Microeconomics exam 3 Cheat Sheet

by db329 via cheatography.com/163736/cs/35665/

Price Discrimination

Definitions

price discrimination	the practice of selling the same good or service at different prices to different groups of customers
perfect price discrimination	the practice of selling the same good or service at a unique price to every customer (set at their max willingness to pay)
First Degree Price Discrimination	perfect price discrimination where the firm will charge a person based on their exact willingness to pay
Second Degree Price Discrimination	Firms will offer discounts based on bulk purchasing
Third Degree Price Discrimination	Firms will charge different prices based on differences in price elasticity of demand (ex. movie theatre concessions or student discounts)

Relationships

Conditions for Price Discrimination	distinguishing groups of buyers with different price elasticities of demand, preventing resale,

Monopolistic Competition and Advertising

Definitions

Monopolistic Competition	a type of market structure characterized by low barriers to entry, many different firms, and product differentiation
Product Differentiation	the process firms use to make a product more attractive to potential customers
Markup	the difference between the price the firm charges and the marginal cost of production
Excess Capacity	phenomenon occurring when a firm produces at an output level smaller than the output level needed to minimize average total costs

Relationships

in monopolistically competitive industries...

- economic profits are zero and are the same as perfectly competitive markets
- MR < Price
- price is more likely to be higher than perfectly competitive industries because of the cost of variety
- it is inefficient because price does not equal minimum ATC
- long run equilibrium, Price = ATC, Price > MC

Monopolistic competition characteristics	low barriers to entry, many different firms, and product differentiation
production differentiation in...	style or type, location, and quality

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Oligopoly and Strategic Behavior

Definitions	
Oligopoly	a form of market structure that exists when a small number of firms sell a differentiated product in a market with high barriers to entry
Collusion	an agreement among rival firms that specifies the price each firm charges and the quantity it produces
Cartel	a group of two or more firms that act in unison
Antitrust Laws	laws that attempt to prevent collusion (that is, prevent oligopolies from behaving like monopolies)
Mutual Indepe-ndence	a market situation where the actions of one firm have an impact on the price and output of its competitors
Price Leadership	phenomenon occurring when a dominant firm in an industry sets the price that maximizes its profits and the smaller firms in the industry follow by setting their prices to match the price leader
Price Effect	how a change in price affects the firm's revenue
Output Effect	how a change in price affects the number of customers in a market
Game Theory	a branch of mathematics that economists use to analyze the strategic behavior of decision-makers
Prisoner's Dilemma	a situation in which decision-makers face incentives that make it difficult to achieve mutually beneficial outcomes, when the socially optimal strategy doesn't equal the dominant strategy
Dominant Strategy	in game theory, a strategy that a player will always prefer, regardless of what his opponent chooses
Nash Equili-brium	a phenomenon occurring when all economic decision-makers opt to keep the status quo (neither player has na incentive to switch their strategy given what the other player is doing)
Tit-for-Tat	a long-run strategy that promotes cooperation among participants by mimicking the opponent's most recent decision with repayment in kind
Backward Induction	in game theory, the process of deducing backward from the end of a scenario to infer a sequence of optimal actions
Decision Tree	diagram that illustrates all of the possible outcomes in a sequential game
Sherman Antitrust Act	the first federal law (1890) limiting cartels and monopolies

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Oligopoly and Strategic Behavior (cont)

Clayton Act	law of 1914 targeting corporate behaviors that reduce competition
Predatory Pricing	the practice of a firm deliberately setting its prices below average variable costs with the intent of driving rivals out of the market
Network Externality	condition occurring when the number of customers who purchase or use a product influences the quantity demanded
Switching Costs	the costs incurred when a consumer changes from one supplier to another
Relationships	
Prisoner's dilemma dominant strategy	rat out your partner to avoid jail time

Consumer Decision Making

Definitions	
Utility	a measure of the level of satisfaction that a consumer enjoys from the consumption of goods and services
Util	a personal unit of satisfaction used to measure the enjoyment from consumption of a good or service
Marginal Utility	the additional satisfaction derived from consuming one more unit of a good or service
Diminishing Marginal Utility	condition occurring when marginal utility declines as consumption increases
Consumer Optimum	the combination of goods and services that maximizes the consumer's utility for a given income or budget (MU/P is equal across products)
Substitution Effect	(1) the decision by laborers to work more hours at higher wages, substituting labor for leisure; (2) a consumer's substitution of a product that has become relatively less expensive as the result of a price change
Real-income effect	a change in purchasing power as a result of a change in the price of a good
Diamond-water paradox	concept explaining why water, which is essential to life, is inexpensive, while diamonds, which do not sustain life, are expensive
Indifference Curve	a graph representing the various combinations of two goods that yield the same level of personal satisfaction, or utility
Maximization point	the point at which a certain combination of two goods yields the greatest possible utility

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Consumer Decision Making (cont)

Budget constraint	the set of consumption bundles that represent the maximum amount the consumer can afford
Marginal rate of substitution (MRS)	the rate at which a consumer is willing to trade one good for another along an indifference curve
Perfect substitutes	two goods the consumer is completely indifferent between, resulting in a straight-line indifference curve with a constant marginal rate of substitution
Perfect complements	two goods the consumer is interested in consuming in fixed proportions, resulting in a right-angle indifference curve
Relationships	
if combination of something one loves and something one hates	maximum utility is gained from purchasing maximum quantity of the thing one loves

Behavioral Economics and Risk Taking

Definitions	
Behavioral Economics	the field of economics that draws on insights from experimental psychology to explore how people make economic decisions
Bounded Rationality	the concept that although decision-makers want a good outcome, either they are not capable of performing the problem solving that traditional economic theory assumes or they are not inclined to do so; also called limited reasoning
Gambler's Fallacy	the belief that recent outcomes are unlikely to be repeated and that outcomes that have not occurred recently are due to happen soon
Hot Hand Fallacy	the belief that random sequences exhibit a positive correlation
Framing Effect	a phenomenon seen when people change their answer depending on how the question is asked (or change their decision depending on how alternatives are presented)
Priming Effect	phenomenon seen when the order of the questions influences the answers
Status Quo Bias	condition existing when decision-makers want to keep things the way they are
Intertemporal Decision--Making	planning to do something over a period of time, which requires valuing the present and the future consistently
Ultimatum Game	an economic experiment in which two players decide how to divide a sum of money
Risk-Averse People	those who prefer a sure thing over a gamble with a higher expected value

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Behavioral Economics and Risk Taking (cont)

Risk-Neutral People	those who choose the highest expected value regardless of the risk
Risk-Takers	those who prefer gambles with lower expected values, and potentially higher winnings, over a sure thing
Preference Reversal	phenomenon arising when risk tolerance is not consistent
Prospect Theory	a theory suggesting that individuals weigh the utilities and risks of gains and losses differently

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