ECON101: MACROECONOMIC ESSENTIALS FOR BUSINESS NOTES

CHAPTER 1 – WHAT IS ECONOMICS?

Definition of economics

Economics – a social science that studies the choices that individuals, businesses, governments and societies make as they cope with ***scarcity*** and the ***incentive*** that influence these choices

- All economic questions arise from scarcity; *wants > resources available*

Microeconomics	**Macroeconomics**
Study of choices that individuals and businesses make, the way these choices interact in markets and the influence of governments E.g. why are people downloading more movies? How would an e-commerce tax affect eBay?	Study of the performance of the national economy and the global economy E.g. why has unemployment risen? Can RBA bring prosperity by keeping interest rates low?

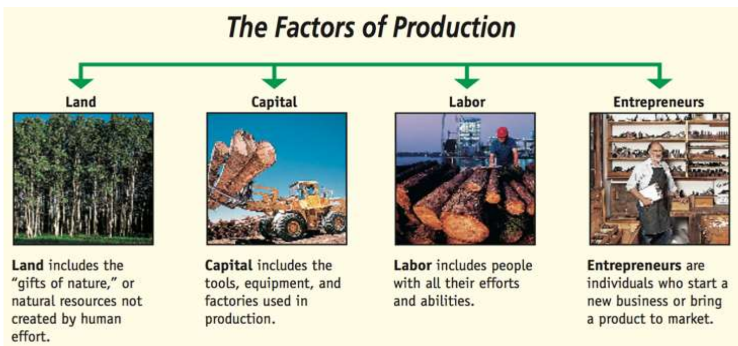
2 main economic questions;

1) How do choices end up determining ***what, how and for whom*** goods and services are produced?

What? – e.g. agriculture, services (retail, wholesale sale, healthcare, education)

How? – Factors of production: land, labour, capital, entrepreneurship

- ***Land*** – the natural resources, e.g. minerals, oil, gas, coal, water, air
- ***Labour*** – the work time and work effort that people devote to producing goods/services
- ***Capital*** – the tools, instruments, machines, buildings and other constructions that businesses use to produce goods/services
- ***Entrepreneurship*** – the HR that organises labour, land and capital



For whom? – Who consumes the goods/services that are produced depends on the incomes that people earn

E.g. *land* earns rent, *labour* earns wages, *capital* earns interest, and *entrepreneurship* earns profit

2) Can the choices that people make in the pursuit of their ***own self-interest*** also promote the broader ***social interest***?

Self-interest – choosing a choice that is the best one available for you

Social interest – choices that lead to an outcome that is the best for society as a whole → efficiency and equity

Self-interest and social interest;

Globalisation – • In self-interest of those consumers who buy low-cost goods/services produced in other countries • In self-interest of TNCs that produce in low-cost regions & sell in high-price regions • NOT self-interest → low paid Indian worker producing Nike shoes (social interest?)	Information-age economy – • Information revolution served consumer's self-interest e.g. smartphone, Internet • Social interest? Initially Microsoft and Intel had little to no competition
Climate change – • We make self-interested choices i.e. use electricity & petrol (carbon footprint) • Social interest – government incentives, use of wind and solar power, replace burning of fossil fuels	Economic instability – • Financial crisis's • Bank's self-interest → lend and borrow money (loans) • Does lending and borrowing serve social interest? • Bailouts = self-interest or social interest?

The economic way of thinking

- Every choice is a trade-off – exchanging more of something for less of something else
- People make rational choices by comparing benefit and cost
- ***Benefit*** – gain you get from something
- ***Cost*** – "opportunity cost" – is what you must give up to get something
- Most choices are made at the *margin* by comparing marginal benefit and marginal cost. Choices respond to incentives (e.g. price).

Economics as social science and policy tool

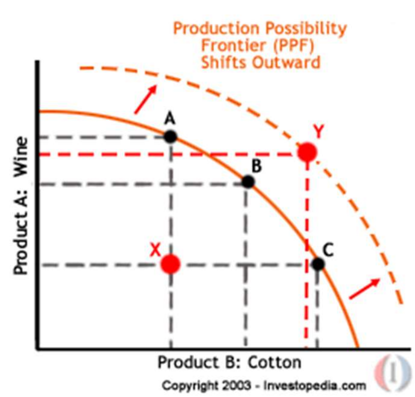
A positive statement is about what is; it says what is currently believed about the way the world operates. A main task of economists is to *test positive statements about how the economic world works* and to weed out those that are wrong.

CHAPTER 2 – THE ECONOMIC PROBLEM

Production possibilities and opportunity cost

Production possibilities frontier (PPF) – the boundary between those combinations of goods/services that can be produced and those that cannot

- PPF illustrates ***scarcity*** because we cannot attain the points outside the frontier (wants that can't be satisfied)



Production efficiency – occurs when goods/services are produced at the lowest possible cost

- Along the PPF, the opportunity cost of producing more of 1 good is the amount of the other good that must be given up.
- The **opportunity cost** of all goods increases as the production of the goods increase.

Using resources efficiently

Allocative efficiency – occurs when goods/services are produced at the least possible cost and in the quantities that bring the greatest possible benefit

- The marginal cost of a goods is the opportunity cost of producing one more unit of it.

The marginal benefit from a goods is the benefit received from consuming one more unit of it and is measured by the willingness to pay for it.	The marginal benefit from a good DECREASES as the amount of the good available INCREASES.	***Marginal cost of each good + marginal benefit = efficient resources***

Economic growth

- **Economic growth** – the expansion of production possibilities (comes from capital accumulation and technological change
- Opportunity cost of economic growth = predetermined current consumption
- *The benefit of economic growth is increased future consumption.*

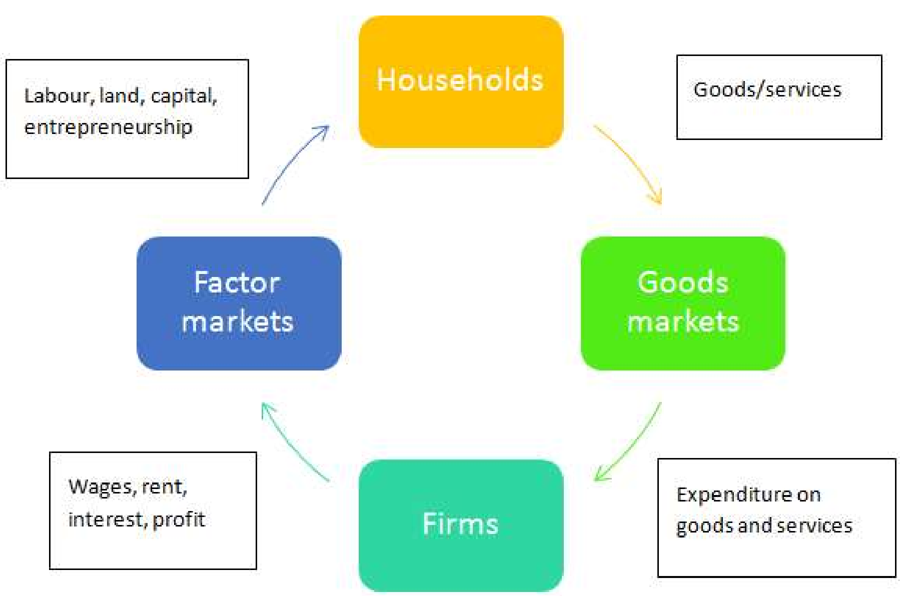
Gains from trade

- A person has a **comparative advantage** in producing a good if that person can produce the good at a lower opportunity cost than others.
- E.g. specialising in an activity

Economic coordination

- Firms coordinate a large amount of economic activity.
- Markets…
  - Coordinate the economic choices of people and firms
  - Can work efficiently only when property rights exist
- **Money** makes trading in markets efficient.

Circular flow in the market economy



Markets and prices

- **Competitive market** – has many buyers/sellers so no single buyer/seller can influence the price
- **Money price** – the price of a good in terms of dollars
- **Relative price** – the ratio of one price to another (the ratio of its money price to the money price of the next best alternative good)

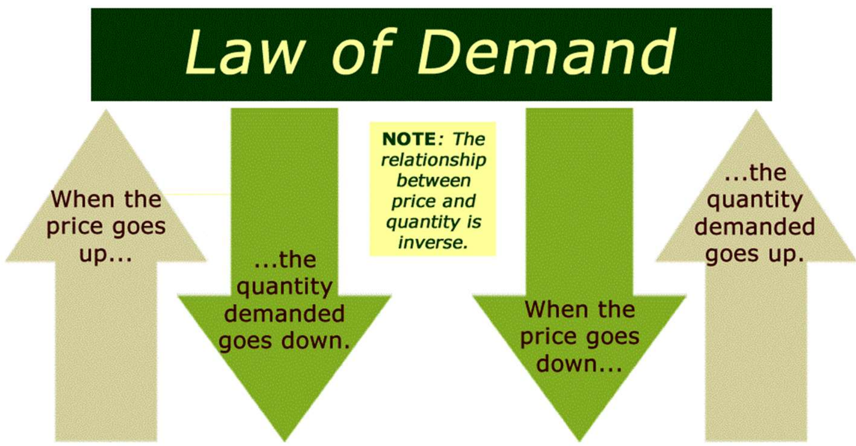
Demand

- Demand happens if you ***want*** something, can ***afford*** it and have a ***plan*** it buy it.
- It refers to the entire relationship between the price of a good vs the quantity demanded
- **Quantity demanded** – of a good/service is the amount that consumers plan to buy during a particular time period, at a particular price

Law of demand (inverse relationship between price/quantity demanded)

*"The **higher** the **price** of a good, the **smaller** is the **quantity demanded** and...*

*The **lower** the **price** of a good, the **larger** is the **quantity demanded**"*



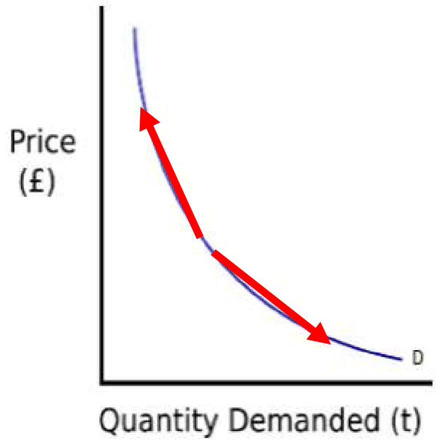
The law of demand results from... the **SUBSTITUTION effect** & the **INCOME effect**

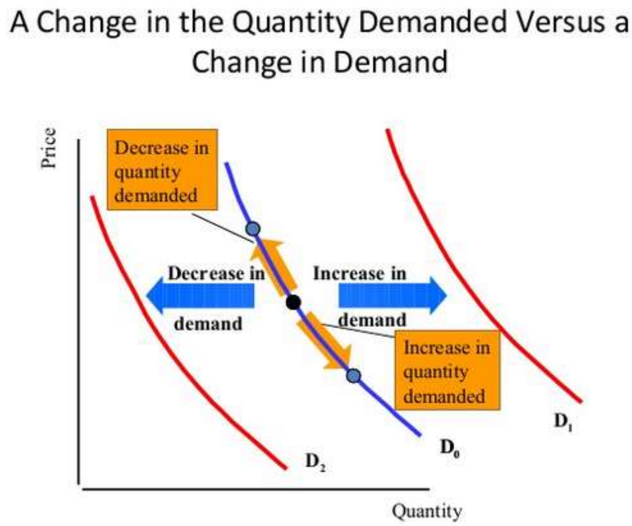
→ Substitution effect; when the relative price (opportunity cost) of a good rises, people seek substitutes for it, so the quantity demanded *decreases*
  - People go to buy a competitor's price if prices go up

→ Income effect; when the price of a good rises relative to income, people cannot afford it, so the quantity demanded *decreases*

A **demand curve** shows the relationship between quantity demanded and its price.

- A rise in the price brings a decrease in the quantity demanded and a movement up along the demand curve
- A fall in the price brings an increase in the quantity demanded and a movement down along the demand curve





<u>Changes in demand are caused by 6 main factors</u>;

Prices of related goods	Expected future prices	Income
Expected future income and credit	Population	Preferences

- **Substitute** – a good that can be used in place of another good
- **Complement** – is a good that is used in conjunction with another good

LAW OF DEMAND The quantity of X demanded...	
Decreases if ✘ The price of X rises	Increases if ✓ The price of X falls
CHANGES IN DEMAND The demand for X...	
Decreases if ✘ The price of a substitute falls ✘ The price of a complement rises ✘ The expected future price of X falls ✘ Income falls ✘ Expected future income falls or credit becomes harder to get ✘ Population decrease	Increases if ✓ Price of a substitute rises ✓ Price of a complement falls ✓ The expected future price of X rises ✓ Income rises ✓ Expected future income rises or credit becomes easier to get ✓ Population increases