The VOTE Textbook
Student Notes
Chapter 5: Conventional Theory: Conservatives and Liberal

Opening Story: Champion wheelchair racer Tatyana McFadden

Conventional theory is an umbrella term that includes both liberal and conservative theories. "Conventional" means mainstream or dominant.

Conservatives and Liberals agree about the assumptions, model, and conclusions, but disagree about policy.

According to conventional theory, capitalism creates the levels of prosperity that make it possible for all of us to realize our potential.

Conventional Theory Assumptions

i. Scarcity

Since all inputs (resources) are limited, output is also limited.

ii. Individuals Maximize Happiness

Individuals act in self-interested ways to maximize happiness by making rational choices to acquire more goods and services.

iii. Firms Maximize Profits

Firms act in self-interested ways to maximize profits by transforming resources into products that people want, using technology to do so.

Conventional Theory Model

The Law of Demand: individuals demand less at higher prices and more at lower prices, ceteris paribus.

$(P\uparrow \rightarrow Q^D\downarrow;\ P\downarrow \rightarrow Q^D\uparrow)$

The Law of Supply: firms supply more at higher prices and less at lower prices, ceteris paribus.

$(P\uparrow \rightarrow Q^S\uparrow;\ P\downarrow \rightarrow Q^S\downarrow)$

Market: A real or virtual place where demanders meet suppliers, and prices and quantities are determined

Two sets of actors (in a market for goods and services):

1. Demanders: Consumers • Households • Individuals • Buyers
2. Suppliers: Producers • Vendors • Firms • Sellers

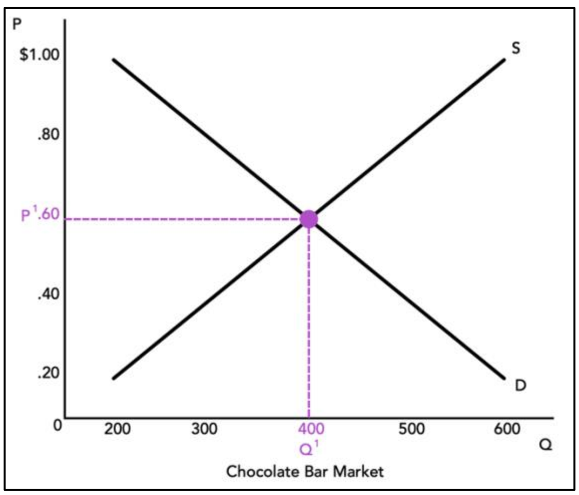
When demanders meet suppliers in markets, prices emerge (price signals) which serve as incentives to act (the invisible hand).

Ceteris paribus, price is the most important factor in your decision either to buy something or sell something.

Demand and Supply Schedule

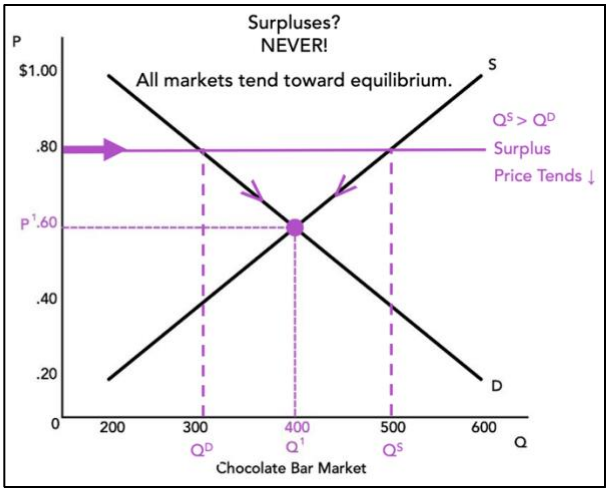
Price	Quantity Supplied	Quantity Demanded	Surplus or Shortage
$1.00	600	200	Surplus: $Q^S > Q^D$ and P ↓
$0.80	500	300	Surplus: $Q^S > Q^D$ and P ↓
$0.60	400	400	Equilibrium: $Q^S = Q^D$, No P Δ
$0.40	300	500	Shortage: $Q^D > Q^S$ and P ↑
$0.20	200	600	Shortage: $Q^D > Q^S$ and P ↑

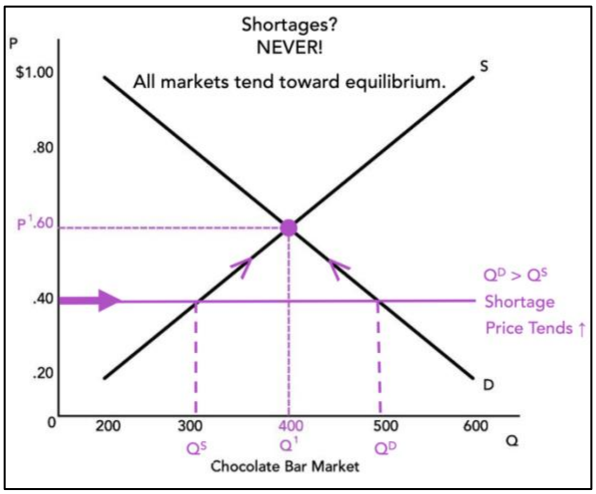
Market Graph:



Surpluses and Shortages:

Never. Price signals will automatically bring the market back to equilibrium, *ceteris paribus*.



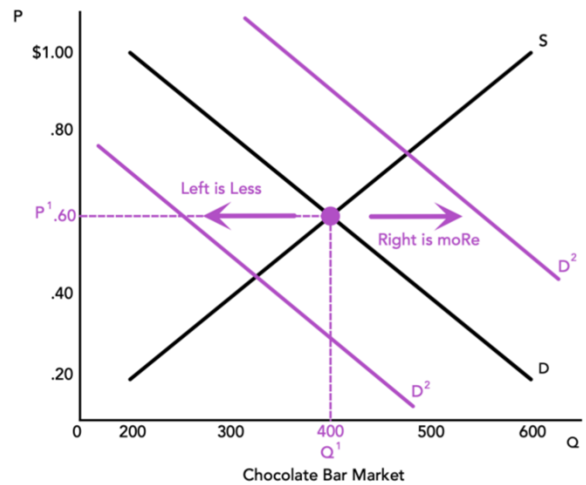


If price signals always lead the market back to equilibrium, prices would never change. But they do all the time.

Release the condition that all other things besides price remain constant (*ceteris paribus*) and consider the six factors that shift the demand curve and the six factors that shift the supply curve.

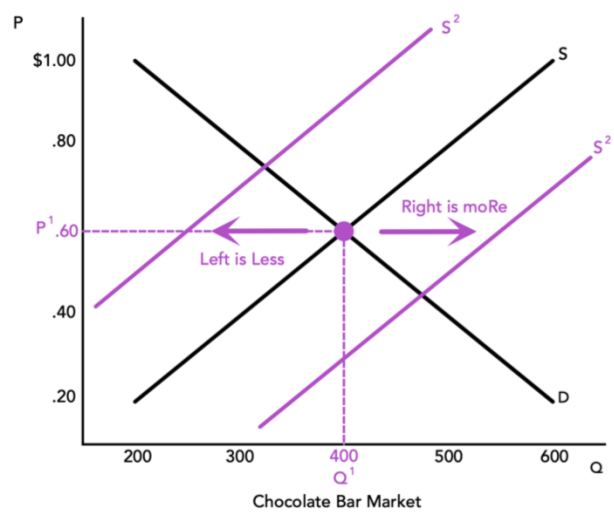
Six Factors that Shift the Demand Curve

1. **Income**
2. **Preference**
3. **Prices of Complements and Substitutes**
4. **Availability/Convenience**
5. **Future Expectations of Price, Income, and Preference**
6. **Number of Buyers**



Six Factors that Shift the Supply Curve

1. **Cost of Inputs**
2. **Number of Firms**
3. **Taxes, Subsidies, and Regulations**
4. **Prices of Related Goods**
5. **Changes in Technology**
6. **Future Expectations**



VOTE Market Change Guide Instructions

Here is a tool to help you analyze changes in markets from the liberal and conservative perspectives. Have a blank Market Change Guide ready and then follow these instructions to fill it in.

VOTE Market Change Guide

A. Read the relevant news article.

B. Name a market that is most affected by this news.

C. Determine the market change.

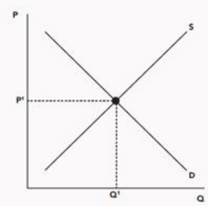
1. *Search* for the relevant factor.

Demand	**Supply**
☐ Income	☐ Cost of Inputs
☐ Preference	☐ Number of Firms
☐ Number of Buyers	☐ Taxes/Subsidies/Regulations
☐ Availability/Convenience	☐ Prices of Related Goods
☐ Prices of Comps and Subs	☐ Changes in Technology
☐ Future Expectations	☐ Future Expectations

2. *Shift* demand or supply curve.

3. *Slide* with the price change.

4. *Settle* at the new equilibrium.



Market:____________________

D. Summarize the conservative and liberal views on this market change.

Conservative	Liberal

A. Read the relevant news article.

B. Name a market that is most affected by this news. Write it on the line below the graph.

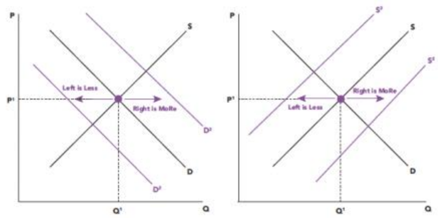
Continue to next page

C. Determine the market change. This happens in four steps (you can even think of them as dance steps):

- **STEP 1: *SEARCH*** for the relevant factor. Look at the list of twelve factors and check the appropriate box.

Demand	**Supply**
□ Income	□ Cost of Inputs
□ Preference	□ Number of Firms
□ Number of Buyers	□ Taxes/Subsidies/Regulations
□ Availability/Convenience	□ Prices of Related Goods
□ Prices of Comps and Subs	□ Changes in Technology
□ Future Expectations	□ Future Expectations

- **STEP 2: *SHIFT*** the demand or supply curve. If the relevant factor affects demand, then the demand curve shifts either to the right or to the left. If the relevant factor affects supply, then the supply curve shifts either to the right or to the left. To draw the shift, start with a horizontal arrow from the original equilibrium price to the left or right.



- **STEP 3: *SLIDE*** with the price change. If, at the original price, quantity supplied (Q^S) is greater than quantity demanded (Q^D), it means the market has a surplus. When there's a surplus, price tends to come down. If, at the original price, quantity demanded (Q^D) is greater than quantity supplied (Q^S), the opposite happens. Use up or down arrows to indicate whether price goes up or down. Here are the two possible answers:
  - $Q^S > Q^D$, Surplus, P tends ↓
  - $Q^D > Q^S$, Shortage, P tends ↑

- **STEP 4: *SETTLE*** at the new equilibrium. It's the new price where Q^S meets Q^D. Here are the four possible answers:
  - New Eq. P↑, New Eq. Q↓
  - New Eq. P↓, New Eq. Q↑
  - New Eq. P↑, New Eq. Q↑
  - New Eq. P↓, New Eq. Q↓

D. Summarize the liberal and conservative views on this market change.

Conservative	Liberal

Here are the possible answers:

- Government interference hurts society.
- Government intervention helps society.

VOTE Market Change Guide Example

US taking steps to ban junk food from school

THE NEW YORK TIMES

Courtesy of the Arizona Daily Star

WASHINGTON—The Obama administration will begin a drive this week to expel Pepsi, french fries and Snickers bars from the nation's schools in hopes of reducing the number of children who get fat during their school years.

In legislation soon to be introduced, candy and sugary beverages would be banned, and many schools would be required to offer more nutritious fare.

To that end, Agriculture Secretary Tom Vilsack will deliver a speech today at the National Press Club in which he will insist, according to excerpts provided to the New York Times, that any vending machines that remain in schools be "filled with nutritious offerings to make the healthy choice the easy choice for our nation's children."

First lady Michelle Obama said last month that she would lead an initiative to reduce childhood obesity, and her involvement "shows the importance all of us place on this issue," Vilsack said.

A. Read the relevant news article.

B. Name a market that is most affected by this news.

C. Determine the market change.

1. ***Search*** for the relevant factor.

Demand	Supply
☐ Income	☐ Cost of Inputs
☐ Preference	☐ Number of Firms
☐ Number of Buyers	☐ Taxes/Subsidies/Regulations
x Availability/Convenience	☐ Prices of Related Goods
☐ Prices of Comps and Subs	☐ Changes in Technology
☐ Future Expectations	☐ Future Expectations

2. ***Shift*** demand or supply curve.

Demand shifts left

3. ***Slide*** with the price change.

$Q^S > Q^D$, Surplus, P tends ↓

4. ***Settle*** at the new equilibrium.

New Eq. P ↓, New Eq. Q ↓

Market:____________________

D. Summarize the conservative and liberal views on this market change.

Conservative	Liberal
Government interference hurts society.	Government intervention helps society.

Conventional Theory Conclusions

Conventional theorists say that even aliens visiting from outer space would see all the good that comes from capitalism. They say that we can't see the invisible hand, but we can see the effects of this marvelous economic system on our lovely blue-green planet. Where there is capitalism, profit brings prosperity to societies and gives humans what they want and need.

The invisible hand of price signals brings about maximum economic well-being.

i. What to Produce?

Firms make what people want.

("Allocative Efficiency")

ii. How to Produce?

Firms make the profit-maximizing amount of products using the fewest resources.
("Productive Efficiency")

iii. For Whom to Produce?
Firms' products go to those who want it most.
("Distributive Efficiency")

Enlightened Self-Interest

When individuals and firms act out of self-interest, those actions enhance well-being for everyone. If you start a business because you want to make a good living, you supply products that benefit others and you create jobs, which enable others to make a good living. Bottom line: put your own mask on first and you will be in a position to help others.

The Benefits of the Invisible Hand

- Products we desire
- High standard of living
- Abundance and prosperity
- Incentives and rewards
- Entrepreneurial innovation
- Social mobility
- State-of-the-art advancements
- Business opportunities
- Choice
- Cooperation
- Thriving communities
- Peace and social harmony

<u>Conventional Theory Policy</u>

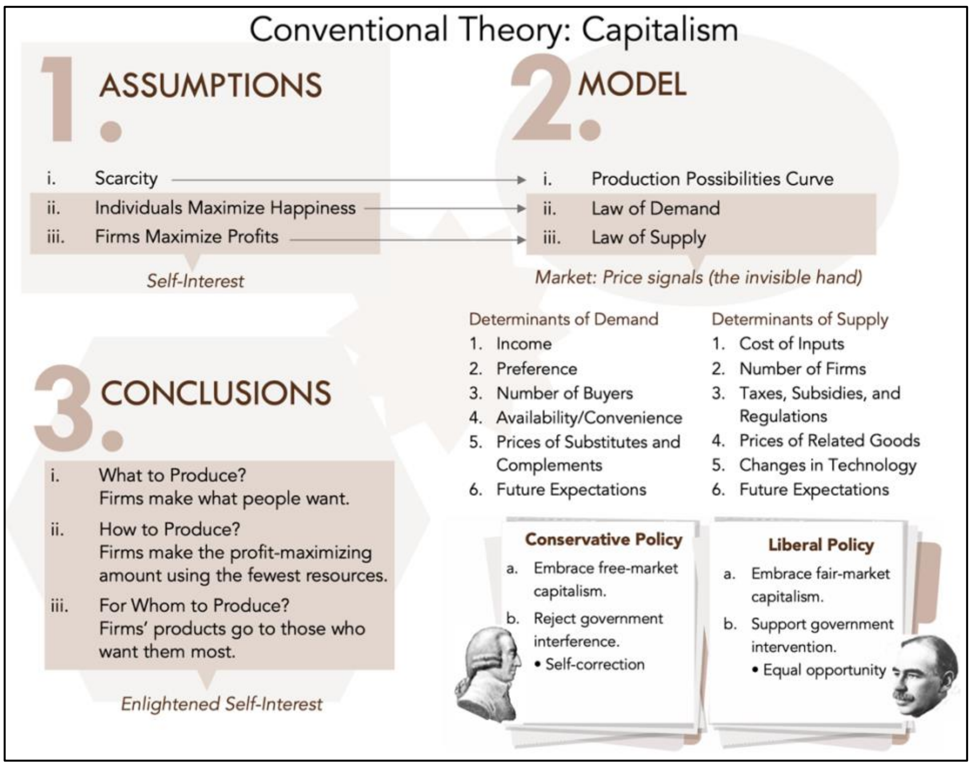
There is no conventional theory policy because liberals and conservatives disagree on what form of capitalism results in economic well-being—free-market or fair-market. They argue that only *their* way will deliver the American Dream.

Conservative Policy

a. Embrace free-market capitalism.
b. Reject government interference.
    - Self-correction

Liberal Policy

a. Embrace fair-market capitalism.
b. Support government intervention.
    - Equal opportunity



<u>Conventional Theory Critique of Socialism</u>

CAUSE		EFFECT
No private property	→	Poverty for all
No profit	→	No innovation and no motivation
No price signals	→	Misallocation and inefficient use of resources
No hierarchy	→	Mob rule and high transaction costs
No competition	→	High prices and low-quality products
No sustainable democracy	→	Totalitarianism