MICROECONOMICS SUMMARY 2011 (BEGINNERS)

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TOPIC 1: INTRODUCTION TO ECONOMICS

1.1 Introduction

Scarcity is a fundamental fact of life. Economics is the study of how people make choice under conditions of scarcity and the results of those choices for society. Economists analyse the choices that people make by comparing the costs and benefits of any action or decision by taking a cost/benefit analysis.

Definition: The **scarcity principle** states that although we have boundless needs and wants, the resources available to us are limited. Consequently, having more of one good thing usually means having less of another.

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Whenever a decision must be made in a context of scarcity it involves trade-offs and we can think of it as an 'economic decision'.

Definition: **Economic decision** is a decision where securing something of value to use means we must go without some other things we value.

Inherent in the idea of a trade off is the fact the choice involves compromises b/w competing interests. Economists resolve such trade-offs by using cost-benefit analysis.

Definition: **Cost-benefit principle-**one should take an action if, and only if, the extra benefits from taking the actions are at least as great as the extra costs.

1.2 Learning to think as an economist

Example: Imagine you are about to buy a $25 computer game at the nearby local store when a friend tells you that the same game is on sale at a store in the city for only $15. if the CBD store is a 30 minute walk away, where should you buy the game?

The **cost –benefit** principle tells us that you should buy it in town if the benefit of doing so exceeds the cost.

The **benefit** of buying in the city is $10 (amount you will save on the purchase price of the game). The **cost** of buying in the city is the dollar value you assign to the time and trouble it takes to make the trip.

Now if the time required for the trip is the only time you have left to study for a difficult test the next day, then the cost of making the trip is probably higher than the $10 benefit of making the trip. In such a case, we say that the **opportunity cost** of making the trip is high, and you are more likely to decide against making the trip

Definition: **opportunity cost** is the value of the next best alternative to taking a particular action.

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Example: If Mr. X sets up his own business and uses his own money (capital) to fund its commencement, some opportunity costs include

- The *foregone* interest Mr. X could've earned by lending his money to the bank, or to a borrower
- The *foregone* amount of wages Mr. X could've earned if he didn't start his own business but worked for an existing business.

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