



Microeconomics

50 Essential Questions

Unit 1: Basic Economic Concepts

1. Explain how to show efficiency, inefficiency, and growth on the production possibilities curve. Efficiency is a point on the PPC, inefficiency is a point inside the PPC, and growth is when the entire PPC shifts outward to the right.
2. Explain the difference between a bowed-out PPC and a straight-line PPC. A bowed-out PPC shows increasing opportunity cost because the resources to make the two goods are not similar. A straight-line PPC shows constant opportunity cost because the resources to make the goods are similar.
3. Explain the difference between an output comparative advantage question and an input question. An output question is when different amounts of goods are made with equal amounts of resources. An input question is when different amounts of resources are used to make the same amount of goods.
4. Explain how to determine if a country has a comparative advantage. To determine if a country has a comparative advantage, compare how much each country gives up when they produce something. The country that has the lower opportunity cost has the comparative advantage.
5. Explain the difference between explicit costs and implicit costs. Explicit costs are the traditional out-of-pocket costs when taking some action. Implicit costs are opportunity costs of taking some action like forgone income, time, and other things given up.
6. Explain why the utility maximizing rule always maximizes total utility when consuming two goods. Consuming the good or service that gives the most marginal utility per dollar ensures that total utility will increase at the fastest rate given the relative price of the two goods.

Unit 2: Supply and Demand

7. Explain why a market demand curve is downward sloping. The law of demand shows a negative relationship between price and quantity demanded because of the substitution effect, income effect, and law of diminishing marginal utility.
8. Explain why an increase in the price of a good does not change the demand for the good. An increase in the price of a good decreases the quantity demanded, not the demand. The demand does not shift.
9. Explain why the total revenue test can't be used to determine the elasticity of a supply curve. Because supply is upward sloping, the price and total revenue are positively related. It doesn't matter if the supply is elastic or inelastic, when the price increases, the total revenue increases.
10. Explain why the elasticity is not constant as you along a downward sloping demand curve. Elasticity is not the same as slope. The percent change in price and the percent change in quantity vary greatly depending on the location on the demand curve.
11. Explain why a price below the equilibrium price causes a shortage. A decrease in price increases the quantity demanded and decreases the quantity supplied resulting in disequilibrium. There is a shortage because more units are demanded than producers are making.
12. Explain why either price or quantity are indeterminate when both demand and supply change. A double shift causes a definitive change in either equilibrium price OR quantity. The one that doesn't definitively change is indeterminate because it depends on the severity (size) of the shift.
13. Explain why a price ceiling above the equilibrium price is not binding. A price ceiling is a cap on market prices. If this cap is above the equilibrium price, this regulation will have no effect on the market. Sellers will continue to sell at the market price since it is still legal to do so.
14. Explain why the change in the price after an excise tax is not equal to the amount of the tax. Consumers don't pay all of the tax. Both buyers and sellers pay a portion of the tax. Consumers pay higher prices while sellers receive less revenue. The tax burden is shared.



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15. Explain why a tax placed on a good with inelastic demand results in less deadweight loss than a tax placed on a good with elastic demand. Quantity is less sensitive to a change in price when the demand is inelastic. A tax placed on a good with inelastic demand results in a smaller change in quantity than a tax placed on a good with elastic demand.
16. Explain why importing goods at a lower price results in more total surplus. Consumer surplus will increase because more people will be able to consume the good after trade since there is a lower world price. Domestic producer surplus falls, but less than the increase in consumer surplus.

Unit 3: Production, Cost, and the Perfect Competition Model

17. Explain why the law of diminishing marginal returns occurs. The LDMR occurs because of fixed resources. When more variable resources are added to production, limited fixed resources make each additional variable resource less productive.
18. Explain why the ATC and the AVC never intersect. ATC equals AVC plus AFC. Since the AFC gets smaller and smaller, but never becomes zero, ATC will never equal AVC.
19. Explain why ATC always hits MC at the lowest point of the ATC curve. When MC is below the ATC, MC pulls the ATC down. When MC is above the ATC, the MC pulls the ATC up. When ATC is at its lowest point (not increasing or decreasing), it must be equal to the MC.
20. Explain the difference between economies of scale and diseconomies of scale. Economies of scale is when the long-run ATC is decreasing due to mass production techniques. Diseconomies of scale is when the long-run ATC is increasing due to higher cost associated with producing more output.
21. Explain why accounting profit is positive when the economic profit is zero. When a firm earns zero economic profit, it covers all its explicit and implicit cost. Since accounting profit doesn't factor in implicit costs, a firm making no economic profit must be earning positive accounting profit.
22. Explain why firms should shut down when the price falls below the AVC. When the price falls below AVC, a firm will lose more money than its fixed costs. To minimize the loss, a firm should shut down and take its fixed cost as a loss instead of producing and having a large loss.
23. Explain why perfectly competitive firms are both allocatively efficient and productively efficient. Perfectly competitive firms have both efficiencies in the long run. They are allocatively efficient because the price equals MC and they are productively efficient because price equals minimum ATC.
24. Explain why perfectly competitive firms make no economic profit in the long run. In the long run, other firms can enter a market when there is profit because there are no barriers to entry. When these firms enter, the price falls causing all firms to make no economic profit in the long run.
25. Explain the difference between a constant cost industry and an increasing cost industry. In a constant cost industry, the entry of firms does not increase production costs. In an increasing cost industry, the entry of firms does increase production costs and the price increases as firms enter.

Unit 4: Imperfect Competition

26. Explain why demand greater than marginal revenue for all imperfectly competitive firms. To sell more units, these firms must lower the price. The marginal revenue of the next unit sold is less than the price of that unit because the firm cannot sell the previous units at the higher price.
27. Explain why the demand is elastic when the marginal revenue is positive. As long as the marginal revenue is positive, a decrease in the price will increase the total revenue. According to the total revenue test, demand is elastic when price falls and total revenue increases.
28. Explain how to identify the profit maximizing price and quantity for a monopoly. Monopolies produce where $MR=MC$ and charge a price up to the demand curve.



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29. Explain why an unregulated monopoly generates deadweight loss. Monopolies produce where the MC of the last unit produced is less than then the price of that unit. Monopolies don't produce the amount society wants because they don't produce where price equals the MC.
30. Explain why monopolies can earn positive economic profit in the long run. High barriers to entry prevent other firms from entering the market.
31. Explain the difference between a natural monopoly and a regular monopoly. A natural monopoly has economies of scale throughout the entire effective demand of its product. The ATC of a natural monopoly is still falling at the socially optimal output.
32. Explain why a price discriminating monopoly generates more profit than a non-price discriminating monopoly. A price discriminating monopoly charges different prices based on how much consumers are willing to pay. This converts consumer surplus into profit. A regular monopoly charges only one price.
33. Explain the difference between a monopoly and monopolistic competition. A monopoly has higher barriers to entry but monopolistic competition has low barriers to entry so firms make no economic profit in the long run.
34. Explain why price equals ATC when a monopolistically competitive firm is in the long run. Monopolistic competition has low barriers to entry so they make no economic profit in the long run. If ATC is less than the price, other firms will enter the market causing the price to fall.
35. Explain why a monopolistically competitive firm doesn't produce the quantity that is productively efficient. A monopolistically competitive firm doesn't produce the quantity that has the lowest ATC. It holds back production to maximize profit even though its ATC is falling and it could produce more output at a lower cost.
36. Explain the difference between a cartel and a regular oligopoly. A cartel is a colluding oligopoly where firms work together to hold back production and increase prices. In a regular oligopoly, firms are actively competing against each other.
37. Explain the difference between a dominant strategy and nash equilibrium. A dominant strategy involves the decisions of one firm based on the actions of another firm. Nash equilibrium is where both firms end up after pursuing their dominant strategies and considering the actions of their opponent.

Unit 5: Factor Markets

38. Explain how more occupational licensing will affect wages in the labor market. If the government requires a license to do a specific job, the supply of labor will decrease causing the wage to increase.
39. Explain how minimum wage affects the quantity demanded and quantity supplied of labor. A minimum wage increases the wage causing disequilibrium. The quantity demanded decreases since firms hire less workers and the quantity supplied increases as more workers enter the market.
40. Explain why the marginal revenue product for workers is equal to the demand for workers. The marginal revenue product is the additional revenue workers generate and represents the benefit that each worker gives the firm. A firm is willing and able to pay a worker up to the amount they generate.
41. Explain why the marginal resource cost for a perfectly competitive firm is horizontal. Perfectly competitive firms in the labor market are wage takers. The wage is set by the market and the wages and cost of each worker is the same.
42. Explain why the least-cost rule always maximizes the total output when using two different resources. Using the resource that gives the most marginal product per dollar ensures that total output will increase at the fastest rate given the relative price of the two resources.



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43. Explain the difference between a monopsony and a monopoly. A monopoly is when there is only one seller of a good or service. A monopsony is when there is only one buyer of a resource.

Unit 6: Market Failure and the Role of Government

44. Explain why negative externalities generate deadweight loss. A negative externality produces a quantity where the marginal social cost is greater than the marginal social benefit. The market overallocates resources and produces too much. Society wants less.

45. Explain why a per unit tax on a negative externality does not generate deadweight loss. A negative externality generates deadweight loss because the output is too high. When it is taxes, output falls to the socially optimal output so the deadweight loss disappears.

46. Explain why positive externalities generate deadweight loss. A positive externality produces a quantity where the marginal social benefit is greater than the marginal social cost. The market underallocates resources and should produce more. Society wants more.

47. Explain the difference between a private good and a public good. Private goods are rival and excludable, and public goods are non-rival and non-excludable. Public goods are often provided by the government since the free market has little incentive to produce them.

48. Explain the purpose of antitrust policies. Antitrust policies are designed to create more competition and prevent monopolies.

49. Explain why a lump-sum tax does not change output in the short run. A lump sum tax only affects fixed costs so the marginal cost doesn't shift. Firms produce where $MR=MC$ and since neither of these change, the output doesn't change.

50. Explain the difference between progressive and regressive taxes. A progressive tax takes a high percent of income from high income groups (example: income taxes). A regressive tax takes a higher percent of income from low income groups (example: sales tax).