DSE 5**

ECONOMICS

STARSHOOTER

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Disclaimer

Ch.1 Basic Economics Concepts

(A) What is Economics?

- It is a social science which examines how individuals, firms and societies make decisions to satisfy their wants under scarcity.
- It predicts human's behavior.
- Economics do NOT study how to solve economic problems. It studies how individual and firms maximize their gains under constraints.

(B) Scarcity

- Definition:

  (1) When the resources available are not enough to satisfy all human wants.

  (2) Quantity demanded > Quantity supplied at zero price.
- Scarcity is implied by the existence of competition, choice, or price.
- Scarce resources do NOT imply unlimited wants, great demand, limited resources.

Concept check (True or False?)

✓ There is no scarcity if the limited resources are still enough to satisfy human wants.

✓ There is no scarcity if there are unlimited resources.

✓ If there is no scarcity, there is no production.

✗ If a good is scarce, the good must have a market price.

✗ Scarcity exists when quantity demanded is greater than quantity supplied at **any** price.

In the absence of scarcity,

(1) there will be no discrimination.

(2) there will be no market price.

(3) there will be no goods.

A. (1) and (2) only B. (1) and (3) only

C. (2) and (3) only D. (1), (2) and (3)

Ans: A

(3) Goods are anything that satisfy human's wants.

The existence of scarcity implies that

A. human wants are unlimited.

B. all goods are economic goods.

C. there is a cost in obtaining some goods.

D. each and every economic good must have a price.

Ans: C

A. If resources are unlimited, there is no scarcity even with unlimited wants.

B. There is still the presence of free good.

(C) Opportunity cost

<u>Concept</u>

(1) Forgone concept: highest-valued option forgone

(2) Full-cost concept: monetary cost + time cost

(3) Possible outcome or risk (e.g. danger or injury)

<u>Change in opportunity cost</u>

- Change in value (quality) of the highest-valued option forgone
- Additional monetary and non-monetary costs are involved in the chosen option
- Change in the possibility of an outcome (e.g. an accident, a potential harm)
- Change in preference when a new option emerges
- Change in preference when the option of lower value increases in value

** Change in the value (~ quality) of <u>the chosen option</u> will NOT change the opportunity cost

<u>Key concepts</u>

- When more than one costs are involved, only take the one with <u>the highest value</u> as the opportunity cost.
- <u>Past cost is irrelevant</u> to option selection, hence it is not regarded as an opportunity cost.
- When considering forgone concept, if there is additional monetary or time cost incurred in the **highest-valued option forgone**, opportunity cost will **remain unchanged**. Only when its value (i.e. attractiveness or quality) changes, opportunity cost changes. However, if there is

additional monetary or time cost incurred in the **chosen option**, opportunity cost will change.

(1) Mr. Wong spent $5 000 on buying a new computer which can be sold for $7 000 in the second-hand market. Mr. Wong's cost of keeping the computer is __________.

A. $0

B. $2 000

C. $5 000

D. $7 000

Ans: D

$5000 is the cost of buying the computer which is a past cost because the buying action has ended. The opportunity cost is only the $7000 forgone from selling it in second-hand market.

(2) Kelly is choosing between two ways of spending her Christmas vacation: to work for her aunt and earn $3 000 or to join a cultural tour to Paris. Which of the following will lower Kelly's opportunity cost of working for her aunt?

A. Kelly's aunt reduces her wage to $2 000.

B. The fee for the cultural tour decreases.

C. An attractive section of the cultural tour is canceled.

D. Kelly's aunt agrees to employ her best friend to work with her.

Ans: C

A. It will only lower the value of the chosen option, not the highest value option forgone.

B. The decrease in fee will not affect the opportunity cost because Kelly no longer has to pay the fee as joining a cultural tour is not her chosen option.

C. It will decrease the value of the highest value option forgone.

D. It will only increase the value of the chosen option, not the highest value option forgone.

(3) Mr. Chan plans to purchase a new racing car from a Italian automobile manufacturer and drive the car in Hong Kong. In which of the following situations will the cost of purchasing the racing car increase?

A. The first registration fee increases.