ECON1101: Microeconomics

University of New South Wales

1 Thinking as an Economist

Economics – Study of choices under conditions of scarcity – how they're made and their results

Micro - Individual consumers and firms; **Macro -** Aggregate economy

Cost benefit principle – Take action if benefit > cost

Economic surplus – Benefit - cost

Scarcity principle – having more of one good means having less of another

Opportunity cost – Cost of not taking the next best option

Pitfalls: 1. Absolute amounts vs proportions 2. Ignoring opportunity costs 3. Sunk costs 4. Average vs marginal costs and benefits

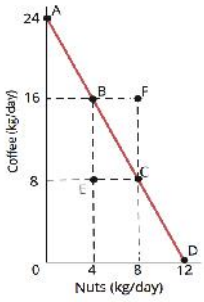
2 Comparative Advantage: the Basis for Trade

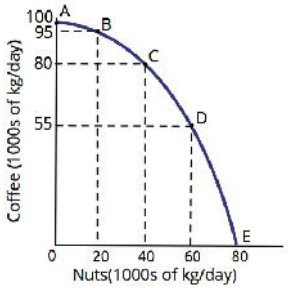
Absolute advantage – Can perform task with less resources

Comparative Advantage – Can perform task with lower opportunity cost

Specialisation according to comparative advantage and trade gives maximum output

PPC – Downward sloping because of scarcity, bow shaped for a many person economy because of low hanging fruit, shifts due to economic growth, population growth, new resources and better technology



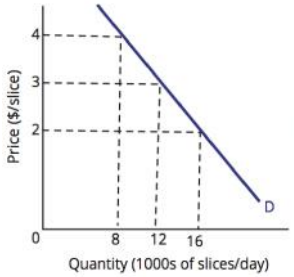


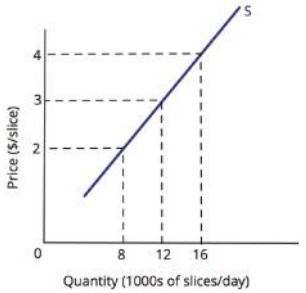
3 Supply and Demand

Market - Where buyers and sellers can facilitate exchange of goods

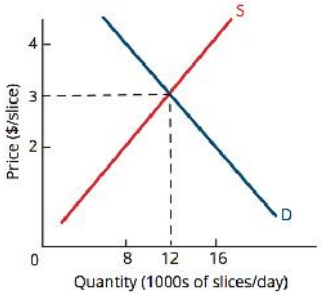
Demand curve – downward sloping because of substitution effect, income effect and reservation prices

Supply curve – upward sloping because of low hanging fruit and rising opportunity costs





Equilibrium – System at rest, nobody wants to change behaviour



Demand shifts right due to drop in price of complement, rise in price of substitute, increased preference by buyers, increased population of buyers and expectation of future higher prices (and vice versa)

Supply shifts right due to decrease in costs of productive factors, improvement in technology, increase in number of suppliers and expectation of lower prices (and vice versa)

Demand shifts right – equilibrium price and quantity both rise

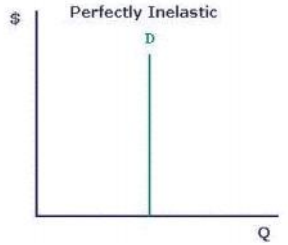
Supply shifts right – equilibrium price goes down, quantity goes up

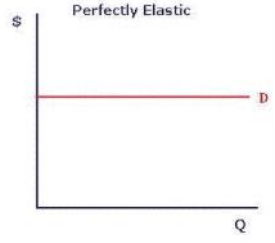
4 Elasticity

Price elasticity of demand/supply - % change in Q demanded/supplied for 1% change in P

$$E = \frac{\Delta Q/Q}{\Delta P/P} = \frac{\Delta Q}{\Delta P} \times \frac{P}{Q} = \frac{1}{slope} \times \frac{P}{Q}$$

E < 1: Inelastic, **E = 1**: Unit elastic, **E > 1**: Elastic, **E = 0**: Perfectly inelastic, **E = infinite**: Perfectly elastic





Elasticity of demand affected by – Substitutes, budget share

Elasticity of supply affected by – Number of producers, mobility of inputs, production period length

Elasticity of demand is – 1 at mid-point of demand curve, <1 to left, >1 to right

Cross price elasticity of demand - % change in Q demanded for %1 change in price of DIFFERENT good.

Complement - $E_C < 0$, Substitute - $E_C > 0$

5 Perfect Competition

Law of demand – Quantity demanded goes down as price goes up and vice versa

Need - something that you cannot live without, e.g. food and water

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