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ECC1000 Microeconomics Revision

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Intro to Microeconomics

Every economic decision entails a ***trade-off***. If a resource is allocated to one activity, it cannot be allocated to another

Best choice is one that maximises surplus (high benefits, low costs)

Opportunity cost – the value of the best alternative you give up by doing something.

Production Possibilities Frontier (PPF)

- Shows various combinations of output that an economy can possibly produce using all available resources
- Demonstrates opportunity cost and efficiency
- Why is it curved?
    - Opportunity cost changes as you produce more or less
    - Workers are skilled and specialised in different areas
    - E.g. more skill workers in one area move to another area (loss of production of one resource is greater than the gain in the other resource)

Statements

- **Positive:** a statement about how the world is
- **Normative:** a statement about how the world ought to be
- *Note: both don't necessarily have to be true*

Absolute and Comparative advantage

- **Absolute advantage**: who can produce more given the same amount of labour/time
- **Comparative advantage:** who has the lower opportunity cost
- Specialisation and trade
    - Two countries will specialise in what they have comparative advantages in (lower opportunity cost).
    - Comparative advantage can be the basis of a mutually beneficial trade
    - If they then trade total output is larger for both goods than consumption under self-sufficiency
    - Gains from trade
        - The "*terms of trade*" determine who receives the gains
        - The trade must be at a rate in-between the opportunity costs for the two countries
        - If the trade is at a rate equal to the opportunity cost of C1 then C2 will take all the gains.
    - Thus, opportunity cost
        - Determines who specialises in what (comparative advantage)
        - Determines the terms of trade

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Demand, Supply and Market Equilibrium

Demand

- Qty demanded is the amount of a good that a buyer is willing and able to buy
- A person's demand shows the qty demanded compared to the price of a good.
- **Law of demand**: Increasing price generally decreases demand

Change in demand

- Demand can change in two different ways
    - When price changes, there is a ***movement along the demand curve*** (it does not shift)
    - When other factors shift (e.g. popularity for a product) the entire ***demand curve shifts***

What causes shifts in demand?

- Income
    - **Normal:** demand increases as income increases (better but more expensive item)
    - **Inferior:** demand decreases as income increases (worse but cheaper item)
    - Type of good relative to individual
        - E.g. Car (normal) vs. train (inferior)
        - E.g. Train (normal) vs. bike (inferior)
- Substitutes vs complements
    - **Substitutes:** goods that can be used instead of each other
        - If goods are substitutes, increasing the price of one good will increase the demand for the other
        - E.g. Chicken and Beef
    - **Complements**: goods that are used together
        - If goods are complements, increasing the price of one good will decrease the demand for the other
        - E.g. Burgers and fries
- Changes in tastes
- Change in number of buyers

Supply

- Qty supplied is the amount of a good that a seller is *willing* and *able* to sell
- Seller's supply shows the quantity supplied at a specific price
- **Law of supply**: Increase in price results in increase in quantity supplied

Change in supply

- Supply can change in two different ways
    - When price changes, there is a ***movement along the supply curve*** (it does not shift)
    - When other factors shift (e.g. technology) the entire ***demand curve shifts***

What causes shifts in supply?

- Input prices