TOPICS 1: INTRODUCTION

INTRODUCTORY ISSUES: SEVEN LESSONS FROM MICROECONOMICS

1. **People face trade-offs:** to get one thing, we have to give up another thing
    - Efficiency vs equity trade-off
        - Efficiency: society gets the most it can from its scarce resources
        - Equity: benefits of these resources are distributed fairly among members of society – difficult to measure
2. **Opportunity costs:** the cost of the next best alternative forgone
    - Knowing this allows us to see whether we are using this resource in the most efficient way
3. **Rational people think at the margin**
    - Individual/firm can weigh up the costs/benefits associated with any decision and choose the option that maximises the net benefit
    - Marginal changes are small incremental adjustments to an existing plan of action
    - People make decisions by comparing costs & benefits at the margin
4. **People respond to incentives:**
    - Incentive: something that induces a person to act, prospect of reward/punishments (rational)
    - Important in analysing how markets work & why public policies are working/failing – taxes/externalities
5. **Trade can make everyone better off:** gains from trading
6. **Markets are a good way to organise activity:**
    - Market economy: an economy that allocates resources through the decentralised decisions of many firms and households as they interact in markets
    - Firms decide who to hire & what to produce, households decide what to buy & who to work for
    - Invisible hand: buyers and sellers act in their own interest but end up unknowingly taking into account the social costs of the actions.
        - ➔ Prices guide decision makers to outcomes that tend to maximise the welfare of society as a whole
7. **Governments can sometimes improve market outcomes:** can intervene to produce the socially efficient outcome

TOPIC 2.1: DEMAND

Demand: refers to the quantity demanded of a g/s by consumers at a particular price at a particular point in time, ceteris parabis
Effective demand: that is a consumer has to be both willing and able to consume the g/s

The ceteris paribus assumption: we focus on one factor at a time and assume that all the other factors remain constant.

Law of demand: the quantity of a good demanded is inversely related to its price.
- Exceptions: inferior goods, status goods, position goods

Individual demand: the demand for a good or service by an individual in a market
Market demand; refers to the sum of individual demands for a certain good or service

Why is the curve downwards sloping?
1. Substitution effect: as the price rises, consumers substitute away from the good towards a relatively cheaper alternative
2. Income effect: a decrease in price, means the purchasing power has increased.

Factors affecting demand:
- Price (Movement)
- Non-Price: will shift the entire curve
    1. Consumer income: increase in income will increase demand for goods
    2. Expectations of future prices:
    3. Taste + preferences: towards or away
    4. Demographic factors (changes in population)
    5. Price of related goods: substitutes/complements

DEMAND CURVE

TOPIC 2.2: SUPPLY:

Supply: the amount of a g/s the producers are willing and able to sell at a particular price at a particular point in time

- The relationship between price & quantity of a g/s supplied

Law of supply: as the price of a g/s rises, the quantity supplied will also rise, ceteris parabis (positive relationship)

Factors affecting supply:

- Price =movement along the curve
- Non price factors shift
  - Price of inputs
  - Price of related goods
  - Technology
  - Expectations of prices. E.g deliberately decrease supply if expect price to rise in the future
  - Natural disasters (weather)

SUPPLY CURVE

- The increase in price acts as a signal to firms to allocate more resources
- As price rises, producers are willing to supply more
  - ➔ Reflects higher (marginal costs) of producing more, > revenues

TOPIC 2.3 MARKET EQUILBIRUM

MARKET EQUILIBRIUM: Occurs when the demand curve and the supply curve intersect (market-clearing price)
Market: a mechanism that co-ordinates the independent intentions of buyers & sellers. No pressure for change in price.

SURPLUS CURVE (S> D)

-Consumers are willing to buy 10 units of this good & sellers are willing to sell 40 units → surplus of 30 units.
-Downwards pressure on price, as price falls the quantity demanded increases until we reach equilibrium.
→ expansion along demand, contraction along supply

SHORTAGE CURVE (D>S)

-Consumers are willing to buy 26 units, suppliers willing to sell 8 → results in a shortage
-Upwards pressure on prices, which induces more firms to supply more.
-As prices increase, the quantity demanded will decrease until we reach equilibrium.
→ expansion along supply, contraction along demand