NOTES

ECON1001: Microeconomics for Business Decision Making

University of Sydney

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1 Introduction, Scarcity and Choice

1.1 Definition of Economics

- Economics is the study of how people make choices under conditions of scarcity.
- AND the study of the results of those choices on society.
- **Microeconomics** is the study of the individual consumer, firm and market behaviour
- **Macroeconomics** on the other hand, is the study of the aggregate economy

1.1.1 Key concepts

- **Cost benefit principle** – AN individual or firm, should only take an action if, and only if, the extra benefits from taking the action are at least as great as the extra costs
- **Economic surplus** is the gain that results from taking an action when the benefits > costs
- **Scarcity principle** – having more of one good means having less of another
- **Economic decision** is any decision where securing something of value means going without some other thing of value → this relates to the Trade-off (no free lunch) principle of economics
- **Opportunity cost** - the value of the next best alternative to taking a particular action

1.2 The Four Economic Decision Pitfall

- Measure costs and benefits as absolute dollar amounts rather than as proportions
- Account for all opportunity costs
- Ignore sunk costs – i.e. when eating at an all you can eat Buffet
- Know when to use average costs & benefits and when to use marginal costs & benefits

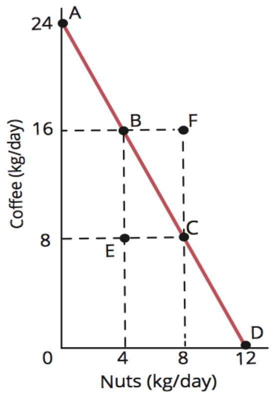
Absolute Advantage	Comparative Advantage
When one person is able to produce a good or perform a given task with **less resources** than another person	When one person's **opportunity cost** of producing a good or service is **lower** than another individual's opportunity cost
E.g. if **Person A** can write an economics report in 1 hr, while **Person B** can write the same economics report in 2hrs, **Person A** would have absolute advantage in writing an economics report	Sources • Differences in resources of a nation/region – e.g. Australia vs. NZ • Country's cultures and institutions • Innate born skills for individuals – e.g. genetics

1.3 Theory of comparative advantage

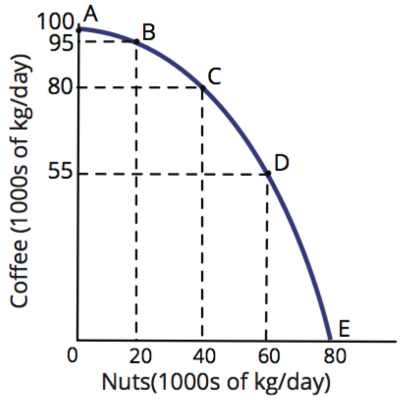
- When two people have different opportunity costs of performing various tasks, they can always increase the total value of output if each person concentrates their efforts on those activities for which their opportunity costs are the lowest
- The lower an individual's opportunity cost means that they are forgoing an activity that is low in value

1.4 Production possibility curve

- A graph that describes the maximum amount of one good that can be produced for every possible level of production of another good
- **Downward slope of the PPC illustrates the Scarcity Principle** – how having more of one good means having to settle less of another



- Any point that lies either below or to the right of the PPC is said to be an **un-attainable point** – meaning that it cannot be produced with currently available resources
- Any point to the left of the PPC is also known as the **inefficient point** – in the sense that the existing resources that an individual has allows for the production of at least one more good without sacrificing the production of any other good.
- Another point lying on the PPC is the **Efficient point**



1.4.1 The Production possibility curve for a many person economy is bow shaped –

- This is due to the **Low hanging fruit principle** – in that we always exploit on those individuals with the lowest opportunity costs first before looking for suppliers/producers with higher opportunity costs.
- The Production possibility Curve for a many-person economy can **shift/increase** due to:
  - Economic growth
  - Population growth
  - Discovery of new resources
  - Improvements in knowledge and technology – leading to greater efficiency