



Economics 103

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Topic 1: Introduction

What microeconomists do,
why they are so weird, and
other stories.

Two kinds of economics

- Macroeconomics ...
 - ... is about big aggregates
 - (unemployment, inflation, output, ...)
 - ... is not what we do in Economics 103
- Microeconomics ...
 - ... is what we do in Economics 103

Free to choose

- (Micro)economics is about making choices or making decisions.
 - We live in a world of *scarcity*.
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Why are microeconomists weird?

- (Micro)economists think about decisions in terms of trade-offs:
 - Every decision has good things and bad things associated with it.
 - We call good things *benefits* and bad things *costs*.
 - They don't have to be monetary costs and benefits. But to make life easy, we will use dollars to measure benefits and costs – at least for now.

Decisions and opportunity cost

- Every decision to do something involves not being able to do something else (scarcity).
 - Every decision has an *opportunity cost*
- More precisely, the opportunity cost of a decision is

Costs and benefits

- Example: should you go see a movie or study for Econ 103?

- Costs and benefits of going to see a movie:

benefit (enjoyment): \$10

- cost of ticket: - \$8

= total:

All costs are opportunity costs

- “Should I go see a movie” in isolation makes no sense to an economist:
 - In the example, you might think that since the benefit is greater than the *explicit* cost, you should go see a movie.
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 - But this explicit cost is only one of the opportunity costs of seeing a movie.

All costs are opportunity costs

- Remember opportunity costs:
 - One of the opportunity costs is giving up the opportunity to do the next best thing:
 - We sometimes call this an *implicit* cost.
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- To make good decisions, you need to take all opportunity costs into account.

Making decisions

Benefits and costs

Economists v Accountants

- Let's say you have a business and want to know whether it's worth keeping it open.

Revenue	\$100,000
- Explicit costs	- \$60,000
- Depreciation	- \$5,000
= Accounting profit	\$35,000

Economists v Accountants

- So your accountant would say that your business makes a profit.
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- If you want to know whether you should stay in that line of business, you need to take all opportunity costs into account.
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“Yes or no” decisions, take 1

- The way to make “yes or no” decisions is to
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But ... sunk costs

- Example:
 - You have already paid \$10 for a non-refundable ticket to a football game.
 - Your friend has a free ticket.
 - On the day of the game, there is a tremendous snowstorm.
 - If you both have the same tastes, who do you think is more likely to attend the game?

But ... sunk costs

- *Sunk costs* are costs that you incur regardless of what decision you take
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“Yes or no” decisions, take 2

- The way to make “yes or no” decisions is to
 - add up all the benefits
 - subtract all the opportunity costs
 - see if the benefits are greater than all the costs
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“How much” decisions

- Not all decisions are “yes or no” decisions.
- Most decisions are “how much” decisions.
 - Economists make “how much” decisions by using *marginal analysis*.

Marginal analysis

- Economists make “how much” decisions by thinking about them one step at a time.
 - Think of it as trying to climb a mountain in the dark. You take one step and if it's a step up, that was a good step to take. If the step is a step down, then that wasn't good.
 - It's called *marginal analysis* because you're pushing out the edge (the “margin”) a little bit at a time, and then see if that was a good or a bad step.

Marginal cost, marginal benefit

- The *marginal cost*:
- The *marginal benefit*:
- Example: lawn-mowing business
 - Costs:
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 - Benefits:
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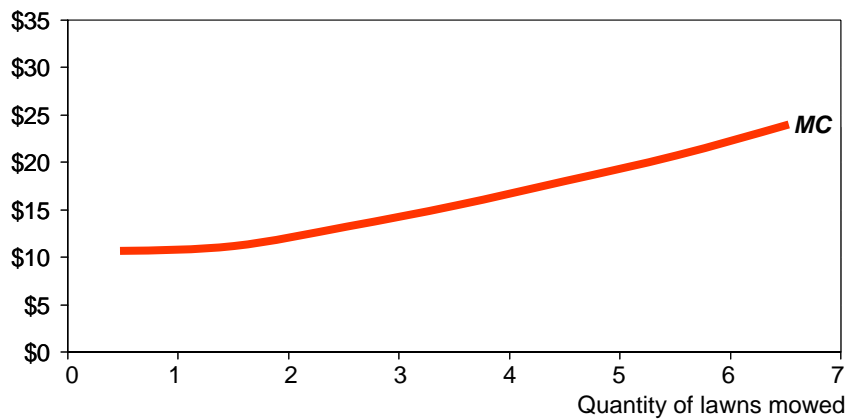
Marginal cost

- Marginal cost of mowing lawns

<i>Quantity of lawns mowed</i>	<i>Total cost</i>		<i>Marginal cost of lawn mowed</i>
0	\$0		
1	10.50		\$10.50
2	21.75		11.25
3	35.00		13.25
4	50.50		15.50
5	68.50		
6	89.25		
7	113.00		

Marginal cost curve

Marginal cost of lawn mowed

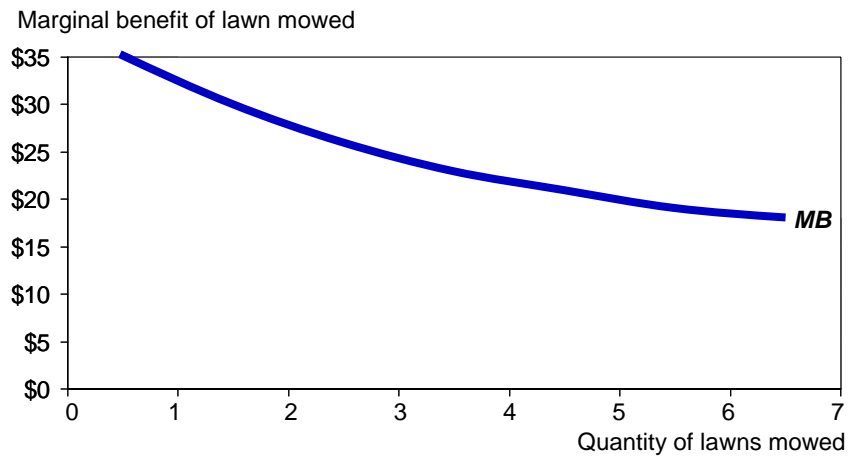


Marginal benefit

■ Marginal benefit of mowing lawns

<i>Quantity of lawns mowed</i>	<i>Total benefit</i>	<i>Marginal benefit of lawn mowed</i>
0	\$0	
1	35.00	\$35.00
2	65.00	30.00
3	91.00	26.00
4	114.00	23.00
5	135.00	
6	154.00	
7	172.00	

Marginal benefit curve



Marginal analysis

- Comparing marginal benefit and marginal cost

<i>Quantity of lawns mowed</i>	<i>Marginal benefit of lawn mowed</i>	<i>Marginal cost of lawn mowed</i>
0	\$35.00	\$10.50
1	30.00	11.25
2	26.00	13.25
3	23.00	15.50
4	21.00	18.00
5	19.00	20.75
6	18.00	23.75
7		

Marginal analysis

Marginal cost, marginal benefit of lawn mowed

