Chapter I.

Economic behavior of small economic units → consumers, workers, managers, markets, entrepreneurs

Factors that influence decisions

Microeconomics = price theory
Microeconomic = small

Microeconomics is concerned with all the individual's or separate units which play a part in the functioning of the economy.

Microeconomics involves a study of the way in which individual decision-makers, functioning as consumers or producers use their limited resources in an attempt to achieve their respective economic goals namely the maximisation of utility and profit.

Macroeconomics deals with economy as a whole/large.

Micro = operation of economy at the level = where basic decisions are taken

Macroeconomy = total economy behavior + performance of economy as a whole.

Scarcity Problem

Material wants are unlimited and can never fully be satisfied while economic resources (produce the goods + services) are limited/scarce.

Unlimited wants

→ Utility = satisfaction + pleasure.

eg: house, car, travel, tv etc.
2 types of utilities

- Essentials (food, clothes etc)
- Luxuries (perfumes, travel, jewelry)

Services satisfies consumer wants - operation, haircut, legal repairs to car etc.

difference between goods & services not always clear.

eg: washing machines/cars purchased for services they provide.

Material wants include business & state wants eg: business needs space, trades, machinery, communication systems

state needs → hospitals, schools, military equipment.

Material wants of a society is unlimited or insatiable / can never be met in full.

⇒ individual’s wants can be met for one service/product but they can never be satisfied for goods/services in general

⇒ new products → new wants

⇒ consumer not satisfied and wants better eg: Black & White TV → color → plasma etc.

* At any given time the individuals & institutions that make up a society have innumerable unfulfilled wants

⇒ some wants have a biological origin

⇒ others influenced by customs & standards of society

eg: types of food, housing, clothes, which people want is mainly determined by the social/cultural environments in which they live

⇒ wants change & multiply over time - process is aided by the development of new products & advertising & sales promotion.
Limited Resources

- Economic resources → factors of production used to produce goods/services
- Natural
  - not easily replaceable (land, oil, water, animals, etc.)

- Human / Labour
  - depends on population size
  - quality more important than quantity
  - limits to both quantity & quality of labour especially in the short term

- Manufactured resources / Capital Goods
  - Money is NOT an economic resource
  - Machinery, buildings, etc. are used to produce consumer goods that satisfy the need
  - not unlimited - wear & tear / technological obsolescence
  - must replace capital goods from time to time

- Entrepreneurial ability
  - Special talent
    - ability to take initiative & have the drive to combine the factors of production (capital, labour, natural resources) in such a way that goods or services are produced
  - Important business decisions that shape the course taken by an enterprise
  - Risk takers - successful or bankrupt
Income - owners of factors of production earns: Rent / wages / profit / capital / entrepreneur.

Economic + Free Goods

Economic good \( \rightarrow \) product produced at a cost by using scarce factors of production \( \rightarrow \) scarce goods

Free good is a good that is not scarce and has no price. eq. sunshine, air, seawater.

Gifts of nature considered a free good because not produced by man but often time + trouble are required to make them available to the consumer. eg. Minerals mined at a high cost. distribution of water is very expensive.

Final Goods + intermediary goods

Final Goods \( \rightarrow \) used by consumer eq. food, clothing

Intermediary \( \rightarrow \) goods sold to be used as inputs to produce a final product - STEEL - is an intermediary product.
Task of the economic System

L> what
L> how
L> for who

* What should be produced?
  -> what goods + services.
  -> what quantities?
  -> can’t produce all goods + services, there is a need for
    has to make a choice
  -> choice is decided by price mechanism
    only goods will be produced for which consumer
    are able + prepared to pay at a price that is at
    least high enough to cover all production costs
  -> consumer permit the manufacture of a product
    by being willing to pay more for it.
    eg rise in chicken drop in milk price - farmers
    produce more chickens + less milk.
  -> reduction in price prepared to pay => less of product
    will be produced.

* How should it be produced?
  -> economic way resources are combined to produce
    the good or service
  -> important that resources be used efficiently as possible

  => way the economic resources are combined in the
    production process is determined by the price mechanism
prices of resources are relative to their scarcity. Firms combine economic resources in such a way that costs are kept to a minimum.

- Price of a resource increase firms will try to use less of it eg: minimum wage increase could lead to use of more machinery instead of labor.

For whom should these products be produced?

- Way which the output (production) is distributed among members of the community.
- Decided by price mechanism
- Income source of expenditure + consumers' vote want for what they are spending their money on particular goods.
- Individuals with unusual skills have a larger quantity of economic resources and have more "money" and have a larger influence on manufacturers to produce more of the product they want.
- Ensure that more of their needs are met.

**Economic Circular Flow**

decision making units ➔ individuals ➔ firms ➔ interaction between care of the market vs. economy

2 kinds of markets ➔ factors & of production ➔ market for goods & services
households → owners of factors of production which are required by firms to produce goods & services
  → offer these factors of production to firms
  → in exchange households receive payment from firms

firms → combine factors of production to produce goods & services that is then sold to on the market for consumer goods.

Income of household is also the expenditure of firms on production.

Circular flow one side → flow of goods & services from firms to households via good market.
  other side → opposite direction → monetary flow factors of production from household to firms via factor market.

[Diagram of circular flow model]
Economic Models

The aim of microeconomics theory is to explain and predict the economic behavior of firms and individual consumers, and the operations of markets, with a view to policy making.

Model → formal representation of a theory
→ simplifications or abstractions of reality
→ purpose to make sense of extremely complicated world by only emphasizing the most important factors
→ omits all unimportant factors

A theory → good theory if it satisfies 2 requirements
* actually describe a large class of observations based on the basis of a model that contains only a few arbitrary elements
* it must make a definite prediction about the results of future observations
  e.g., road map showing all landmarks would be confusing
  Remove these show only important intersections etc. = good map

Model → simplification of reality, its primary goal is to analyze and predict.
Model - number of assumptions which can be used to draw/make conclusions.
- Must be a simplification of a reality.
- Assumptions need not necessarily reflect reality exactly in all respects.
- If not 100% in reality is ok. Provided that the model was able to predict events so reliably that it was still useful despite any inaccuracies.

- Usually a result of an observation made in society.
- But it needs to test in practice.
- Can be expressed by means of mathematical symbols & equations / words / graphs / graphs / tables

Ceteris paribus - assume all variables other than the one they are specifically dealing with remain unchanged.
- All other things being equal.
- Short term reasonable.
- Long term more difficult to leave forces out.

Equilibrium.
- Situation once reached, tends to persist.
- All opposing forces are in balance.
- Reluctance to change but could change.
- Includes
Prices

relative prices \( \Rightarrow \) relationship between the price in question and the price of other products.

\[ \uparrow \text{in price} = \text{product more scarce} \]

Price rises \( \Rightarrow \) producers make profits \( \Rightarrow \) more resources into manufacturing product

Rational individuals \( \Rightarrow \) assume all consumers are rational \( \Rightarrow \) will try to maximize their utility \( \Rightarrow \) entrepreneurs will maximize profit