

Buss1040 Class Notes: Economics for Business

Decision Making

Semester 2 2025

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1 Week 1: Key Concepts and Comparative Advantage

1.1 What is Economics?

- Economics is the study of choice under scarcity
 - This is because typically, consumers want more goods and services than they can afford to buy
- Given that resources are limited, the key questions that an economy needs to decide are:
 - What to produce
 - How to produce it
 - Who should get what is made

1.1.1 Markets in Economics

- In a modern economy, these 3 questions are typically resolved in the ‘market’
 - A market is a place where buyers and sellers of a particular good or service meet
- Even in market economies, governments play a critical role in markets
- Our focus is on the behaviour of individuals (consumers, firms, governments) in markets

1.1.2 Microeconomics and Macroeconomics

- Microeconomics deals with individual households, firms, industries, and markets
 - Relative prices
 - Allocation of output
 - Employment
- Macroeconomics deals with the economy as a whole, including the financial and real sides
 - The overall price level
 - Aggregate output
 - Aggregate employment
 - Unemployment
 - Interest rates and exchange rates

1.1.3 Scarcity and Opportunity Cost

- Scarcity arises due to limited resources
 - This results in trade-offs as by choosing one thing, consumers must forgo another

- The opportunity cost of any choice is the value of the next best forgone alternative
- Opportunity costs include both explicit costs and implicit costs, but not sunk costs
 - Explicit costs are the costs that involve direct payment as a result of the choice that has been made
 - Implicit cost are the opportunities that have been forgone as a result of the choice
 - Sunk costs have been incurred and cannot be recovered
 - Thus the formula for opportunity cost = explicit costs + implicit costs

1.1.4 Marginal Analysis

- The additional benefit of an extra unit of good is referred to as the marginal benefit, and the additional cost of an extra unit of good is referred to as the marginal cost
 - A consumer will purchase the good if $MB > MC$ and will not purchase the good if $MC > MB$

1.1.5 Correlation and Causation

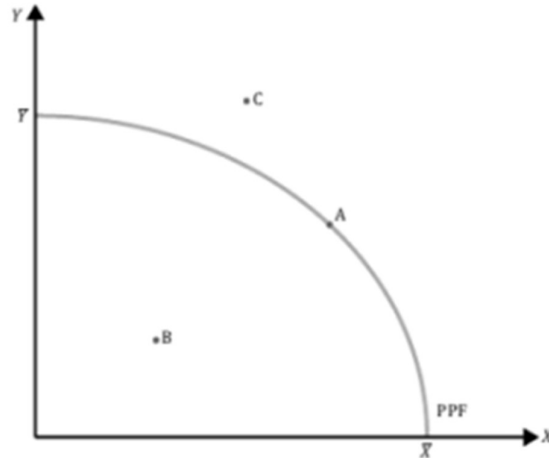
- Correlation refers to a situation in which 2+ factors are observed to move together or in opposite directions, whereas causation refers to a situation where a change in one variable directly brings about a change in another variables

1.1.6 Ceteris Paribus

- Ceteris paribus means ‘other things equal’
 - It is used when we are interested in how a change in one variable will affect another variable and we need to isolate this effect to examine the relationship between the two variables

1.2 The Production Possibility Frontier (PPF)

- The PPF traces out combinations of the quantity of two goods that an individual or country can produce if it uses its given resources and current technology at maximum efficiency



- The axes are labelled with the goods
- $\bar{x}$ represents the maximum amount of good x that can be produced with the resources, and the same for $\bar{Y}$
- Any point inside or on the PPF is obtainable in that it is feasible to produce that quantity of X and Y given the current level of resources and state of technology
- Any point on the curve itself is efficient in that it maximises use of the available resources
- Any point outside the PPF is unattainable because production of those levels of X and Y would require more resources or better technology than currently available

1.2.1 The Shape of the PPF

- The PPF shows us that the slope will decrease as more of good X is produced, and thus the opportunity cost of producing good X will increase with each additional unit as more of good Y must be given up (and vice versa)
 - This is because some resources are better suited to making X and others are better suited to making Y
 - When moving away from the maximum production of a single good, the least efficient resources would be given up and hence result in a lower opportunity cost for producing the alternate good
 - As you move further away from the maximum production, specialised resources are allocated and hence increase opportunity cost of producing the alternate good, creating a concave PPF