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SCARCITY

Microeconomics

The **PROBLEM** of Scarcity

- **Limited** resources, **unlimited** wants.
- Such resources include land, labour, capital and entrepreneurship.
- Society constantly wants more and more. However, the current level of resources are insufficient to match up to this.
- As a result, this gives rise to an **OPPORTUNITY COST**.

Opportunity Cost

- Defined as the **NEXT BEST ALTERNATIVE**.
- As a result of a case of scarcity, more people are only left with the next best alternative.

E.g. A consumer has $10 to eat a meal, watch a movie or buy a toy. If the movie is his first choice, the meal is second choice and toy is his third choice, the ***opportunity cost*** *of seeing the movie will be the meal and chance to buy the toy he has to forego.*

Production Possibility Curve

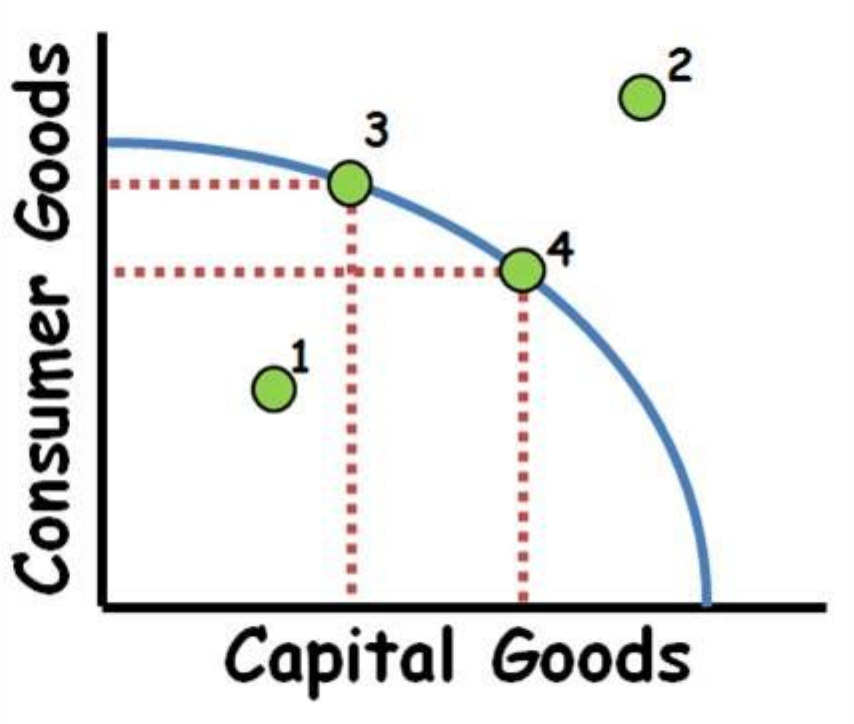
- Shows the **<u>maximum amount of 2 goods</u>** which the economy can produce with a given quantity and quality of resources, assuming a particular state of technology.
- Tends to compare **consumer** vs **capital** goods.

Assumptions

- Resources available are fixed in both quantity and quality during this period.
- The available technology does not change.

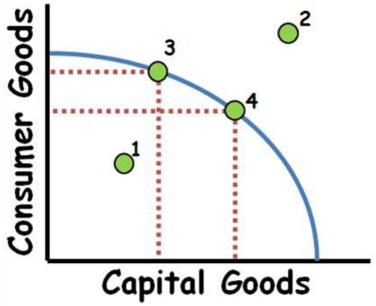
[*Chances are there will be a change in technology in the long term and quality of workforce can also improve*]

Production Possibility Curve



Production Possibility Curve

- Scarcity is indicated by the unattainable combinations **outside of the boundary**.
- Choice is indicated by the need to choose among the alternative combinations **along** the curve.
- Most economies operate on or below the curve. Dependent on priority/CA of country, some may produce higher up (**3**) the PPC or lower (**4**), indicating the type of goods they produce.
- The sloping PPC curve shows an **increasing opportunity cost** which has been brought about by scarcity (*not enough resources to produce the same amount of capital and consumer goods*).



Economics is all about **SCARCITY**

*There are **trade-offs** in every choice made,*

*and every choice made is affected by **scarcity**.*

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RATIONAL Decision Making

Microeconomics

The <u>3</u> economic questions

1. **<u>What to produce?</u>**
- The economy has to decide how much to produce.
- Overproduction or underproduction is undesirable.
- ***Allocative efficiency*** is affected.

2. **<u>How to produce?</u>**
- A decision on the **method** of production [Labour-intensive vs Capital-intensive]
- Producers will aim to use the least-cost method of production to maximise profit.
- Important as choosing the right method maximises the level of output and minimises any wastage of resources in an already scarce world [***Productive efficiency***].

3. **<u>For whom to produce?</u>**
- Who has the purchasing power, or is it for everyone.
- Affects ***equity*** in distribution of goods and services.

The **<u>Marginalist Principle</u>**

- States that economic agents make decisions based on the margin by looking at the **<u>additional/marginal benefit</u>** and **<u>costs</u>**.

Marginal Benefit:

- Additional utility (benefits) from consumers' perspective.
- Additional revenue from producers' perspective.
- Additional social costs from governments' perspectives.

Marginal Cost:

- Additional cost of purchasing one more unit (consumers)
- Additional cost of producing one more unit (producers)
- Additional cost of spending could be an opportunity cost in another sector of economy.

Objectives of **<u>CONSUMERS</u>**

- Aim to maximize **<u>total utility or benefits</u>**.
- Face the **Law of diminishing marginal utility (LDMU)**
    - As consumers consume additional units of a good, the marginal utility from the consumption of those additional units will fall.
    - *E.g. After a workout, the want to pay a large price for a bottle of 100 plus is huge, however, after the first, once satisfaction is achieved, the want to pay the same amount for a second bottle is less.*
    - Consumer will only consume additional units of a good if the marginal benefit **exceeds** marginal costs.

*<u>**Rational consumers**</u> will consumer up to where **marginal benefit = marginal cost** so as to maximise total utility/satisfaction.

Objectives of **PRODUCERS**

- Aim to maximize **total profits**.
- Profit = Revenue - Cost
- Producers will only produce additional units of a good if the marginal revenue **exceeds** the marginal cost.

***Rational producers** will produce up to where **marginal benefit = marginal cost** so as to maximise total profit.

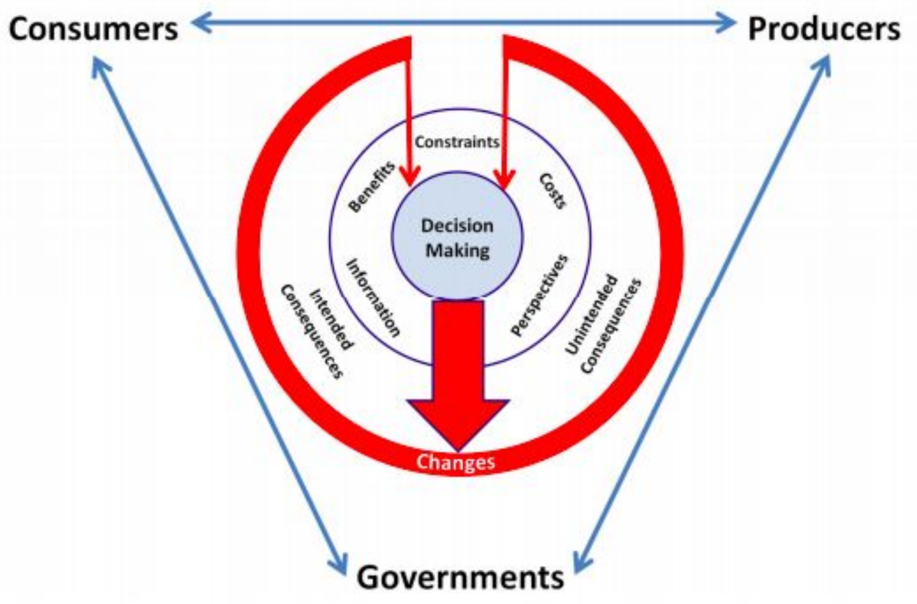
Objectives of **GOVERNMENTS**

- Aim to maximize **social welfare,** interested in the benefits and costs to the entire society.
- However, they may not consider the pollution cost on the environment (known as **external costs**).

*__Rational Governments__ will produce up to where **social marginal benefit = social marginal cost** so as to maximise social welfare.

- A case of *market failure or government failure* may erupt [covered in later videos].

What is the **RATIONAL DECISION MAKING MODEL**?



FACTORS affecting Rational Decision Making

- Benefits
- Costs
- Constraints
- Perspectives
- Information
- Intended and Unintended Consequences

Exam Requirements

- Understand the different factors which affect the decisions made by an economic agent (consumer, producer or government), namely the **Rational Decision Making Model**.
- Be able to apply these factors into the context of the question.

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