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Section 1: Basic Economic Concepts

1.1 - First Principles

Five Principles of Economic Interaction

Four Principles of Individual Choice

1. People must make choices because **resources** are scarce.
    (a) You only have so much time, money, or things to do. As a consequence you must choose where to spend it (cost/benefits)
2. The opportunity cost of an item - what you must give up to get it - is its true cost.
    (a) Two classes you want to take (same time/workload/cost), the opportunity cost of taking class A is whatever you would've learned from class B.
3. "How Much" Decisions require mankind trade-offs at the margin. compare the costs and benefits of doing a little more of something vs. a little less.
    (a) Do I spend 1 more hour on micro, or do I spend an hour studying CS?
4. People usually respond to incentives, exploiting opportunities to make themselves better off.
    (a) People will take discounted item of a non-disc. of the same (or similar) quality.
5. There are gains from trade.
    (a) If I specialize in Engineering & someone else specializes in Farming. The opportunity cost for me to farm my own food is greater than if I were to produce the thing I specialize in, and then tradethat for the food I need.

6. Markets move toward equilibrium because people respond to incentives.
    (a) New line at supermarket opens up during rush. People will then flood to that spot because they can benefit from that. Once the new line fills up there is no reason to change what line you're in. Therefore this system is in equilibrium.
7. Resources should be used as efficiently as possible to achieve society's goals.
    (a) If you have an overfull small classroom, but a nearly empty large classroom you are not being efficient with your resources. You should swap the class locations, this would be an efficient allocation of resources.
8. Because people usually exploit gains from trade, markets usually lead to efficiency.
    (a) The invisible hand will correct any inefficiencies automatically.
9. When markets don't achieve efficiency, government intervention can improve society's welfare.
10. One person's spending is another person's income.
11. Overall spending sometimes gets out of line with the economy's productive capacity.
12. Government policies can change spending.
13. **Economics** is the study of the choices people make facing scarcity. It is a social science that primarily examines the **economy**.
14. The **Economy** is the system of people that produce, distribute, and purchase goods and services.
15. a **Command Economy** is one in which the government decides what is produced, and distributed in the economy.
    (a) China was a command economy up to the 1970's (1978 apx).
16. In a **Market Economy** the decisions on what is produced, and distributed is made by the people that are participating in the economy.
    (a) Good ol' US of A is a market economy.
17. The **Invisible Hand** is the idea that the collective self interest of the people will inevitable cause change in society.
    (a) This can be for good or bad. Society pressuring companies to improve diversity or equality.

(b) When the IH harms society we call it a **Market Failure**.

18. **Microeconomics** is the study of individual choices, and how those choices interact with each other.

    (a) Individual people going about their day will, as an aggregate, cause change and economists what to understand this.

19. **Macroeconomics** is the study of the general trend of the economy.

20. **Market Failure** is when the collective self interest of the people causes harm to society. (makes some people worse off)

    (a) The market outcome is inefficient in this case.

       i. Ex. is a company producing T.V.'s dumping waste into a river which would harm people, and the environment downstream.

21. **Recessions** are economic dips when output & employment decrease.

    (a) Covid forcing people home which led to layoffs as spending in the economy was massively down. Stimuli were introduced to increase spending, but this was mostly for very large organizations with some political power. (or in the proximity of it).

22. **Economic Growth** is the increasing ability of an economy to produce goods, and services as it grows.

    (a) This is a positive feedback cycle. An example of this is Amazon not making huge profits at one point because it was reinvesting all of that (would be) extra income into expansion, research & development.

23. **Sustainable Long-run Economic Growth** is the balancing of the burden of economic growth by greater investment into environmental protections and living standards.

1.2 - Models and the Production Possibility Frontier

Definitions

1. A **Resource** is anything that can be used to produce a good or service.

   (a) The four common resources are:

      i. **Land**
      ii. **Labor**
      iii. **Physical Capital**
         A. Consists of man-made objects that a company uses to produce goods.
         B. Examples of this are the tools, buildings, and machinery that a company owns. (basically **Factors of Production**)

   iv. **Human Capital**
      A. Includes resources that humans can provide
      B. Education, experience, or unique skills – that contribute to the production process.

2. **Scarcity** is when there is demand for some resource but for whatever reason the economy is unable to provide it.
   (a) Can consider also that there is a scarcity of choice in everyone's lives.
3. **Opportunity Cost** is the real cost of an item: what you must give up in order to get it.
4. **Trade-offs** are a comparison of costs and benefits of doing something.
5. **Marginal Decisions** are decisions about the benefits of doing a little more Vs. a little less of something.
6. **Marginal Analysis** is the study of marginal decisions.
7. An **Incentive** is anything that rewards a change in behavior.
   (a) Lower prices an item will incentivise people to choose that item over other items of similar quality. This is a market out of equilibrium.
8. **Trade** the practice of exchanging your personal goods, or services for someone elses.
9. **Gains from Trade**: by dividing tasks and trading, two people can each get more of what they want than they could get by being self-sufficient.
10. **Specialization** is the situation in which each person specializes in the task that they are good at performing.
11. **Equilibrium** is an economic situation in which no individual would be better off doing something different.
12. An **Efficient Economy** is one in which it takes all opportunities to make some people better off without making other people worse off.
13. **Equity** is fairness; everyone gets their fair share.
14. **Production Possibility Frontier** a model that illustrates the trade-offs facing an economy that produces only two goods.
    (a) This model helps us understand the opportunity costs of production. Or help our understanding of trade-offs.
15. **Factors of Production** are the resources used to produce goods and services. Labor and capital are examples of factors.

1.3 - Comparative Advantage and Trade

Definitions

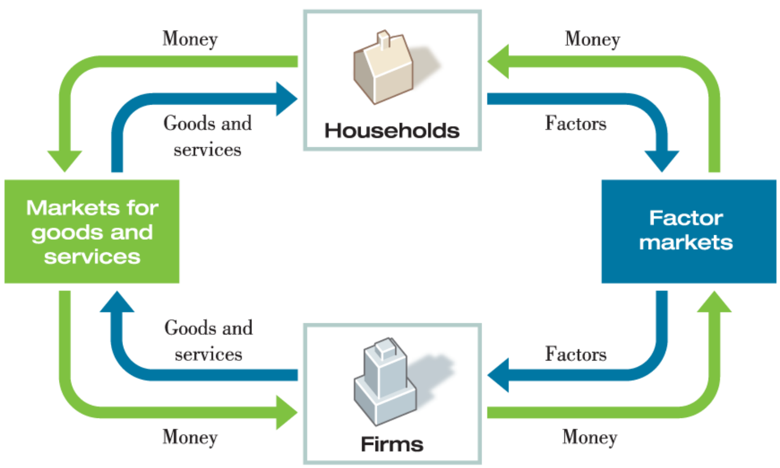
1. A **Comparative Advantage** is the advantage gained if the opportunity cost of producing the good or service is lower for that individual or country than for other producers.

2. An **Absolute Advantage** is the advantage gained if the individual or country can do it better than others. A country with an absolute advantage can produce more output per worker than other countries.

   (a) *comparative, not absolute, advantage is the basis for mutual gain.*

      i. It doesn't matter if it takes more resources for one country to produce something than another, only that the opportunity cost of producing a particular G&S is lower than the other country.

1.4 - The Circular-Flow Diagram



Krugman/Wells, *Microeconomics in Modules*, 4e, © 2019 Worth Publishers

1. A **Circular Flow Diagram** (shown above) represents transactions in an economy as two circular arrows showing the flow of money, goods, and services.

2. There are two kinds of inhabitants in an economy:

   (a) **Households** are people or groups of people who share their income

   (b) **Firms** are organizations that produce goods or services.

   (c) NOTE: **1.** differences between firms, and HH is not clear cut, i.e. family owned business. **2.** often firms are selling to other firms. i.e.

a steel producer mostly will sell to firms. **3.** The Gov can take money out of the flow via taxes, and put money in via spending policy.

3. A **Factor Market** trades in production factors which are the resources required to produce G&S.
   (a) i.e. the labor market.
4. **Bartering** is the direct exchange of G&S without the use of money.
5. **Positive Economics** involves situations in which there is a definite answer about what is the right Vs. wrong choice.
6. **Normative Economics** involves the way the economy "should" work. This is the area of economics that is more human, and messy.

Section 2: Demand, Supply, and Equilibrium

2.5/6 - Demand/Supply

1. A **Supply and Demand Model** models the behavior of a **competitive market**.
2. A **Competitive Market** is one in with many buyers and sellers of the same goods & services.
   (a) No individual producer can influence the market by selling their good.
   (b) In a non-competitive market (like aluminum production) a producer can wildly impact their profits through a shift in their supply.
3. A **Demand/Supply Schedule** is a table that shows the demand or supply of a good or service as the price changes\
4. **Demand or Supply Quantity** is the actual amount of a g/s that people are willing to buy (in the case of demand), or producers are willing to supply at a given price point.
5. The **Demand/Supply Curve** is a visual of how the demand/supply of a good changes as the price of that good changes.(this is a line, and can be described mathematically)
6. The **Law of Demand** is the principle that (all else equal) the higher the price of something the lower the quantity demand for that G/S will be.
7. A **Shift of the Demand/Supply Curve** represents a change in the quantity demanded, or supplied at a given price point.
   (a) An increase in demand, or supply at the same price point will shift the graph to the right. A decrease results in a shift to the left.

8. **Movement along the Demand/Supply Curve** represents a change in demand/supply driving a change in price. the reverse is true as well.
9. A **Substitute** refers to pairs of goods for which the rise in price of one drives a demand for the other.
10. **Compliments** are pairs of goods for which an increase in the price of one leads to a decrease in the demand of the other.
    (a) phones & apps. coffee & egg Muffins. Gas & Gas Guzzlers
11. A **Normal Good's** demand will increase with an increase in income
12. An **Inferior Good's** demand will decrease with an increase in income.
    (a) for both normal, and inferior goods the opposite cases are true too. income down => normal demand down inferior demand up
13. An **Individual Demand/Supply Curve** shows the Demand/Supply curve for an individual person or firm.
14. The **Market Demand/Supply Curve** is the "horizontal" sum of the demand/supply quantities.
    (a) if the quantity for bill is 30 at a given price, and 20 for Jill at same price, market demand for item at that price is 50.
15. **Input** is any good or service that is used to produce another good or service.
16. **Equilibrium Price** is the price at which both demand and supply match.
17. **Equilibrium Quantity** is the number of goods sold at equilibrium price.
18. **Market Price** is basically the price that a market will settle on if it is a well-established and ongoing. (both sellers and produces have been in the market for a long time).
19. A **Surplus** is when the quantity supplied is greater than the quantity demanded.
    (a) This can occur when the price is above equilibrium price.

Module 7: Changes in Equilibrium

Changes in equilibrium price& quantity are the result of shifts in both the supply and demand curves. If demand increases both equilibrium prices and quantity increase, but if it decreases both prices, and quantity decrease. If supply increase equilibrium quantity **increases** but equilibrium prices will **decrease**. If supply decreases quantity decreases but prices increase.

The 5 key elements of a Supply and Demand model:

1. The **Demand Curve**
2. The **Supply Curve**
3. The set of factors that will shift a supply, or a demand curve.
4. Market Equilibrium: equilibrium price, and quantity
5. How the market equilibrium changes as a result in the shift of supply and demand curves.

Extra Resources