Microeconomics - The Basics

Economic Thinking

Scarcity – Everything is scarce
- Constraints – all choices are constrained
- Institutions – rules guide choices
- Tradeoffs – making choices involves weighing alternatives
- Opportunity cost – the cost of a choice is the next best alternative forgone

Rationality – People choose purposively
- Incentives - people respond to incentives
- Marginality – people choose at the margin
- Information - people get just enough information

Markets work …most of the time
- Specialisation - people do what they do best
- Trade - both parties benefit from trade
- Price - signal that brings goods to market
- Markets - trade allows scarce resources to be used efficiently

Rationales for government intervention

Market failure – Helping the market work better
- Externalities – unintended, uncompensated impacts on 3rd parties
- Public goods – non-rival and non-excludable
- Market power – monopolist sets quantity or price
- Information asymmetry – parties have different information
- Missing markets – not possible to trade or transact
- Rationality – bounded ability to make good decisions

Equity – Making distribution of goods and services fairer
Others eg
- Government failures
- Legal framework
- Residual risk bearer
- Morality

Policy levers

Regulation
- Legal framework
- General
- Industry

Taxation
- General taxation
- Excise taxes

Funding
- Redistribution
- Services
- Subsidies

Ownership/provision
- Public goods
- Infrastructure

Information
- Disclosure
- Provision

Behavioural "nudges"
- E - Easy
- A – Attractive
- S – Social
- T – Timely

Policy decisionmaking

Assessment criteria
- Effectiveness – will it work?
- Equity – is it fair?
- Efficiency - do the benefits outweigh the costs/ does it distort behaviour/ does it prevent innovation?

Cost Benefit Analysis
- Discount rate
- NPV=PV benefits- PV costs
- B:C Ratio = PV benefits/PV costs

Uncertainty and complexity
- Robust policy analysis
- Systems thinking
- Best available evidence
- Transparency about limitations and risks
- Assessment of options
- Feedback loops and learning