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, 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.

(12PP/1)

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)

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

(12SP/1)

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 market price.

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 cost are involved in the chosen option
- Change in the possibility of 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 is not taken are not counted as 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.

(12PP/2)

Mr. Chan spent $5 000 on buying a new mobile phone which can be sold for $7 000 in the second-hand market. Mr. Chan's cost of keeping the mobile phone is __________.

A. $0

B. $2 000

C. $5 000

D. $7 000

$5000 is the cost of buying the phone 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.

(12SP/2)

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

A. Mary's uncle 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. Mary's uncle agrees to employ her best friend to work with her.

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 Mary 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.

(12/2)

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

Ch.8 Determination of Market Price

A. Demand

- The quantity of a good that a consumer is **willing and able** to buy at **all given prices** over a period of time, ceteris paribus (i.e. holding other factors constant)
- Consumption plan instead of an actual payment

(13/10)

Which of the following is assumed to be constant when the market demand curve of a good is derived?

(1) The income of the consumers

(2) The price of the good

(3) Prices of related goods

(4) Preference of the consumers

A. (1) and (3) only

B. (2) and (3) only

C. (1), (2) and (4) only

D. (1), (3) and (4) only

When plotting a demand curve, other non-price factors must be kept constant as shown in the definition of demand.

B. Quantity demanded

- Quantity demanded (Qd) for a good refers to the amount of the good which a consumer is **willing and able** to buy at a **given** price.

Key concept: what are the differences between demand and quantity demanded?

- demand refers to the demand schedule i.e. the demand curve.
- quantity demanded is a point on a single demand curve which corresponds to a specific price.

C. Law of demand

- The law of demand states that an increase (a decrease) in the price of a good will result in a decrease (an increase) in quantity demanded, ceteris paribus. **
- The law of demand states that price and quantity demanded are **negatively-related**, ceteris paribus.
- A demand curve consistent with the law of demand is **downward-sloping**.

Exam Key:

- *State the correct definition of law of demand whenever it applies to the question.*
  - *negatively-related*
  - *vice versa*
  - *ceteris paribus / holding other factors constant*

D. Money Price (Nominal Price) and Relative Price

- Nominal price of a good is a price expressed in terms of money.
- Relative price of a good is a price expressed in terms of another good
- Relative price of good A (in terms of good B) = Money price of good A/Money price of good B.

Key concept

- If nominal price of a good increases (while prices of other goods remain unchanged), relative price of that good increases.
- If nominal prices of all the goods increase by the **same percentage (not same amount)**, the relative price remains unchanged.

Exam Focus: Relative price and the law of demand

- An increase (a decrease) in the **relative** price of a good will result in a decrease (an increase) in its relative quantity demanded, ceteris paribus.
- Reminders:
  - Units of relative price is in terms of another good, not dollar sign.
  - Relative price should be expressed in terms of decimal number instead of fractions.

- Conditions when this question type applies:
  - there is a change in price / cost (opportunity cost applies as well)
  - the presence of higher quality and lower quality goods or services
  - concerning the improvement or worsening of quality of goods and services

Structured Question Answer Key

e.g. The urban taxi fare for the first 2 km was raised from $18 to $20. What is the change to the average duration of taxi trip?

1. State the change in price: The urban taxi fare for the first 2 km was raised from $18 to $20.
2. Compare the change in relative price: Price of short-trip taxi increases **relative** to long-trip taxi price.
3. State the law of demand: According to the law of demand, people will take **relatively** more long-trip taxi.
4. Result: The average duration of trip of taxi will decrease.

Key concept

- Do not mix up the effect on **relative** quantity demanded and quantity demanded!
- When the price increases, the quantity demanded of both short and long duration taxi trip actually both **decreases** according to the law of demand.

Past Paper Practice

Common Question Type 1: Which of the following is INCONSISTENT with the law of demand?

- *Key concepts in tackling these types of question:*
  - *identify whether law of demand can be applied in the first place (is there a change in price or other factors?)*
  - *fulfill the negative relationship between price and quantity demanded?*
  - *when the price or cost increases, customers tend to be more generous and opt for better quality goods*