



MARGINAL THINKING

UNIT II: 5 PRINCIPLES OF ECONOMICS



THINKING LIKE AN ECONOMIST

- It is not about doing something versus not doing something
- Economists think “what to do more of or what to do less of”
 - Maximize profit
 - Maximize efficiency
- **Marginal thinking** requires decision-makers to evaluate whether the benefit of one more unit of something is greater than its cost.
 - “Is cleaning under the refrigerator worth the time if I am hosting a party?”
 - Generally people won’t because it isn’t an area that is visible – it’s simply not worth the unit of time to do it!

RATIONALITY

- **Rational:** Systematically and purposefully doing the best you can to achieve your objectives
- Economists assume all people are rational
- Consumers want to purchase the bundle of goods and services that allows them the greatest level of satisfaction given their incomes and the prices they face.
- Firms want to produce the level of output that maximizes the profits.
- Generally, rational decisions are influenced by **incentives, opportunity cost, and trade-offs!**



QUESTIONS

- How many people should a company hire?
- At what point does the company begin to *lose* money?
- What might happen if a shift in prices occurs?
- If production decreases should the company let someone go?
- If the price of overheads costs increases how might customers react?



SIMPLE EXAMPLE

HOUR	WAGE	VALUE OF TIME	NET GAIN
1	\$10	\$2	\$8
2	\$10	\$2	\$8
3	\$10	\$3	\$7
4	\$10	\$3	\$7
5	\$10	\$4	\$6
6	\$10	\$5	\$5
7	\$10	\$6	\$4
8	\$10	\$8	\$2
9	\$15	\$9	\$6
10	\$15	\$12	\$3
11	\$15	\$18	-\$3
12	\$15	\$20	-\$5

- The hourly wage represents what I earn for working an extra hour - it is the marginal gain or the marginal benefit.
- The value of time is essentially an opportunity cost - it is how much I value having that hour off. In this example it represents a marginal cost - what it costs me by working an additional hour.
- The increase in marginal costs is a common thought.
- However, as I start to work more hours it reduces the number of hours I have for other activities.
- I have to start giving up more and more valuable opportunities to work those extra hours.

APPLIED ECONOMICS

OPTIONS	BENEFIT	OPPORTUNITY COST
1 st hour of extra study time	Grade “C” on test	1 hour of sleep
2 nd hour of extra study time	Grade “B” on test	2 hours of sleep
3 rd hour of extra study time	Grade “A-” on test	3 hours of sleep
4 th hour of extra study time	Grade “A-” on test	4 hours of sleep

- Thinking at the margin forces people to make decisions or **trade offs**
- **Opportunity costs** come back into play
- As production increases, benefits tend to decrease
 - People must determine at what margin it is “still worth it”