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Micro Economics notes

Chapter 1

What is economics?

## Definition of economics

We want more than we can get. Our inability to get everything we want is called **scarcity**, it is universal. E.g. want a laptop and tablet but can only afford one so have to choose.

Incentives reconcile choices. An **incentive** is a reward that encourages an action or a penalty which discourages one. Prices are incentives. Price too high = more on sale than wanted, price too low = less available than wanted. Seek middle ground where supply meets demand.

Economics is the social science that studies the choices that individuals, businesses, governments and entire societies make as they cope with scarcity and the incentives that influence and reconcile those choices.

## Micro eco

Choices that individuals and businesses make, the way these choices influence markets and Gov. e.g. why people download more movies

## Macro eco

Study of national and global economics, E.g. why japans eco has stagnated

## Big economic questions

1. How do choices end up determining what, how and for whom goods and services are produced
2. Can these choices people make in the pursuit of there own self interest also promote broader social interest

**1 What how and for whom**

- **What**
  What we produce varies across countries and time. E.g. 4% of aus production is agriculture
- **How**
  Goods and services are produced using **factors of production**
  - **Land –** natural resources
  - **Labour –** physical and mental effort of people who produce. Quality depends on human capital (knowledge and skills people achieve through education or experience)
  - **Capital –** tools, machines, buildings used to produce. Money is not capital in this sense
  - **Entrepreneurship –** human resources that organise labour land and capital. Come up with ideas, make decisions, and bear the risk.
- **Whom**
  Who goods and services are produced for depends on personal income. People earn by selling goods/ services or factors of production they own.
  Land = rent
  Labour = wages
  Capital = interest
  Entrepreneurship = profit

## 2 Can pursuit of self interest promote social interest?

Self interest = a choice you make because you think its best for you
Social interest = a choice that leads to an outcome that's best for society
E.g. eat because you're hungry not because it benefits farmers who grow food

**Efficiency** = resources used to produce goods and services at lowest cost and best quality
**Equity** = fairness

**Globalisation** = self interest produce cheep places sell high markets. Self interest for Indian workers but displace local producers
**Info age economy** = Microsoft/ Intel monopoly. Did they produce efficiently in social interest or profit based in self interest?

## Economic way of thinking

**A choice is a trade-off** = because of scarcity we have to make choices. This is a trade-off, giving up one thing to get something else
**Making a rational choice** = a choice that compares costs and benefits and achieves greatest benefit over cost to the person making the choice
**Benefit** = the degree of gain or pleasure which determines its worth and is subjective to individuals
**Cost** = the opportunity cost of something is the highest valued alternative that must be given up to get it.
**Margin** = choices aren't all or nothing. Marginal cost vs. marginal benefit.

### Choices respond to incentives

All economic entities pursue self interest. This allows economists to predict self interested choices people will make be looking at incentives they face. People undertake activities where marginal benefit out ways marginal cost

## Economist as a social science

**Positive statement** = what is currently believed can be tested by facts
**Normative statement** = can't be tested, what should be e.g. policy goals

### Cause and effect

Are more people buying laptops because they are cheaper?
Or
Are laptops cheaper because more people buy them?

Chapter 2

The economic Problem

## Production possibilities and Opportunity Costs

The quantity of goods and services that we can produce is limited by our available resources and technology. If we want to increase production of one good we must decrease another (a trade-off)

The Production Possibilities frontier (PPF) is the boundary between goods that can be produced and those that can't. To illustrate this we focus on 2 goods at a time and hold all others as constant.

**Production Possibilities frontier (PPF)**
PPF illustrates scarcity because we cannot attain points outside the frontier

**Production efficiency**
This is achieved when we produce goods and services at the lowest possible cost. This occurs at all points on the PPF, points inside are inefficient because more than necessary of one good is being given up to produce another. Production becomes inefficient when resources are unused or misallocated.

**Trade-off along PPF**
We are limited by the resources of production which we possess, in order to produce more of one thing we must produce less of something else e.g. in this chap trade off cola for pizzas. All trade-offs involve a cost an **opportunity cost**.

**Opportunity cost**
The highest valued alternative forgone, PPF makes this idea precise and allows calculation of opportunity cost. E.g. the opportunity cost of producing more pizzas is the cola we forgo. In figure, to produce a million more pizzas we produce 3 million less cola. 1 pizza = 3 cola or 3/1. The opportunity cost of producing an additional cola is the inverse of the opportunity cost of producing an additional pizza.

**Increasing opportunity cost**
The opportunity cost of a pizza increases as the quantity of pizza increases. The PPF is bowed outwards because resources are not equally productive in all activities. As we produce more of one good we must use resources that are less suited to that activity, so we face increasing opportunity cost.

## Using Resources Efficiently

We achieve production efficiency anywhere along the PPF but which point along it is best. When goods and services are produced at the lowest possible cost and in the quantities that provide the greatest possible benefit, we have achieved allocative efficiency.

**The PPF and marginal cost**
The marginal cost of a good is the opportunity cost of producing one more unit of it. This is calculated from the slope of the PPF. As the quantity of pizzas produced increases, the PPF gets steeper and the marginal cost of a pizza increases.
The average marginal cost of a pizza is 3 cola. However to produce 1 million pizza cost 1 million cola 1/1 but to produce 5 million pizzas cost 15 million cola 1/3.

**Preferences and Marginal Benefit**
The marginal benefit from a good or service is the benefit received from consuming one more unit. This is subjective. Marginal benefit stands in contrast to marginal cost and production possibilities. The device used ton illustrate marginal benefit is the marginal benefit cure. This is measured from the most people are willing to pay. The more you have of a good or service the smaller the marginal benefit and the less you are willing to pay.

**Allocative Efficiency**
At any point of the PPF we cannot produce more of one good without giving up another. At the best point we cannot produce more of one good without giving up another good that provides greater benefit. We are producing at the point of allocative efficiency.

## Economic Growth
The expansion of production possibilities is called economic growth. Economic growth increases our standard of living but it doesn't overcome scarcity and avoid opportunity cost. To make our economy grow we face a trade-off. The faster we make production grow the greater the cost of economic growth

**The cost of economic growth**
Economic growth comes from technological change and capital accumulation.

- **Technological change** = is the development of new goods and better ways of producing goods and services.
- **Capital accumulation =** growth of capital resources, including human capital.

New technology's and new capital have an opportunity cost. By committing resources to technology and capital we decrease our current production (opportunity cost) but increase our future production possibilities.

## Gains from trade
People can produce for themselves all the goods and services that they consume or they can produce one or two and trade with others. This is called **specialisation.**

Comparative advantage and absolute advantage
A person has a comparative advantage in an activity they can perform at a lower opportunity cost than anyone else. These differences arise from individual ability and characteristics of other resources.
A person who is more productive than others has an absolute advantage
Absolute advantage= production per hour
Comparative advantage = opportunity cost

**Achieving gains from trade**
By focusing on specialisation and trading to meet needs more efficient and mutually beneficial production can be attained.

## Economic Coordination
People gain specialisation in producing of goods and services in which they have a competitive advantage.
Two competing economic coordination systems have been used