ECONOMIC PRINCIPLES

ECO10004 Essential Course Notes
2016

- Key Concepts & Market Forces
- Elasticity
- Cost of Production
- Perfect Competition
- Market Power
- Oligopoly and Market Failure
- GDP and Economic Growth
- Unemployment and Inflation

SWINBURNE UNIVERSITY

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1 – Key Concepts and Market Forces

Economics: The study of the choices and interactions consumers and societies make in the market in order to satisfy their wants, given their scarce resources.

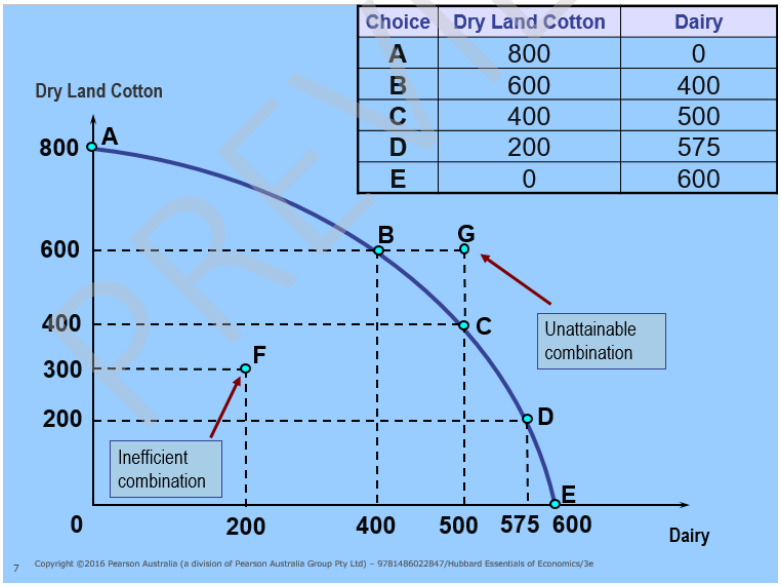
Scarcity: A situation in which unlimited wants exceed the limited resources available to fulfill those wants.

Resources: Inputs used to produce goods and services. Examples include – land, water, minerals, labour, capital and entrepreneurial ability.

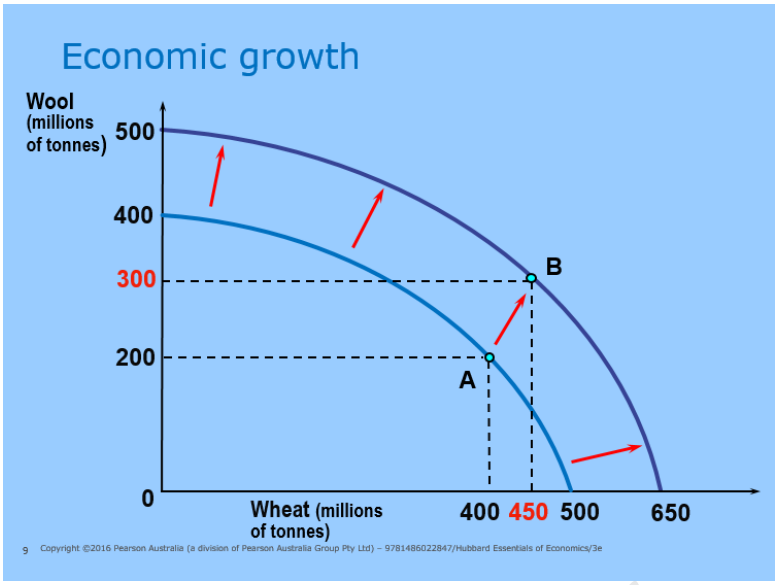
Trade-off: The concept that states that due to scarcity, producing more of one good/service means sacrificing another good/service and thus making less of it.

Opportunity Cost: The opportunity cost of any activity is the highest-valued alternative that must be given up in order to engage in that activity.

Production possibility frontier: A curve showing the maximum attainable combinations of making two products at a time with the available resources. The bowed-out shape also reflects increasing marginal opportunity costs – *Thus, the more resources already devoted to an activity, the smaller the pay-off to devoting additional resources to that activity.*



Choice	Dry Land Cotton	Dairy
A	800	0
B	600	400
C	400	500
D	200	575
E	0	600


Economic growth
Wool (millions of tonnes)
500
400
300
200
0
B
A
Wheat (millions of tonnes)
400
450
500
650
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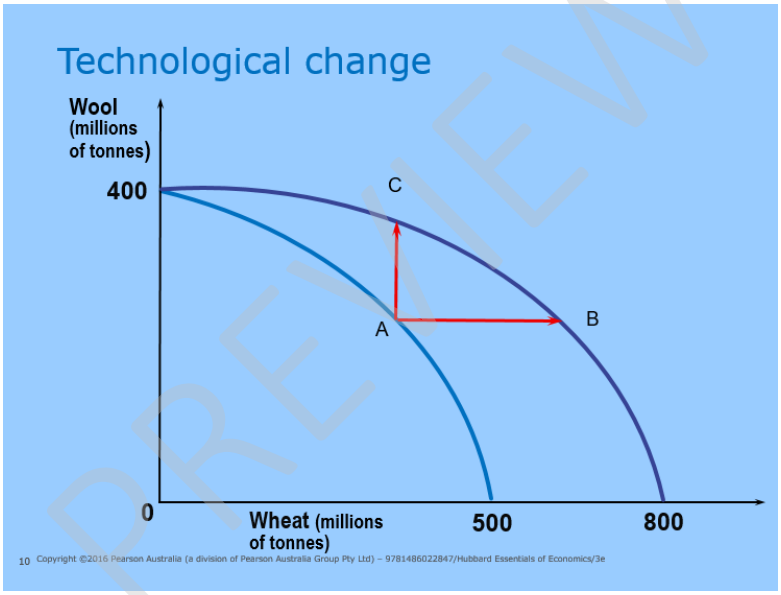
Technological change
Wool (millions of tonnes)
400
C
A
B
0
Wheat (millions of tonnes)
500
800
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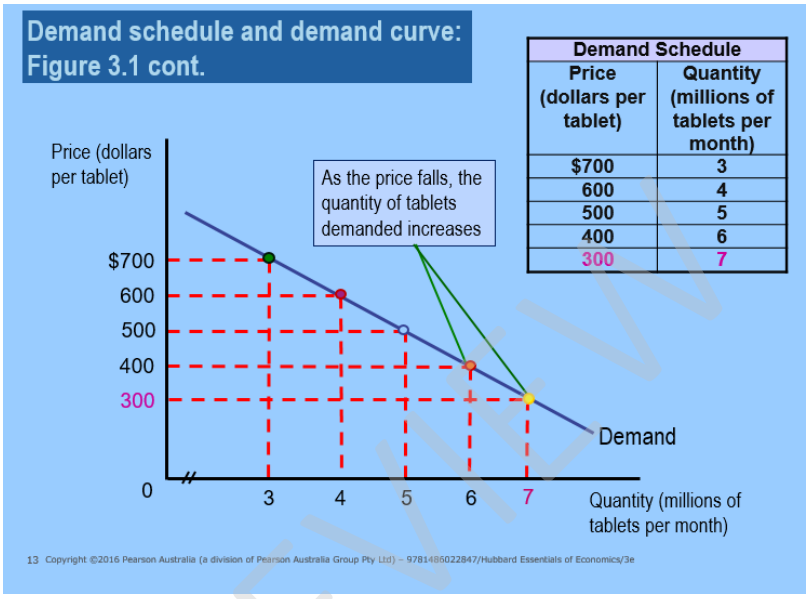
The Interaction of Demand and Supply

The demand side of the market →

Quantity demanded: The amount of a good/service that a consumer is willing and able to buy at a given price.

Demand curve: A curve that shows the relationship between the price of a product and the quantity of the product demanded.

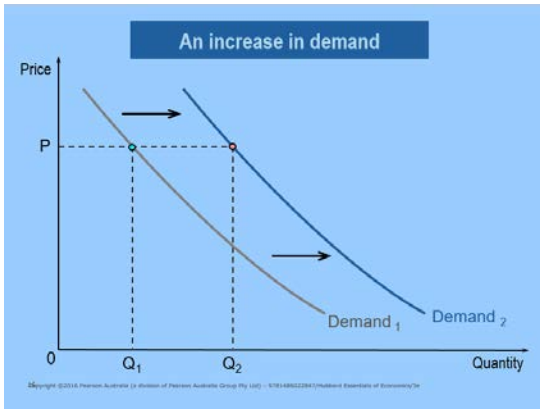


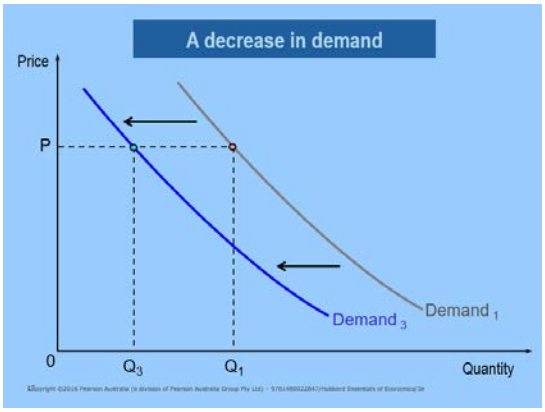
Demand Schedule	
Price (dollars per tablet)	Quantity (millions of tablets per month)
$700	3
600	4
500	5
400	6
300	7

The law of demand: (Holding everything else constant) When the price of a product falls, the quantity demanded will increase. Thus, when the price of a product rises, the quantity demanded will decrease.

Variables that shift market demand:

1. Income → Normal good (demand increases as income rises and decreases as income falls) & Inferior good (demand increases as income falls and decreases as income rises)
2. Prices of related goods → Substitutes (goods/services that can be used for the same or a similar purpose) & Complements (goods and services that are used together)
3. Tastes → (broad category that refers to the many subjective elements that can influence a consumer's plans to buy a good or service – etc. season, trends, fashion)
4. Population and demographics → Demographics (changes in the characteristics of a population with respect to age, race and gender)
5. Expected future prices → If consumers expect prices to increase in the future, they have an incentive to increase purchases now, and *vice versa*.





→ A *change in the quantity demanded* refers to a movement along the demand curve because of a change in the product's price.
→ A *change in demand* refers to a shift in the demand curve (changes quantity demanded at all price levels.
→ Occurs due to a change in the variables, other than the product's own price, that affect demand.

The supply side of the market →

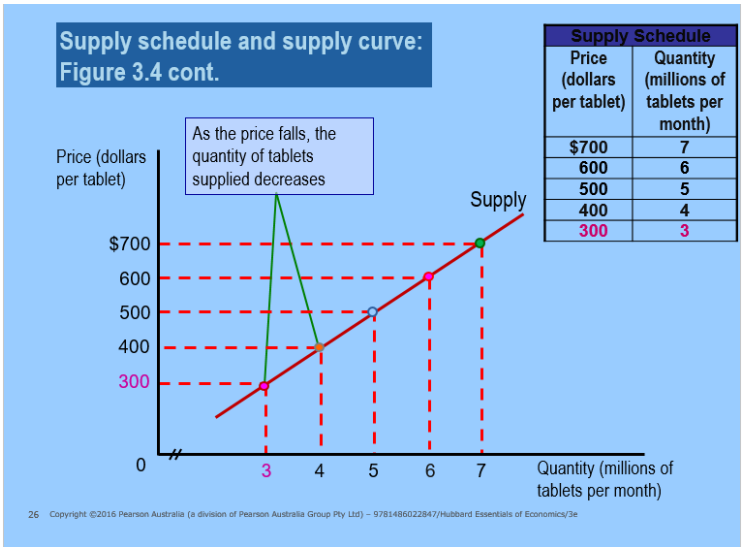
Quantity supplied: The amount of a good or service that a firm is willing and able to supply at a given price.

Supply schedule: A table showing the relationship between the price of a product and the quantity of the product supplied.

Supply curve: A curve that shows the relationship between the price of a product and the quantity of the product supplied.

Market supply: The supply by all the firms of a given good or service.

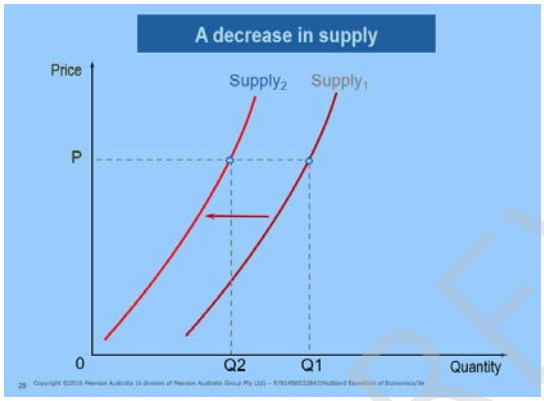
The law of supply: Holding everything else constant, an increase in the price of a product causes an increase in the quantity supplied, and a decrease in the price of a product causes a decrease in the quantity supplied.

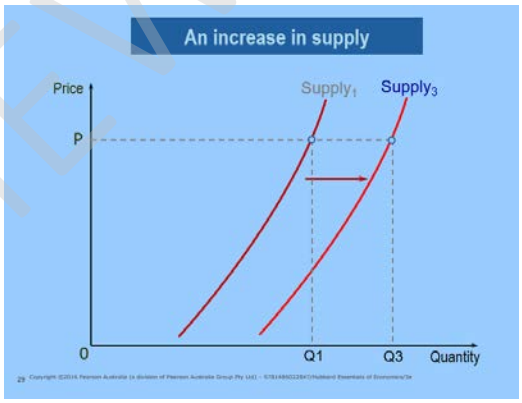


Supply Schedule	
Price (dollars per tablet)	Quantity (millions of tablets per month)
$700	7
600	6
500	5
400	4
300	3

Variables that shift supply:

1. Prices of inputs → An increase in the cost of an input increases the cost of production. The firm supplies less. A decrease in the cost of an input decreases the cost of production at every price. The firm supplies more at every price.
2. Technological change → A change in the ability of a firm to produce output with a given quantity of inputs. Technological change allows the firm to produce more outputs with the same amount of inputs.
3. Prices of substitutes in production → An increase in the price of a substitute in production decreases the supply of the initial good, while a decrease in the price of a substitute in production increases the supply of the initial good.
4. Number of firms in the market → When new firms enter the market, supply increases. When firms exit the market, supply decreases.
5. Expected future prices → If firms expect the price of its product will increase in the future they have an incentive to decrease supply now.





→ A *change in the quantity supplied* refers to a movement along the supply curve as a result of a change in the product's price.

→ A *change in supply* refers to a shift in the supply curve (quantity supplied changes at all price points).

→ Occurs due to a change in the variables, other than the product's own price, that affect supply.