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Elasticity

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Basic Concepts of Elasticity

Elasticity is basically the effect of price change on quantity supplied or demanded of a good. It is the percentage change in quantity per unit of percentage change in price.
Price Elasticity of Demand

Price elasticity of demand is an economic measure of the change in the quantity demanded or purchased of a product in relation to its price change.

\[
\text{Price Elasticity of Demand} = \frac{\% \text{ Change in Quantity Demanded}}{\% \text{ Change in Price}}
\]

which means \(\frac{dQ}{Q_{\text{avg}}} \times 100\)

\(\frac{dP}{P_{\text{avg}}} \times 100\)
Price Elasticity of Supply

Similar to price elasticity of demand, price elasticity of supply measures the responsiveness to the supply of a good or service after a change in its market price.

\[
\text{Price Elasticity of Supply} = \frac{\text{% Change in Quantity Supplied}}{\text{% Change in Price}}
\]

which means \( \frac{\text{d}Q}{Q_{\text{avg}}} \times 100 \) \( \frac{\text{d}P}{P_{\text{avg}}} \times 100 \)}
Income Elasticity of Demand

Income elasticity of demand is an economic measure of how responsive the quantity demanded for a good or service is to a change in income.

Income Elasticity of Demand =

% Change in Quantity Demanded

% Change in Income

which means \( \frac{dQ}{Q_{avg}} \times 100 \)

\( \frac{dI}{I_{avg}} \times 100 \)
Cross Elasticity of Demand

The cross elasticity of demand is an economic concept that measures the responsiveness in the quantity demanded of one good when the price for another good changes (complementary and supplementary goods in demand).

Cross Elasticity of Demand =

\[
\frac{\% \text{ Change in Quantity Demanded of } X}{\% \text{ Change in Price of } Y} \times 100
\]

which means \( \frac{dQ}{Q_{avg}} \times 100 \)

\( \frac{dP}{P_{avg}} \times 100 \)

Cross Elasticity of Supply

The cross elasticity of supply is an economic concept that measures the responsiveness in the quantity supplied of one good when the price for another good changes (complementary and supplementary goods in demand).

Cross Elasticity of Supply =

\[
\frac{\% \text{ Change in Quantity Supplied of } X}{\% \text{ Change in Price of } Y} \times 100
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which means \( \frac{dQ}{Q_{avg}} \times 100 \)

\( \frac{dP}{P_{avg}} \times 100 \)
Surplus and Government Intervention

- Consumer Surplus and Producer Surplus
- Price Floor
- Price Ceiling
- Taxes
- Subsidies

Government Intervention
Consumer Surplus and Producer Surplus

- Consumer Surplus is the difference between the price that consumers pay and the price that they are willing to pay. On a supply and demand curve, it is the area between the equilibrium price and the demand curve.

- Producer surplus is the difference between how much a person would be willing to accept for given quantity of a good versus how much they can receive by selling the good at the market price.

- Total Surplus, market efficiency.
Price Floor

- Price floor is a government set restriction on the minimum amount of price that can be charged for a good.

- It does not affect market equilibrium if equilibrium price falls above it.

- But if price floor is set to a price above equilibrium price, it leads to a surplus as quantity supplied is now more than quantity demanded.

- Results in DWSL.

- Eg: Min. wages higher than eq. P.
Price Ceiling

- Price ceiling is a government set restriction on the maximum amount of price that can be charged for a good.

- It does not affect market equilibrium if equilibrium price falls below it.

- But if price floor is set to a price below equilibrium price, it leads to a shortage as quantity supplied is now less than quantity demanded.

- Results in DWSL.
Taxes

- If taxes are imposed on suppliers, supply decreases and if on consumers, demand decreases.

- Both result in a DWSL
Subsidies

A subsidy or government incentive is a form of financial aid or support extended to an economic sector generally with the aim of promoting economic and social policy. For example: govt. giving money to a farmer to assist his plantation.

Pushes the supply curve right as supply increases due to reduction in costs of producers.
Consumer Behaviour
Externalities
Output and Costs
Perfect Competition

- Market Structure in Perfect Competition
- Market vs Firms
- Entry and exit of firms (Long run)
Market Structure in Perfect Competition

- Many-many sellers.

- All selling identical goods.

- Entry/exit cheap and easy (no barriers to entry).

- Each firm produces a relatively small amount compared to the whole industry.
Market vs Firms

- Market is the price-setter whereas firms are the price-takers.

D-Curve for a firm is perfectly elastic as no matter how much the quantity demanded from the firm changes, their price will stay fixed.
Entry and Exit of firms

-If a firm starts making profits (AC > AR), other firms see this as an incentive to enter the industry. This increases the market supply which lowers equilibrium price and so profits are returned back to 0.

-If on the other hand a firm makes losses (AR > AC), exiting the industry pulls supply down and thus equilibrium prices go up. Again the profits are returned back to 0.
Thank You :)  
Good luck!