

ECON1101 Topic 1 – Thinking as an Economist

What is Economics?

- **Economics:** Study of how people make *choices* under conditions of *scarcity* & the results of those choices on society
 - *Unlimited wants* to be satisfied by *limited resources + Choices* – What, How, Whom gets the produce?
- **Microeconomics:** how firms/households make decisions to allocate limited resources [supply side economics]
- **Positive Economics:** Explains what happens + why, **Normative Economics:** Explains what should or ought to happen

Scarcity Principle: No Free Lunch → **Tradeoffs** (*compromise between competing interests*) → more of 'x' = less of 'y'

Cost Benefit Principle:

- An individual should undertake a particular action if the *marginal benefits* exceed the *marginal costs*
- **Assumptions: "Rationality"** → people compare the costs & benefits of alternative actions in pursuing their goals
 - "*Ceteris Paribus*" → everything else remains constant
- **Opportunity Cost** → The value of the next best alternative to undertaking a particular action (economic surplus)
 - **Estimating Cost of Qualitative Examples** – What is the minimum dollar value I'd want to be paid to do it?
 - **Estimating Benefit of Qualitative Examples** – What is the maximum you'd pay for it to be done?
- **Incentive Principle:** A person is more (less) likely to undertake action if economic surplus increases (decreases)

Reservation Price: Buyers Side – Highest price a consumer will buy for, **Sellers Side** – Lowest price a producer will sell for

Sunk Costs: Unrecoverable costs, results of past decisions & should not affect current decisions/not included in the C/B Model

Pitfalls:

1. **Failing to account for all opportunity costs [Ask questions that highlight the trade-off]**
2. Failing to ignore sunk costs
3. Failing to account for all benefits
4. **Failing to measure costs and benefits in absolute dollar terms rather than as proportions**
5. Failing to know when to use average costs/benefits & when to use marginal costs/benefits
6. Failure to incorporate time into C/B thinking → Discount future costs & benefits into present values

ECON1101 Topic 2 – Comparative Advantage: The Basis for Trade

Opportunity Cost, Comparative Advantage & Specialisation

- People in a group can either be self-sufficient or they can specialize [The Principle of Comparative Adv.]
 - **If comparative advantage exists, specialisation will lead to a higher output for the entire group**
- **Absolute Advantage:** When an economic agent can produce more G&S than another economic agent
- **Comparative Advantage:** When one economic agent's opportunity cost is lower than another agent O.C

Example Diane & Liz

- Diane has abs. adv. over Liz in both tasks
- Diane comparative adv. In washing as her O.C is lower, while Liz has a comp. adv. in cooking as her O.C is lower

Sources of Comparative Advantage

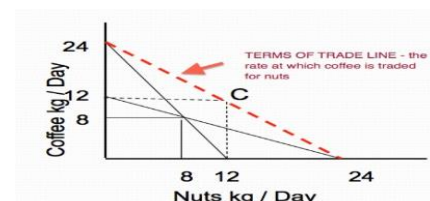
- **Individual**

- In-born talent
- Education & Training
- Experience – Specialisation in comp. adv reinforces itself over time = more specialisation

- **National**

- Natural Resources – Australia's easy access to ore/minerals
- Infrastructure, R&D (subsidies e.g. JPN Semi-conductor sector)
- Cultural Institutions & Education Systems (& Entrepreneurial Spirit)

	Time to Cook Meals	Time to Wash Dishes		OC 1 Meal	OC 1 Wash
Diane	20 mins	10 mins	For Diane	2 washes	1/2 meal
Liz	30 mins	30 mins	For Liz	1 wash	1 meal



The Production Possibilities Curve (PPC)

- **Assumptions – Ceteris Paribus, Fixed Technology, Resources Fully Employed, Only 2 Goods Are Produced**

- Sam can produce 2kg Nuts or 4kg of Coffee, OCN = 2Ckg, OCC = ½ Nkg
- Tim can produce 4kg Nuts or 2kg of Coffee, OCN = ½ Ckg, OCC = 2Nkg
- *Should specialise in the axis where gradient is flatter*
- Sam & Tim will trade when the terms of trade are lower than their opportunity cost
 - Assuming ToT = 1, Sam will trade 1 coffee for 1 nut since he would have to give up 2 coffee to gain 1 nut without trade. Likewise, Tim will trade a nut for a coffee as without trade he would lose 2 nuts to gain 1 coffee

The Production Possibilities Curve for a Many-Person Economy

- Some resources are suited for producing 'A', while others are for 'B'; Differing abilities = different efficiencies of workers in an economy
- **Principle of Increasing Opportunity Cost → Outwardly Bow Shaped**
 - In expanding the production of any good, first employ those resources with the lowest opportunity cost & only afterwards turn to resources with a higher opportunity cost

Factors That Shift the Economy's PPC

- Economic growth causes an outward shift in the PPC
 - Increases in productive resources
 - Improvements in technology & knowledge → increases productivity of current resources
 - Population Growth (does not raise Sol)

Costs & Benefits of Specialisation

- Costs
 - Time & effort to change to specialisation, Destroys variety, repetitive, Vulnerability, e.g. food at war time
- Benefits
 - Increased total output for the group, increased efficiency, The > the difference in OC the > the gains from trade

ECON1101 Topic 3 – Supply & Demand

What, How & For Whom, Central Planning Vs. Market (Unplanned)

- Centralised → Decisions made by an individual or small group on behalf of a larger group
- Unplanned/Free Market → Individual in private markets decide what products to buy or produce
 - Most modern industrial countries 'mixed' → G&S are allocated by free markets (mostly) & regulation
- Free markets tend to assign production tasks & consumption benefits more effectively

Buyers & Sellers – Need Trade Because of Specialisation

- **Market:** A set of conditions that allows willing & able buyers & sellers to exchange goods & services
- The market price is determined by both the supply (cost of production) & demand curve (value to consumer)

The Demand Curve

*The Demand Curve is a representation of the relationship between the **amount** of a particular G/S that buyers want to purchase in a **given period** & the price of that G/S.*

- Assumptions → Ceteris Paribus (to isolate the relationship between price & demand)
- Law of Demand → Demand rises as price falls → Downward Sloping
 - **Income Effect**
 - A price increase (decrease) reduces (increases) purchasing power/real income, leaving extra income to purchase higher quantities
 - **Substitution Effect**
 - Price increases will cause people to switch to alternatives
- **Shifts In Demand**
 - Changes in the prices of other goods → Complements & Substitutes
 - Changes in Income → Normal Goods & Inferior Goods
 - Changes in Tastes & Preferences
 - Changes in Population
 - Expectations of Changing Future Prices or Future Products

The Supply Curve

The Supply Curve is a representation of the relationship between the amount of a particular G/S that sellers want to supply in a given period of time & the price of that G/S.

- Assumptions → Ceteris Paribus (to isolate the relationship between price & supply)
- Law of Supply → Supply rises as price rises as more people will be willing to supply [vice-versa] - Upward Sloping
 - **Principle of Increasing Opportunity Costs:** At higher prices more people will be willing & able to supply
- **Shifts In Supply**
 - Changes in Costs of Inputs
 - Changes in Technology
 - Weather – Especially for Agricultural Goods
 - Number of Producers
 - Expectations of Changes in Future Prices