UNIT 3 AOS1 - MICROECONOMICS

1. RELATIVE SCARCITY: NEEDS, WANTS, RESOURCES AND OPPORTUNITY COST

What is an economy –
- A system that allocates resources to satisfy the needs and wants of a society
- A place where production, income and expenditure (economic activity) occur

What is economics –
- **Study of how scarce resources (such as land and labour) are allocated by key participants to best satisfy the needs and wants of society**
- Relative Scarcity: how a nation's resources are limited when compared to the demands placed upon them, creating an imbalance.
- UNLIMITED WANTS MEET LIMITED RESOURCES

RELATIVE SCARCITY

4 major resources categories (key inputs in the production process, FACTORS OF PRODUCTION) –
1. Land and natural resources
   a. Forests, minerals, water
2. Capital resources
   a. Machinery, robotics, trucks
3. Labour resources
   a. Workers such as teachers, managers
4. Entrepreneurial resources
   a. Gina Rinehart, Bill Gates

- UNLIMITED WANTS MEET LIMITED RESOURCES
- Given that all resources can be valued by money + all demands for g+s can be valued by money = **scarcity means that we don't have enough money to purchase all of the goods or services that we desire**
- OPPORTUNITY COST
  - Define: the value that could have been derived if the next best alternative was chosen
  - When we decide to use our resources (or money), it usually involves us forgoing the opportunity to use those same resources (or money) in some other way
  - Because resources are relatively scarce and have alternative uses

THE PRODUCTION POSSIBILITY CURVE (PPC)

- Or Production Possibility Frontier (PPF)
- Used to highlight:
  - Opportunity cost
  - Productive capacity
  - Productive or technical efficiency

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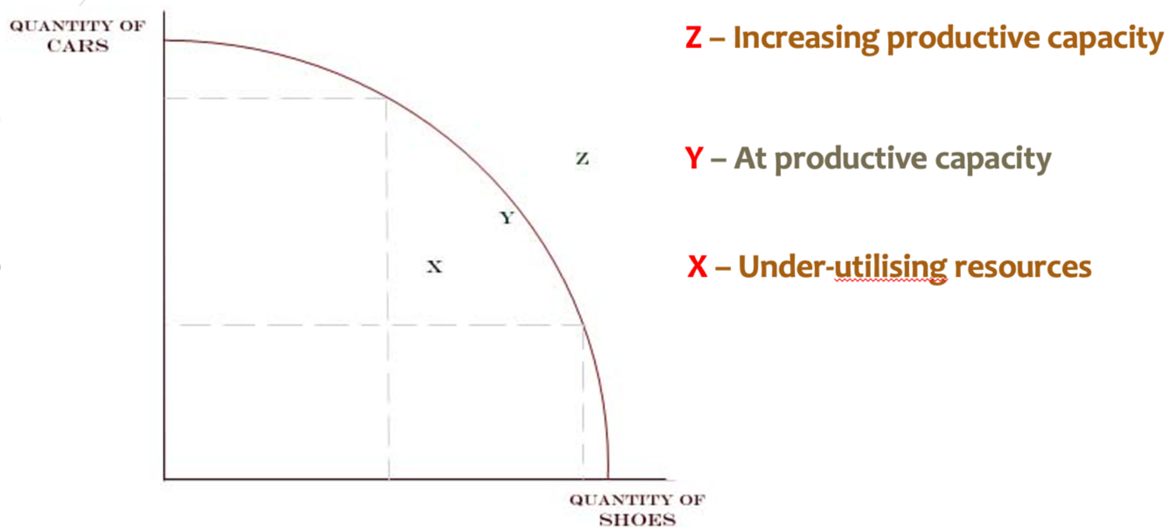
- Allocative efficiency
- Dynamic efficiency
- Inter-temporal efficiency

- Relies on ASSUMPTIONS:
  - Only two goods are being produced in an economy
  - All resources or facts of production can be used in the production of either good
  - If all resources are being used efficiently, the economy's productive capacity must be 'bounded' by the curve (i.e., you cannot produce beyond this point at the current time)



- Key points:
  - A movement from one point to another means a country is allocating more to the production of one good and less to another (OPPORTUNITY COST)
  - Points like 'Z' are not achievable today, but are in the future
  - Points inside curve = not technically or allocatively efficient
  - All points on the line are technically efficient but may not be allocatively efficient

WAYS TO EXPAND PPF:

- Increase the population of the workforce (skilled migration program)
- Innovation + technology redevelopment
- Increase education – more skills and knowledge
- Increasing incentives – make people more willing to work
- Improve efficiency in harvesting resources
- Promoting positive trade relations

Dynamic efficiency: the speed or pace at which an economy can move from one point on the PPC to another (the ability of markets to quickly re-allocate resources to the production of much needed products to achieve allocative efficiency)

Inter-temporal efficiency: the point on of production on the PPC can reflect this in an economy

Technical/Productive efficiency: involves firms producing at the lowest possible long run (average) costs and will mean output from the available resources has been maximized.

Allocative efficiency: represents the best combination of goods and services produced such that living standards are maximised.

THE BASIC ECONOMIC QUESTIONS

What to produce?

- How we allocate our scarce resources
  - Coal fired electricity or solar electricity?

How to produce?

- What combination of scarce resources will we use to produce those goods and services that we have decided to produce
  - More labour than capital or more capital than labour?

For whom to produce?

- How the goods and services produced are allocated/distributed to society
  - Use free markets (without government intervention)?

SOLUTION CONSIDERATIONS

- How do we maximise welfare and living standards?
- Australia primarily uses a market-based economy to allocate resources
  - Producers that seek to maximise profits need to produce g+s that satisfy the needs and wants of consumers (consumer sovereignty)
  - The market will effectively determine the way most resources are allocated via the market mechanism

2. THE NATURE OF, AND CONDITIONS FOR, A PERFECTLY COMPETITIVE MARKET

THE MARKET MECHANISM AND ‘PERFECT MARKETS’ – THE ROLE OF MARKETS

- Market: a place where buyers and sellers (demand and supply) come together to allocate resources.
  - The market/price mechanism is the main instrument of allocation

PERFECT COMPETITION

- The market structure that usually forms the basis for demands and supply analysis
- The model is a useful tool that enables predictions to be made about how resources move around in an economy
- Characteristics:
  - A large number of buyers and sellers
  - Perfectly homogenous productions (identical products)

- Freedom of entry/exit into market by sellers
  - Buyers and sellers possess perfect information about products
  - Buyers seek to maximize satisfaction (utility)
  - Sellers seek to maximize profit
  - Resources are perfectly mobile
- Nature:
  - Production takes place at the lowest possible cost (technical efficiency)
  - Consumers would be able to purchase the g+s they desire (consumer sovereignty) at the lowest possible prices (perfect info)
  - Competition would ensure that firms priced their products at their 'marginal' costs of production
    - Any further price reductions would result in insufficient profits or losses, encouraging firms to exit the market
  - Consumers get lowest possible prices + highest quality
  - Allocatively efficient

PERFECTLY COMPETITIVE MARKET

conditions	**nature**
many small firms	More efficient (trying to increase efficiency to lower costs of production, lower prices to compete)
homogenous	Consumer sovereignty
Easy entry and exit	Price competition
Mobile resources - Easily reallocated	Improved living standards

THE MARKET OR PRICE MECHANISM AND RELATIVE PRICES

- Market/Price mechanism: describes how the forces of demand and supply determine (relative) prices of g+s which then ultimately determines the way our productive resources are allocated in an economy.
  - E.g., as prices change, demand may be strong, sends signals to suppliers that profit opportunities exist if they direct resources into those markets
    - With advances in technology, products such as DVD players become obsolete relatively quickly
    - The changing conditions cause changes in relative prices of g+s
    - Suppliers would then remove resources from supply of DVD players and reallocate them to produce more advanced technology
  - E.g., the toilet paper demand during the pandemic spiked due to panic buying
    - The prices for toilet paper then increased as there was an increase in demand which created shortages that the price increase eliminated
    - This encouraged toilet paper companies to remove resources from production of other goods they sell (tissues, nappies etc.) and reallocate it to the production of toilet paper due to the higher profit prospects