ECC1000 notes

Based on

Principles of Microeconomics 2nd

What's included?

- **Comprehensive chapter notes on all subjects chapters**
- **Diagrams to illustrate curves and tables**

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Chapter 1: Five foundations of economics

Scarcity

Economics is the study of how people allocate their limited resources to satisfy their unlimited wants. Scarcity does not mean that there is a shortage of something.

Foundation 1: Incentives matter

People typically respond to positive and negative incentives. A positive incentive leads people to respond as they will receive a good outcome, and a negative incentive leads people to respond in order to avoid a bad outcome.

The intended responses to incentives are known as primary responses. However sometimes, there are unintended consequences of providing incentives — these are known as secondary results. For example, a cash incentive for a high subject score can have the primary result of students working harder and the secondary (unintended) result of students cheating to gain the incentive.

Foundation 2: Life is about trade-offs

The concept of scarcity implies that there is a choice we must make about how to allocate limited resources. Every decision incurs a cost, because in order to have one thing, we have to give up another. Trade-offs affect all aspects of life, including government budgets, i.e., where to cut costs in order to reduce budget deficit.

Foundation 3: Opportunity cost

Opportunity cost is the highest-valued alternative that must be sacrificed in order to get something else. Suppose your order of preferences for an activity are: go to the football, family dinner, house chores. The opportunity cost of doing house chores is missing the football game, as going to the football is the highest-valued alternative to doing house chores, and this has been sacrificed in order to do the chores.

Scarcity requires choices to be made, and each choice has an opportunity cost attached to it. The value of a trade-off (or choice) is represented by the opportunity cost. Think about it as the cost of acquiring an opportunity.

Chapter 3: Supply and demand

Markets

A market is a place where buyers and sellers meet. These do not need to be brick and mortar — they can also be online. An imperfect market is one in which buyers or sellers exert some level of control over the price of goods, whereas in a competitive market, the high number of sellers means that there is less fluctuation. The absence of a single seller in a competitive market doesn't have much effect on the quantity supplied and demanded.

Demand

The law of demand states that holding all else constant, when the price of a product falls, the quantity demanded of the product will rise. And vice versa, when the price of a product rises, the quantity demanded of the product will fall.

Price	Rises	Quantity demand	Falls
Price	Falls	Quantity demanded	Rises

Movement along the demand curve

As the table shows, there is an inverse (negative) relationship between price and quantity demanded. When one rises, the other falls. If we graph this relationship, there are many coordinates along the curve, each representing a different combination of price and quantity demanded. The y-axis is price and the x-axis is quantity demanded.

Each combination makes complete sense. When price changed, so did quantity demanded. Nothing is strange about that. The price and quantity demanded changes are called movements along the demand curve. The demand itself does not change, only the quantity demanded.

Shifts in demand

Sometimes, however, the entire **relationship** between price and quantity demanded changes, and these are called shifts in demand. A shift in demand is caused by non-price factors such as changes in people's incomes or preferences, changes in the price of related goods, or changes in the numbers of buyers in the markets. In these scenarios,

Chapter 4: Elasticity

Elasticity means responsiveness to price. What changes occur when price changes, and how dramatic are these changes?

Price elasticity of demand

Price elasticity of demand is the responsiveness of quantity demanded to changes in price. There are five main factors that typically cause price elasticity of demand to be high (meaning that demand drops more dramatically when price increases, and vice versa).

1. The existence of substitutes

When there are more substitutes for a good, the price elasticity of demand will be higher as consumers will buy a cheaper substitute rather than a more expensive item. When there are few or no substitutes for a good, price elasticity of demand will be lower as consumers do not have as much or any choice in the market. This is referred to as inelastic demand.

2. Share of the budget spent

If you are looking for big-ticket items such as a new TV, a small drop in price will likely have more of an effect on you than if a chocolate bar had a discount. Big-ticket items have more elastic demand, whereas inexpensive items are more inelastic.

3. Necessities versus luxuries

For necessities such as rent and utilities, the need for the item trumps the price, leading to inelastic demand. For luxuries, you don't need them, but a price change may cause you to buy them if you can afford it, leading to more elastic demand.

4. Broad or narrow definition of the market

The more broadly a market is defined, the harder it is to live without. For example, everyone needs some type of housing, so "housing" has more inelastic demand. But for specific items within a market (narrow definition), you don't need *that specific item*, so demand is more elastic.

5. Time for adjustment