which points does the marginal cost intersect the average variable and average total costs?**
- 5) Write a formula relating the marginal cost to the marginal product.**
- 6) In the long run, if a business gets more cost effective as it grows in capacity, what is this called?**

Answers: Costs

- 1) **Total Fixed Cost**
- 2) **Total Variable Cost**
- 3) **Both the Total Costs & the Total Variable Costs are affected by marginal cost**
- 4) **It intersects each at their respective minimum values**
- 5) **$MC = \text{Wages} / MP$**
- 6) **It is called **Economies of Scale** or equivalently.....**Increasing Returns to Scale****

Cost: questions



- 1) At what level of output is AVC at a minimum?
- 2) What is minimum AVC in this case?
- 3) At what level of output is ATC at a minimum?
- 4) What is minimum ATC in this case?
- 5) What other cost curve intersects each of these at their respective minimum points?
- 6) Approximately, how large is AFC when output is 10 units?
- 7) Approximately, how large is AFC when output is 20 units?

Cost : answers

- 1) $Q = 10$
- 2) $AVC = 2$
- 3) $Q = 15$
- 4) $ATC = 8$
- 5) MC
- 6) Approx. 8 \$
- 7) Approx. 3 – 4 \$