

Microeconomics, Module 2: “Prices, Costs, and the Gains from Trade”

*Micro Module 2 Readings* from eight edition: Landsburg, Chapter 2

(The attached PDF file has better formatting.)

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Module 2 and 3 show how differences in tastes and ability lead to potential benefits from trade. Later modules have more rigorous valuations of the benefits received by consumers (consumers’ surplus) and producers (producers’ surplus).

*Read Section 2.1:* The absolute price is in dollars; the relative price is in terms of other goods given up to buy the good in question. We use relative prices, not absolute prices.

*Read Section 2.2:* The economic term *cost* means *sacrificed opportunity*, not dollar cost. A person who can do an activity at a lower cost has a comparative advantage. Everyone is better off when people or countries specialize in their areas of comparative advantage and trade to get the goods and services they want.

*Illustration:* Jacob excels at growing grapes and making wine; Rachel excels at baking bread. Jacob likes bread, and Rachel likes wine. Both Jacob and Rachel gain if Jacob makes wine, Rachel bakes bread, and they trade.

*Final Exam:* The illustrative test questions discuss relative prices; expect a similar question on the final exam. The practice problems and homework assignments discuss comparative advantage; expect a multiple choice question on this topic on the final exam.

Review exercise N1 on page 43. Be sure you can answer *Part B*; the final exam has similar problems. Review problems 3 and 7 on page 43, and problem 15 on page 54. These problems assume perfect markets; the final exam problems have the same assumption.