

# ECON111- Microeconomic Principles

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## Lecture 1

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### 1.1-Definitions

- The economic problem states that all economic problems and questions arise because **human wants exceed the resources available to satisfy them**

### Scarcity

- The condition that arises because **wants exceed the ability of resources** to satisfy them
- Limited resources, but unlimited wants
- Faced with scarcity, we must make choices
- Choices are made by comparing benefit versus cost

### Opportunity Cost

- The value that you place on the **next best alternative want** that you did not choose to satisfy (given up).
- When you choose to satisfy a particular want you are simultaneously deciding not to satisfy other wants and this gives rise to opportunity cost
- The choices we make depend on the incentives we face

### Economics Defined

- Economics is the social science that studies the choices that individuals, businesses, governments and entire societies make as they cope with scarcity, the incentives that influence those choices and the arrangements that coordinate them.
  - **Microeconomics** – The study of the choices that individuals and businesses make and the way these choices interact and are influenced by governments
  - **Macroeconomics**- The study of the aggregate (or total) effects on the national economy, focus on Australia as a whole.
- Two big economic questions:
  - How do choices determine what, how and for whom goods and services get produced?
  - When do choices made in self interest also promote social interest?

### What, how and for whom?

- Goods and services are the objects (goods) and actions (services) that people value and produce to satisfy human wants
  - **WHAT** goods and services get produced and in what quantities?
  - **HOW** are goods and services produced?
  - **FOR WHOM** are the various good and services produced?

### Can the pursuit of self interest be in the social interest?

- The choices that are best for the individual who makes them are choices made in the pursuit of self interest
- The choices that are best for society as a whole are choices made in the social interest
- **Efficiency:** Do choices that we make in self interest promote social interest
- Adam Smith argues that under certain conditions, markets are the best mechanism to coordinate self interested choices, so that they promote the social interest
- A market is defined as any arrangement that brings buyers and sellers together and enables them to get information and engage in exchange.
  - Example: Globalisation: it is in the interest of the owners of multinational firms that profit from this process, but is it in the social interest?

### 1.2- The Economic Way of Thinking

#### Six economic ideas:

1. Choice is a tradeoff
  2. Cost is what you must give up to get something
  3. Benefit is what you gain from something
  4. People make rational choices by comparing benefits and costs
  5. Most choices are “how much” choices made at the margin
  6. Choices respond to incentives
- **A choice is a tradeoff:** A tradeoff is an exchange- giving up one thing to get something else
  - **Cost:** Refers to what you must give up to get something
  - **Benefit:** The gain or pleasure that something brings and is determined by an economics agent’s preferences. It is measured by what you are willing to give up.
  - **Rational choice:** A choice that uses the available resources to best achieve the objective of the person making the choice
    - We make rational choices by comparing costs and benefits
    - Choices can be:
      - All or nothing (whether to buy an apple or undertake a degree)
      - How much (whether to buy a second banana or not)
    - A decision is rational if  $MB > MC$
    - Also rational if net benefit  $> 0$ .
    - **NET BENEFIT (NB) = MB- MC**

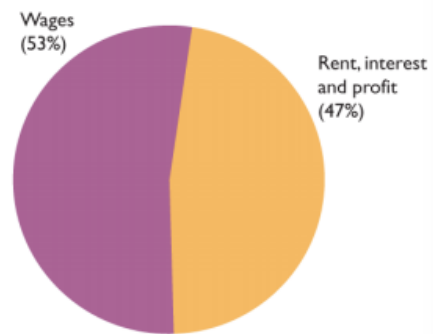
#### Marginal Analysis

- A choice made at the margin is a choice made by comparing all the relevant alternatives systematically and incrementally
- **Marginal Cost (MC)-** What you must give up to get one additional unit of it
- **Marginal Benefit (MB)-** What you gain when you get one more unit of something. It is measured by what you are willing to give up to get one additional unit of it.

## The Global Economy

### Advanced Economies

- The richest 29 countries, Australia, United States, Japan, Italy, Germany, France and Canada all belong to this group
- Almost 1 billion people live in advanced economies



(a) Functional distribution of income

### Emerging market and developing economies

- Emerging market economies are the 28 countries of Central and Eastern Europe and Asia
- Developing economies are the 119 countries in Africa, Asia, Middle East, Europe and America that have not yet achieved high average incomes for their people (5.5 billion population)
- Differences in what is produced:
  - Developing economies have large and growing manufacturing industries which produce textiles, footwear etc..
  - Food economies is a small part of the advanced economies and a large part of developing economies
- Similarities in what is produced:
  - Retail industries in advanced economies are similar, but so is the structure of what they produce

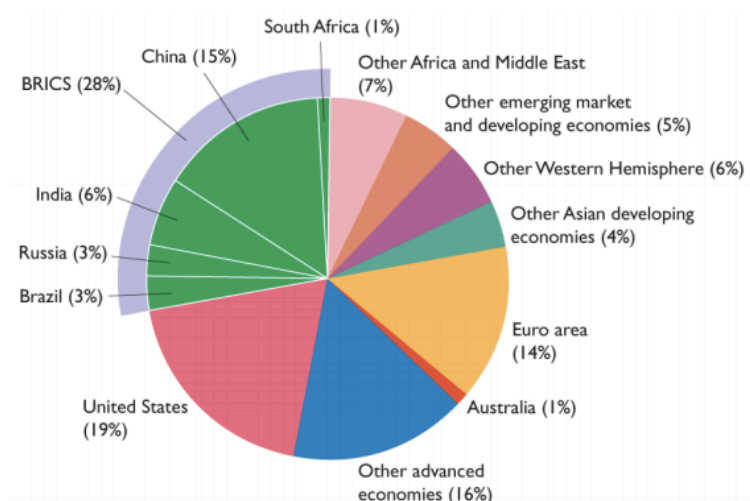
### What in the Global Economy

- In 2014, global production was worth \$80 trillion
- This chart shows the distribution of production across countries globally

### How in the Global Economy

#### Human Capital Differences

- The quality of labour depends on human capital
- The differences in human capital between the advanced economies and the developing economies is enormous and arises from:
  - Education, on the job training and experience
  - Physical ability



#### Physical Capital Differences

- The physical capital available for producing goods and services differentiates an advanced economy from a developing economy:

## Influences on Demand

The main influences on buying plans that change demand are:

- Prices of related goods
- Expected future prices
- Income
- Expected future income and credit
- Number of buyers
- Preferences

## Prices of Related Goods

- **Substitute**- A good that can be consumed in place of another good
  - For example, apples and oranges are substitutes
  - The demand for a good **increases**, if the price of one of its substitutes **rises**
  - The demand for a good **decreases**, if the price of one of its substitutes **falls**
- **Complement**- A good that is consumed with another good
  - For example, icecream and fudge sauce
  - The demand for a good **increases** if the price of one of its complements **falls**
  - The demand for a good **decreases** if the price of one of its complements **rises**

## Expected Future Prices

- A **rise** in the expected **future** price of a good **increases** the **current** demand for that good
- A **fall** in the expected **future** price of a good **decreases** **current** demand for that good
- For example, if the price of a computer is expected to fall next month, the demand for computers today decreases.

## Income

- **Normal good**- A good for which the demand increases if income increases, and demand decreases if income decreases
- **Inferior good**- A good for which the demand decreases if income increases and demand increases if income decreases.

## Expected Future Income and Credit

- When **income is expected to increase** in the future of the cost of borrowing is low, the **demand for some goods increases**
- When **income is expected to decrease** in the future, or when the cost of borrowing is high, the **demand for goods decreases**
- Has the greatest effect on homes, cars etc...

## Number of Buyers

- The greater the number of buyers in a market, the larger is the demand for any good

## Preferences

- When preferences change, the demand for one item increases and the demand for another item decreases
- Preferences change when:

- People become better informed
- New goods become available

### Change in Quantity Demanded Versus Change in Demand

- A **change in the quantity demanded** is a change in the quantity of a good that people plan to buy that **results from a change in the price** of the good
- A **change in demand** is a change in the quantity that people plan to buy when any influence **other than the price** of the good changes.

### Supply

- **Quantity supplied**- The amount of a good, service or resource that people are willing and able to sell during a specified period at a specified price

### The Law of Supply

Other things remaining the same:

- If the price of a good **rises**, the quantity supplied of that good **increases**
- If the price of a good **falls**, the quantity supplied of the good **decreases**

### The main influences on selling plans that change supply are:

- Prices of related goods
- Prices of resources and other inputs
- Expected future prices
- Number of sellers- greater number of sellers, larger the supply.
- Productivity – output per unit of input. An increase in productivity lowers costs and increases supply. A decrease in productivity raises costs and decreases supply.

