

CIE Economics AS-level

Topic 1: Basic Economic Ideas and Resource Allocation

a) Scarcity, Choice and Opportunity Cost

Notes



- 📖 The basic economic problem is scarcity. Wants are unlimited and resources are finite, so choices have to be made. Resources have to be used and distributed optimally.
- 📖 For example, if you only have £1 and you go to a shop, you can buy either the chocolate bar or the packet of crisps. The scarcity of the resource (the money) means a choice has to be made between the chocolate and the crisps.
- 📖 This gives rise to **opportunity cost**. The opportunity cost of a choice is the value of the next best alternative forgone. In the above example, the opportunity cost of choosing the crisps is the chocolate bar.
- 📖 If a car was bought for £15,000 and after 5 years the value depreciates by £5,000, the opportunity cost of keeping the car is £5,000 (which could have been gained by selling the car), regardless of the starting price.
- 📖 Opportunity cost is important to economic agents, such as consumers, producers and governments. For example, producers might have to choose between hiring extra staff and investing in a new machine. The government might have to choose between spending more on the NHS and spending more on education. They cannot do both because of finite resources, so a choice has to be made for where resources are best spent.
- 📖 When producing goods, the following questions have to be considered:
 - **What to produce:** determined by what the consumer prefers. Consumers tell producers what they prefer by demanding goods and using their 'spending votes'.
 - **How to produce it:** producers seek profits and aim to minimise production costs
 - **For whom to produce it:** whoever has the greatest purchasing power in the economy, and is therefore able to buy the good
- 📖 **Ceteris paribus** is a key assumption made in economics. It assumes that all other things are held constant or are equal.
- 📖 For example, the effects of an interest rate change can be estimated using the assumption of ceteris paribus. The basic principle is that the higher the interest rates, the more likely consumers are to save. However, without the assumption of ceteris paribus, other factors such as consumer confidence and average incomes will affect the savings rate.



The margin and decision making at the margin:

-  To think at the margin means to think about what the next step or action means for the consumer.
-  Economic theory suggests that each extra unit of a good or service consumed gives the consumer less utility. This is the **law of diminishing marginal returns**.
-  Every time an individual makes a decision, they make it considering what the additional cost or benefit will be to them. The options which gives the consumer the largest marginal benefit is likely to be the option chosen.
-  Making decisions at the margin usually involves small changes in resources. It could consider how one extra hour could be spent, for example.
-  This helps to simplify decision making, and could help optimal decisions to be made.

Short run, long run, very long run:

-  In the short run, at least one factor of production is fixed. This means there is a limit to the extent it can respond to price changes.
-  In the long run, all factors of production are variable. This means firms can increase their capacity by increasing their factors of production.
-  In the very long run, the firm's factors of production are variable, as are the inputs beyond their control. This means land, labour, capital and entrepreneurship are variable, as are government rules and technology.

