BT244: Microeconomics Notes

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1 Principles of Economics

Economics is the study of how individuals make decision: how we produce, distribute, consume goods and services in a society where resources are scarce. The principles of economics are as follows:

- Choices are necessary because resources are scarce.
  - A ***resource*** is anything that can be used to produce something else.
  - A resource is ***scarce*** when there is not enough of the resource available to satisfy all the various ways a society wants to use it.
- The true cost of something is its ***opporunity cost*** (def: what you must give up in order to get something).
- *How much* is a decision at the margin (for each additional unit).
  - A ***marginal decision*** is a decision made at the margins of an acitvity about whether to do a bit more or a bit less of that activity
  - ***Marginal analysis*** is the study of margin decisions.
- People respond to incentives (def: anything that offers rewards to people who change their behavior), exploiting opportunities to make themselves better off.

Trade allows us to consume more than we otherwise could; gains from trade arise from specialization. ***Specialization*** is the situation in which each person specializes in the task that he or she is good at performing. The principles of the interaction of individual choices are as follows:

- There are gains from trade.
- Markets (def: a place where a good or service is exchange) move toward equilibrium (def: an economic situation in which no individual would be better off doing something different)