

Question #69746 Economics / Macroeconomics

In the above figure, illustrate the effect on the AS curve from an increase in the money price of a key input/resource such as oil.

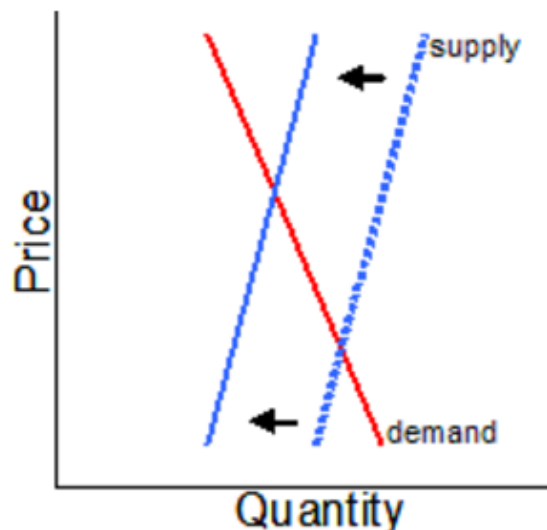
Example:

During the early 2010s, the development of hydraulic fracturing ("fracking") as a method to extract oil from shale rock formations in North America gave rise to a positive change in supply in the oil market. Non-OPEC oil production rose by over one million barrels per day, the majority of this coming from fracking in North America.

Consequently, the per-barrel price of oil, which had reached an all-time high of \$147 in 2008, plunged as low as \$27 in February 2016. Economists projected lower prices to create greater demand for oil, though this demand was tempered by deteriorating economic conditions in many parts of the world.

Supply of conventional oil is also relatively inelastic, although for a different reason. The actual cost of pumping a marginal barrel of oil is relatively low, once the capital expenses of prospecting and building an oil rig (and associated infrastructure) has been put in place. An oilfield will cost roughly the same to operate whether it is producing at 50% of capacity or at full capacity. Given this, once you have an oil field in place, producers will tend to pump at their maximum sustainable rate. Of course, there is always some flexibility: old wells can be "uncapped", scheduled maintenance can be postponed, and greater concentrations of gas can be pumped into the well. But these have costs, and oilfield owners are loath to do these, unless the price of oil is high enough to justify it.

The result of this is that the oil market is one where small changes to the supply or demand curve cause large changes to the clearing price.



Conclusion: with increasing costs for production, the supply curve moves up by the magnitude of the change in costs.

Sources:

<http://www.theoil Drum.com/node/2899>

<http://www.investopedia.com/terms/t/theory-of-price.asp>

<https://www.boundless.com/economics/textbooks/boundless-economics-textbook/introducing-supply-and-demand-3/supply-47/changes-in-supply-and-shifts-in-the-supply-curve-178-12276/>

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