

Some Tools of The Economist

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I. Opportunity Costs

- a. **OPPORTUNITY COSTS:** the highest valued alternative sacrificed in order to choose
 - i. Different for each person
 - ii. Subjective
- b. Your opportunity cost is only known by you
 - i. A teacher does not know what a student choose to do instead of coming to class
- c. Difficult (impossible?) for others to make decisions for you
 - i. The government
 - ii. Your friends
 - iii. Parents
- d. Money does **NOT** represent the total opportunity cost of an action
 - i. There are also intangible assets that are factored into opportunity costs
 - ii. I.E. Giving up sleep to come to class

II. Opportunity Costs Impact Decisions

- a. Billy just got accepted to college! If he attends, his tuition and books will total \$10,000 a year. If he does not attend, he will clean rooms at the Madison chain of hotels and earn \$15,000 a year. Let's find the opportunity cost of Billy attending four years of college!

What is given up?

Tuition	$\$10,000 \times 4 = \$40,000.00$	Direct cost	HAVE TO PAY
Foregone Wages	$\$15,000 \times 4 = \$60,000.00$	Indirect costs	GIVE UP THIS
	$\$100,000$		TOTAL LOSS

- a. It takes one hour to travel from New York City to Washington D.C. by plane, but it takes 4 hours to drive. The airfare is \$200 and the gas and vehicle wear and tear is \$80. Other than the cost of time, how many dollars would an individual gain by choosing air travel if, and only if, his time were valued at \$40.00 per hour? how many dollars per hour?

$$\text{Difference in } \$\$ = \$200 - 80 = \$120$$

$$\text{Difference in Hours} = 4 - 1 \text{ hr} = 3 \text{ hr}$$

$$\$120 / 3 \text{ hr} = \$40.00$$

an option

class

,000 per year. If
15,000 per year.

Y
5

takes four hours
ings constant,
at more than

Professors are more likely to fly- time is more valuable than money

Students are more likely to drive- money is more valuable than time

III. Failure to consider opportunity cost

- a. Leads to false conclusions and poor decision making
- b. "This stadium improved the quality of life in Dallas and created jobs."
 - i. Ignored cost to build stadium
 - ii. Stadium built by government
 - iii. Government paid by tax payers
 - iv. Tax payers can't pay for daily needs i.e. milk at Walmart
 - v. No one is buying Walmart's inventory due to high taxes- Walmart employee
- c. Only true from stadium greater than benefit from other uses

IV. Trade makes both better off

- a. Trade is voluntary
- b. We only engage in mutually beneficial trades
 - i. Selling text books- one student gets money and the other student gets a cheaper book
- c. Increases the total wealth in an economy
- d. Moves goods to people who value them most

V. Transaction Costs

- a. **TRANSACTION COSTS:** the time, effort, and other resources needed to search out, negotiate, and complete an exchange
- b. Transaction costs are a barrier to trade
 - i. Can either buy a banana for \$0.69 or grow the bananas in your backyard and incur the cost of time/money/effort

VI. Middlemen reduce transaction costs

- a. **MIDDLEMAN:** a person who buys and sells goods or services or arranges trades
- b. Middlemen make trades more efficient and lower their overall costs

VII. Property Rights

- a. **PRIVATE PROPERTY RIGHTS:** involved three things
 - i. Right to exclusive use
 - ii. Legal protection against invasion