

What is economic capital?

Economic capital is one of the factors of production, the others being labor, land (natural resources), and entrepreneurship. Capital consists of goods that have been produced for the purpose of producing other goods. Examples of capital include buildings, equipment, and inventories.

Capital does NOT consist of final goods and services, but rather involves items that are used to further the production of final goods and services.

The financial definition of capital is not used in economics. This version states that capital involves funds used to finance the accumulation of other assets.

What is a production possibilities curve?

The production possibilities curve or frontier (PPF) is a combination of two outputs that a society can produce in a given time period. The points on the curve assume efficient production level, i.e. a full employment of all resources and full utilization of all available technology. Points inside the PPF are attainable, yet inefficient (more can be made with the current level of technology and resources). Points outside the PPF are unattainable given the current level of resources and technology. A PPF shifts when advancement in technology occurs or more resources become available. A decrease in unemployment causes a movement from inside the PPF to on the PPF. A movement of the PPF does not occur because of a decrease in unemployment, because production levels on the PPF already assume full employment of all resources (including labor).

A PPF bows outward when there are increasing opportunity costs associated with making the two products. Increasing opportunity costs occur when the resources are not equally well suited to produce both goods. A PPF that is a straight downward sloping line indicates that there are constant opportunity costs and that resources are equally well suited for the production of both goods.

What is the *Ceteris paribus* assumption and how does it apply to economics?

Ceteris Paribus means “all other things unchanged” and it is used when the relationship of two variables is being studied in an economic model. Other variables that can affect the situation remain constant (or unchanged). By isolating the two variables it is easier to see the relationship between them.

The difference between demand and quantity demanded

Demand is a schedule, which reflects the willingness and ability of an individual to purchase (buy) a good or service for a given price. Thus, in order to be part of the demand for a good or service one must be both willing and able to buy that good or service. For example, if Jack has \$0.25 and Jill has \$ 1.00, and they both want Tacos, but tacos cost \$ 0.50. Jack will not be considered part of the demand for Tacos because he is not able to buy the Taco, although he wants to (willingness). Jill, however, may demand a quantity of 2 tacos. The **demand** for any good or service **is only affected by the number of buyers, their incomes, their tastes and preferences, expectations and the priced of related items i.e. substitutes or compliments.**

However, the quantity demanded relates to the part of the demand schedule which shows how much (quantity) of that good or service individuals are demanding for that price. Thus the quantity demanded changes as the price changes, but the demand for that good or service is not affected.

Key Ideas: Demand is a schedule and is not affected by the price of the good or service. Price only affects the quantity demanded of that good or service.

The difference between supply and quantity supplied

Supply is a schedule, which shows a producer's willingness and ability produce (supply) a good or service at a given price. Thus, in order to be part of the supply of a good or service the producer must be both willing and able to produce that good or service. The main goal of the supplier is to earn a profit. Thus, they will only produce (supply) if the price of the product is more than it is going to cost to produce it. Consequently, the **supply** of any good or service offered **is only affected by input prices (labor, capital), price of related products, the number of firms, technology, producers' expectations, taxes and subsidies.**

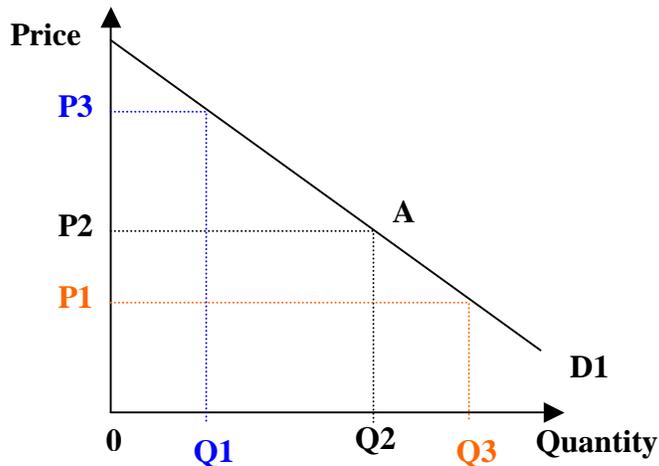
However, the quantity supplied relates to that how much suppliers are able to supply for a particular price. Thus the quantity supplied changes as the price changes. For example, if it cost Jill \$15.00 to make a dress and dresses are selling for \$10.00. Jill will not be willing to make the dress, as she will be loosing money. Therefore, she will not be considered as part of the supply of dresses. Jack however can make a dress at a cost of \$5.00, so he will be willing to supply a quantity of 2 dresses. However, if the price of a dress rises to \$15.00, the quantity of dresses Jill will supply would be is 1 and the quantity of dresses Jack will supply would be dress 3. Thus at \$5.00 the quantity supplied would be 4.

Key Ideas: Supply is a schedule and is not affected by the price of the good or service. Price only affects the quantity demanded of that good or service.

Why are Price and Quantity Demanded inversely related?

Graphical Explanation

Graph 1.1



On graph 1.1, given a specific demand curve D1 we can tell the quantity demanded given any price. For example, in the graph above look at the price P2. According to the demand curve, D1, the price P2 and the quantity Q2 correspond at point A. So we know that at a price of P2, the quantity demanded is equal to Q2. Now let's increase the price to P3. At P3 the quantity demanded is equal to Q1. As shown, as the price of the good increased, the quantity demanded of that good decreased. If the price decreases to P1, the corresponding quantity demanded at that price is Q3. Here, as the price of the good decreased, the quantity demanded of that good increased.

As we have seen, when price increases, the quantity demanded decreases. When price decreases, the quantity demanded of that good increases. Thus we say that these two variables are inversely related (they move in the opposite direction).

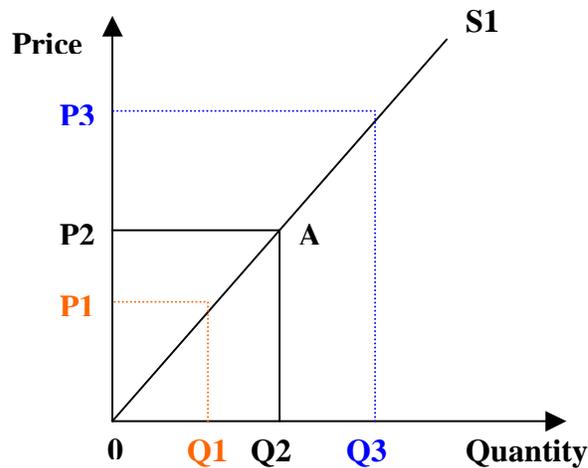
Intuitive Explanation

Now think of this intuitively for a moment. Let's say that you only have enough money to buy two Cokes a day -- Now suddenly the price of Coke doubles. As a result you only have enough money to buy one Coke a day. Because of an increase in the PRICE of the product, your willingness and ability to pay for that product has decreased. In short, because of an increase in the PRICE of Cokes, the Quantity you demand of Cokes has decreased.

Why are Price and Quantity Supplied directly related?

Graphical Explanation

Graph 1.2



In graph 1.2, given a specific supply curve (S1) we can tell the quantity supplied given any price. For example, in the graph above look at the price (P2). (P2) intersects line (S1) at point A. Also intersecting at that point is Q2. So at a price of (P2), the quantity supplied is equal to (Q2). Now let's increase the price to (P3). At (P3) the quantity supplied is equal to (Q3). As shown, as the price of the good increased, the quantity supplied of that good also increased. If the price decreases to (P1), the corresponding quantity supplied at that price is (Q1). Here, as the price of the good decreased, the quantity supplied of that good also decreased.

As we have seen, when price increases, the quantity supplied also increases. When price decreases, the quantity supplied of that good decreases. Thus we say that these two variables are directly related (they move in the same direction).

Intuitive Explanation

If the costs of producing a good remain the same while the price of the product increases, profits will be higher and so will the producers' willingness to supply a product. Assuming all else is constant (no changes in input costs, government intervention, etc.), as the price increases, so does the producers' willingness to supply the good. This shows a direct relationship between price and quantity supplied.