MAE101 ECONOMICS NOTES

2017 Revised

Faculty of Business and Law

Economics is a social science that focuses on how societies (business's, individuals, governments and other groups) react to scarcity and solve economic questions (such as how to allocate scarce resources and how income is distributed among individuals and countries).

Microeconomics: The study of how households and firms make decisions and how they interact in markets

Why does the baker sell you bread? (Old exam question)

Baker sells you bread to make a profit (pursuing own self-interest) whilst the consumer buys bread to satisfy their own self-interests (satisfy hunger). This summarises gains from trade and how by pursuing self-interest can benefit society.

Markets

Markets generate jobs, incomes, raise welfare, and provide the means to improve environmental outcomes.

Market based economies also tend to be more liberal and show greater respect for human and civil rights. They tend to be 'freer societies'. Markets generally work very well.

Markets hate profits. This is because markets promote competition and increased competition means business' try and make their prices as low as possible to attract customers which reduces profits (decreased profit margins).

Market economy: an economy that allocates resources through the decentralised decisions of many firms and households as they interact in markets for goods and services

The invisible hand

The idea that society's interests will be best met if governments and other intervening hierarchies don't intervene in markets and let the economy prosper naturally. This helps promote competition as business' constantly try to boost efficiency to reduce prices to attract buyers which has positive effects on consumers (society) as they can now purchase more (increased purchasing power).

Core Economic Concepts

Resources: Time, land, labour, capital, etc (e.g. the workforce is a labour resource)

Scarcity: The idea that there is only limited (scarce resources) as there is limited people (labour resources), property (land resources), etc.

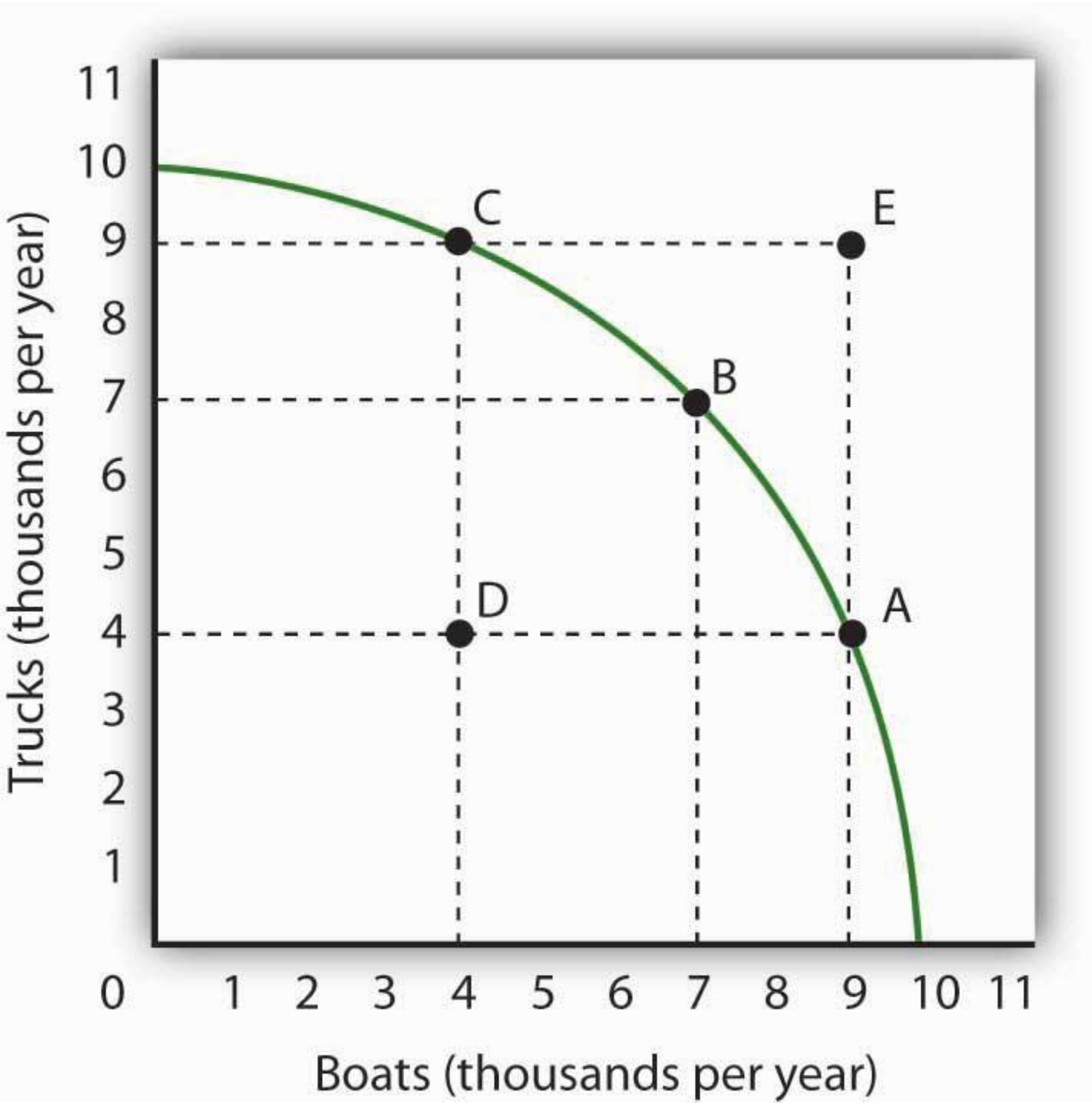
Choice: Business' and individuals must make economic choices on what they value most highly as scarcity prevents them accessing everything

Opportunity Cost: The value of next best alternative that is lost (foregone) when an economic decision is made. (e.g. when purchasing a holiday for 5000$, the opportunity cost may be investing 5000$ in shares which is the next best alternative). Enforces the idea that nothing is free because even your time is worth something as you could be doing something with it.

Sunk Cost: In economics and business decision-making, a sunk cost is a cost that has already been incurred and cannot be recovered. For example, if you buy a movie ticket for 40$, then your friend invites you to a party the same night which you would rather go to, the 40$ spent on the movie ticket is a sunk cost as even if you decide to watch it as you would rather be doing something else.

Benefits of voluntary exchange and competition: Competition reduces prices eroding profit for business' which boosts consumers (society's) living standards.

Production possibility frontier:



• Maximum amount that can be produced by the available resources (including technology) is shown by points along the curved line (frontier)