



DSE 5***

ECONOMICS

STARSHOOTER

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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

Concept

- (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)

Change in opportunity cost

- 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 the chosen option will NOT change the opportunity cost

Key concepts

- When more than one costs are involved, only take the one with the highest value as the opportunity cost.
- Past cost is irrelevant 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.