Microeconomics in One Lesson

All about the world of price

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“Demand” means a list of prices and the quantities that people buy or would buy at those prices, holding all other variables constant. The demand can be either during a time interval or at a moment in time. The amount purchased at a particular price is the quantity demanded.

Demand is graphed with the price on the vertical and the quantity on the horizontal. Each price can only have one quantity demanded. Demand is thus a relationship between price and quantity, when all else is held constant. The relationship is the “law of demand,” by which a higher price will not be associated with a greater quantity. Usually, a lower price has a greater quantity demanded, thus demand curves slope down. But demand curves can also be vertical or horizontal. A vertical or fixed demand means that the same quantity is demanded regardless of price, such as perhaps for urgent medicine.

A change in demand means that at the various prices, the quantities change. If anything changes other than price, the demand shifts. If the price changes, then demand is unchanged, as the result is a change in quantity demanded, not the relationship between the prices and quantities.

Supply means a list of prices and the quantities that are sold at those prices. The amount produced or sold at some price is the quantity supplied. For produced goods, higher prices are associated with greater quantities supplied. Spatial land is fixed in supply, as the quantity supplied does not change with the rent and purchase price of land.

With supply curves sloping up or vertical and demand curves sloping down, the market price and quantity are set by the intersection, where quantity supplied equals quantity demanded. That is called the market-clearing point or equilibrium.

If the price is higher than equilibrium, quantity supplied is greater than quantity demanded, and there is a surplus. If the price is lower than equilibrium, there is a shortage. Market dynamics eliminate a surplus or shortage by entrepreneurs moving the price towards equilibrium to eliminate the surplus or shortage. Price controls such as a minimum wage perpetuate shortages and surpluses.

A shortage is different from scarcity. A good is scarce if the quantity demanded is greater than the quantity supplied at a price and cost of zero. Scarce goods fetch positive market prices.

Utility is the satisfaction from or the subjective importance of goods. Marginal utility is the gain in utility from an extra amount of a good. There is diminishing marginal utility as extra amounts of a good eventually provide ever less utility. Consumers maximize their utility when the marginal utility of all goods, relative to their prices, is equal.

An opportunity cost is what is given up to get something. A comparative advantage means a lower opportunity cost. Trade takes place because one provides the other with goods that have a lower opportunity cost in exchange for those with a higher opportunity cost.

Elasticity is the responsiveness of a variable to a change in another variable. The price elasticity of demand means the responsiveness of quantity demanded to a change in price. A good is elastic if it is very responsive, and inelastic if its response is relatively small.

A consumer surplus is the difference between the highest price one would pay and what is actually paid. The benefit of goods is that surplus. Economists call the difference between the price and the cost of producing that next quantity the “producer surplus,” but it is usually rent that is paid to be located in more productive locations. The social surplus is the total of the consumer and the producer or land-rent surplus, which is maximized in a free market, since price controls and taxes on producers and consumers reduce the surplus.

The supply of a produced good is based on the cost of production. A tax raises the price by the amount of the tax, and the higher price reduces the quantity purchased and sold and produced. The reduction in the quantity creates a misallocation and waste of resources, called a deadweight loss or excess burden.

When the supply is vertical or completely inelastic, as with spatial land, there is no deadweight loss. A tax on land rent or land value reduces the price of land, since it has no cost of production, and the tax cannot be passed on to tenants, since if it were, it would create vacancies, and the landlords would lower the rent back to equilibrium.

An externality is an uncompensated effect on others. A negative externality such as pollution comes from a lack of property rights, such as to the atmosphere, and can be remedied in some cases by negotiation, in others by lawsuits, and for large-scale pollution, by charging polluters for the social cost. Traffic congestion can be avoided with tolls just high enough to let traffic flow.

A collective of public goods is used by a group at the same time. Public goods such as streets and parks increase land rent. A levy on the rent pays back value received and avoids a subsidy to landowners that takes place when the public goods are financed from taxes on wages.

An accounting profit is revenue minus the explicit costs, those paid to others. The implicit cost is the opportunity cost of foregone wages or investment yields. The economic profit is the revenue minus all costs, explicit and implicit. The real gain is the economic profit.

Markets have various types of competitive structures. An industry with atomistic or perfect competition has many small firms producing an identical product. In that case, the price efficiently equals the marginal cost of a good, the cost of producing the next good.

An absolute monopoly is an industry or product with one seller, such as because of a patent. Firms maximize profit at the quantity at which the marginal cost equals the marginal (extra) revenue from one more unit. In monopolistic competition, there are many firms producing varieties of goods that are close substitutes, like different brands. An oligopoly is an industry with few firms, or a few dominant firms, in which case the actions of the other firms or the largest ones affect the others.

To minimize the excess burden of taxation and to avoid pollution and environmental damage, public revenue should come from land rent and pollution levies, as well as user fees. Maximum prosperity requires free trade, the removal of restrictions and taxes on exchange. The replacement of taxes on wages, goods, and enterprise with a land value tax (LVT) and pollution tax would provide maximum productivity, greater equality, and minimum pollution.

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FRED E. FOLDVARY, Ph.D., (May 11, 1946 — June 5, 2021) was an economist who wrote weekly editorials for Progress.org since 1997. Foldvary's commentaries are well respected for their currency, sound logic, wit, and consistent devotion to human freedom. He received his B.A. in economics from the University of California at Berkeley, and his M.A. and Ph.D. in economics from George Mason University. He taught economics at Virginia Tech, John F. Kennedy University, Santa Clara University, and San Jose State University.

Foldvary is the author of *The Soul of Liberty*, *Public Goods and Private Communities*, and *Dictionary of Free Market Economics*. He edited and contributed to *Beyond Neoclassical Economics* and, with Dan Klein, *The Half-Life of Policy Rationales*. Foldvary's areas of research included public finance, governance, ethical philosophy, and land economics.

Foldvary is notably known for going on record in the *American Journal of Economics and Sociology* in 1997 to predict the exact timing of the 2008 economic depression—eleven years before the event occurred. He was able to do so due to his extensive knowledge of the real-estate cycle.