

Economics AP

Unit 1: Economics 101

Covers chapters 1-4, 19

Chapter 1: The Nature of Economics

Economics	A subject of social science that examines how individuals and societies seek to satisfy endless needs and wants with limited resources.
Resources	Simply referred to as "stuff" which will satisfy people's wants.
Wants	"Stuff" that people would buy if they had unlimited income.
Microeconomics	A field of economics that studies the decisions and behaviors of individual consumers, industries, and firms.
Macroeconomics	A field of economics that studies the sum of individual economic decisions such as economics growth, unemployment, and price stability.
Aggregates	A factor within macroeconomics that deal with the total amounts or quantities such as aggregates demand, which is the total demand for goods and services in the economy.
Rationality Assumption	The assumption that individuals always choose what they believe to be the best means to achieve their given ends.
Incentives	A factor (such as a reward) that provides a motive for a particular activity. Individuals react by weighing the costs and benefits.
Models or theories	Formally Economic models or theories are simplified representations that help explain economic phenomena on a larger scale.
Ceteris Paribus Assumption	The assumption that simplifies economic expressions easier for understanding that keeps all factors unchanged except for the factors being studied.
Empirical	The reliance on using real world evidence and data to prove and explain the usefulness of models.
Positive Economics	The way of analyzing economics through a cause-and-effect relationship and supports it with hard facts. A statement of what is.
Normative Economics	The way of analyzing economics through value judgments that predicts what the economy should be like or what actions need to be taken in order to reach a desirable goal.

Chapter 2: Scarcity and the World of Trade-Offs

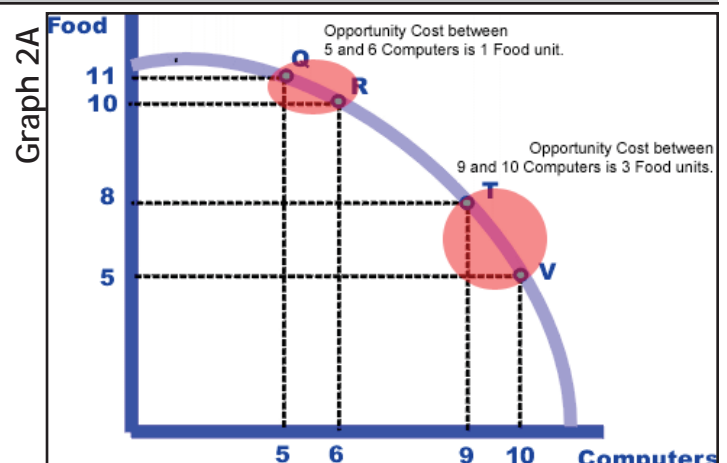
Scarcity	The inability of not having enough resources (wealth or income) to fulfill one's desires
Production	Any activity which converts resources that we want into products that may be used in consumption.
Land	The natural resources available from nature
Physical Capital	The manufactured resources including equipment and natural resources improvements used to aid production

Human capital	The total education and training of workers to increase their productivity and skill.
Entrepreneurship	The factor of production that involves allocating human resources into utilizing other factors of production to make business policies. The entrepreneur takes risk that might lead to more money income.
Goods	Anything that gives satisfaction or happiness to an individual.
Economics Goods	Goods that are derived from scarce resources.
Services	Mental or physical assistance goods which are purchased by consumers.
Opportunity cost	The cost of something in terms of an opportunity given up and all the benefits that could be received from that opportunity. (See Graph 2A)
Production Possibilities Curve (PPC)	A graph that depicts the trade-off (opportunity costs) between any two items produced. (See Graph 2A)
Efficiency	A given level of input used to produce the maximum amount of output with available resources and technology
Inefficient point	Any point at which resources are being used inefficiently and drops below the PPC
The law of increasing relative cost	As more resources are allocated into the production of one item, the opportunity cost increases for each additional one of those items produced. This result in the curve bowed outwards in a PPC graph.
Consumption	The use of goods and services to provide satisfaction and happiness
Specialization	The division of productive activities between various labors to increase that specific labor's productivity.
Absolute Advantage	The ability to produce goods or services at a cheaper cost and it is also the ability to produce more with the same amount of resources.
Comparative Advantage	The ability to produce goods or services at a lower opportunity cost compared other producers.
Division of Labor	The division of labor into specific roles and tasks intended to increase the efficiency to produced a desired product

Charts and Graphs

Assumptions Underlying the PPC

- All resources are fully employed
- There is a specific time period
- The resources points, both quantity and quality, are fixed over the time period
- No change in technology

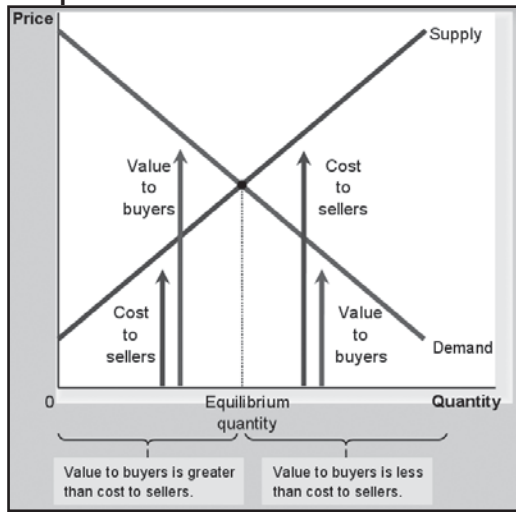


Chapter 3: Demand and Supply

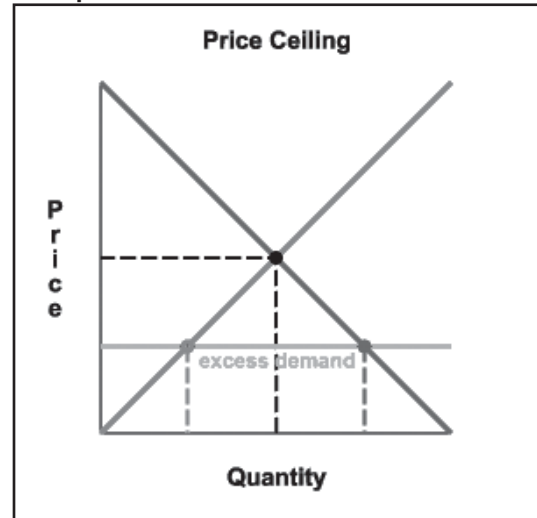
Market	An abstract way of defining a group of people that work in the same exchange/trade. <i>I.E. labor market, automotive market, loan market.</i>
Demand	How many people are willing to pay for a good or service at any given price.
Law of Demand	An inverse proportion of the amount of demand for a product and the price set on that product. Product price increase then demand decrease and vice-versa.
Relative Price	Price of a commodity compared to another commodity.
Money price	The given price of a commodity in terms of dollars and cents. <i>Also known as absolute, nominal, or current price.</i>
Demand Curve	The graphical representation of demand for a certain commodity. Seen on the Price-Unit graph as a line or curve with a negative slope. (Look at Graph 3A)
Market Demand	The total price of the entire consumer demand in a market. A summation of all consumers willingness to pay in the certain market.
Normal Goods	Goods which rise in demand as income increases
Inferior Goods	Goods which decrease in demand as income increases
Substitutes	Two goods are substitute if you can buy one OR the other. Either will work so if you buy more of one, you buy less of the other. An increase demand in one brings decreased demands in the other.
Complements	Two goods are complements if you buy BOTH at a constant. Buy the same amount of both. An increase demand in one brings increased demands in the other.
Supply	The amount of a good produced given a specific time and production-cost.
Law of Supply	The higher the price of a good, the more producers are willing to make the good, thus increasing the supply of the good in the market.
Supply Curve	The graphic representation of the supply. Seen on the Price-Unit graph with a generally positive slope. (Look at Graph 3A)
Subsidy	Payment to the producer by the government for producing a certain product.
Market Clearing or Equilibrium, Price	The price at which demand and supply equal out. Where the two curves intersect. (See Graph 3A)
Equilibrium	The state of when quantity produced is equal to quantity supplied. Impossible if there is an imposed tax. (Look at Graph 3A and Graph 4A)
Shortage	Not enough supply to meet demand
Surplus	More supplied than demanded, causing extra to be produced.

Charts and Graphs

Graph 3A



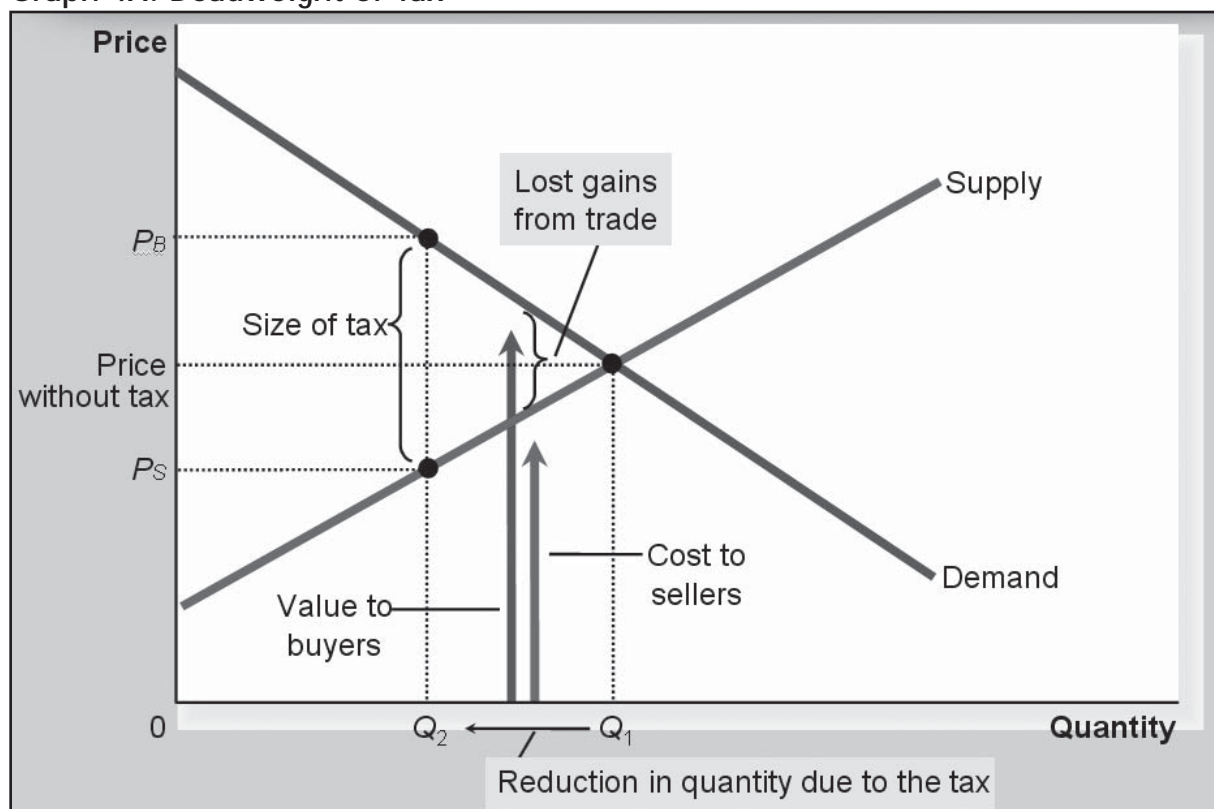
Graph 3B



Chapter 4: Extension Demand and Supply Analysis

Price System	An economic system where price constantly changes due to fluctuations in supply and demand for different commodities.
Voluntary Exchange	An act of trade on a voluntary basis. Here it is assumed that both parties involved in the trade will receive benefits.
Terms of Exchange	The terms of a trade.
Transaction Costs	All costs associated with an exchange that does not include the price of the traded item. These include informational costs, contracting costs, servicing records, etc.
Price Controls	Government created ceilings or floors that limit how high or low the price of a commodity can go. (See Graph 3B)
Price Ceiling	The legal maximum price imposed by the government. (See Graph 3B)
Price Floor	The legal minimum price imposed by the government. (See Graph 3B)
Nonprice Rationing Devices	Methods used to ration scarce goods. If the price system is not working due to government controls, Nonprice Rationing Devices are made to ration commodities.
Black Market	A market where price ceilings are not regulated. Illegal goods are also sold.
Rent Control	Price ceilings put on rents in particular cities.
Minimum Wage	A wage floor created by government that sets the lowest hourly wage that firms are required to pay workers.
Import Quota	A supply restriction put on imported goods. Foreign markets cannot sell more than their quota to the United States.

Graph 4A: Deadweight of Tax



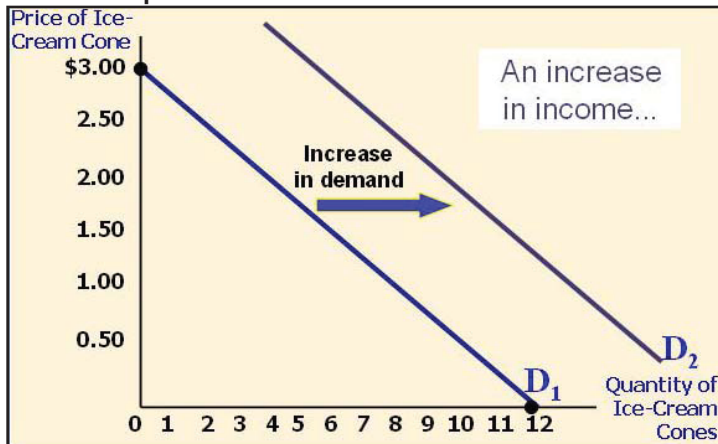
Chapter 19: Consumer Choice

Utility	The want-satisfying power of a good or service. The concept of utility is subjective, but we can infer the amount of utility received by comparing one person's to another's.
Util	Unit by which utility (satisfaction) is measured.
Marginal Utility	change in total utility due to a one-unit change in the quantity of a good/service consumed. Marginal always refers to a change in the total. Marginal utility = $\frac{\text{Change in total utility}}{\text{Change in number units consumed}}$
Marginal Utility versus Total Utility	Total utility refers to the happiness/usefulness received by the good as a whole, whereas marginal refers to satisfaction from a single unit of a good. All consumers make decisions by comparing costs and benefit on the margin
Economic "bads"	When a consumer gains negative marginal utility by consuming a good. A rational consumer would stop consumption before this point
Diminishing Marginal Utility	The more any good/service is consumed, the less utility gained on the margin. "You can never have too much of a good thing" is proven untrue with this principle. Example: All-you can eat buffets

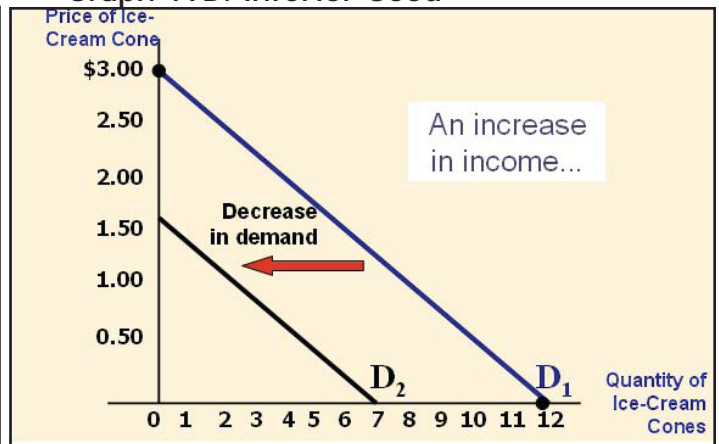
Consumer Optimum	Choice of a set of goods/services that maximizes utility for each consumer. This is limited by consumer income, and is attained when marginal utility of the last dollar spent on each good yields the same utility and income is completely exhausted. Amount of good consumed depends on: price of goods, consumer income, marginal utility, and demand
Substitution Effect	Tendency of people to substitute cheaper commodities for more expensive commodities. Examples: Kirkland Signature Costco generic brand versus name brands
Principle of Substitution	When the price of a more expensive good rises, consumers and producers will shift towards goods/resources that are less expensive

Charts and Graphs

Graph 19A: Normal Good



Graph 19B: Inferior Good



Chapter 19: Consumer Choice Cont.

Purchasing Power	Value of money for buying goods and services. A person's purchasing power increases if income is constant and prices lower. Purchasing power decreases if income is constant and prices rise.
Real Income Effect	Change in people's purchasing that occurs when price of a good changes. However, this effect is practically negligible because of the massive amount of number of consumers. The substitution effect is more important.
"Diamond-water paradox"	Diamonds are useless clear rocks, while water is required to sustain life. So why do people pay more for diamonds than water? Though the total utility of water exceeds total utility of diamonds (water is more useful overall than diamonds), the marginal utility of diamonds are greater (more satisfaction is received by buying one diamond than a unit of water). Therefore, the rational consumer buys the diamond.