

ECO2013 - Midterm 1: Dr. Holcombe

CH 1:

Key Terms:

Scarcity: Fundamental concept of economics that indicates that there is less of a good freely available from nature than people would like

Choice: The act of selecting between alternatives

Resource: An input used to produce economic goods: Land, labor, skills, and natural resources. And human-made tools and equipment provide examples. Throughout history, people have struggled to transform available, but limited, resources into things they would like to have --- economic goods

Capital: Human-made resources, such as tools, equipment, and structures used to produce other goods and services. They enhance our ability to produce in the future.

Objective: A fact based on observable phenomena that is not influenced by differences in personal opinion.

Subjective: An opinion based on personal preferences and value judgments

Rationing: Allocating a limited supply of good or resources among people who would like to have more of it. When price performs the rationing function, the good of the resource is allocated to those willing to give up the most "other things" in order to get it.

The method of rationing influences the nature of competition... **Competition:** Is a natural outgrowth of scarcity and the desire of human beings to improve their conditions

Economic Theory: A set of definitions, postulates, and principles assembled in a manner that makes clear the "cause and effect" relationships.

Micro economics: the branch of economics that focuses on how human behavior affects the conduct of affairs within narrowly defined units, such as business households or business firms

Macroeconomics: the branch of economics that focuses on how human behavior affects outcomes in highly aggregated markets, such as markets for labor or consumer products

4 broad categories of resources:

1. **Land** (natural resources)
2. **Labor** (human resource - mental or physical)
3. **Capital** (physical - man made or financial)
4. **Entrepreneurship** (brings together all of the above)

4 Returns/ incomes generated from above:

1. **Land** (charge rent)
2. **Labor** (wages)
3. **Capital** (charge interest)
4. **Entrepreneurship** (make profit)

Because of scarcity, we need a way to ration these resources.

Communism: allocating by need

Capitalism: allocating by price

8 guidelines to Economic thinking

1. There is ALWAYS a trade-off

- a. Opportunity cost: highest value thing you give up when you decide to do one thing over another.
- b. When you use resources, you give up the opportunity to use them in a different way.
- c. Cronyism: concentrated money and power given to friends of the government (Cuba)

2. Individuals choose purposefully, therefore economically

- a. We try to get the most for the least
- b. The basis for a decision maker's alternatives is based on utility
- c. Utility - the subjective benefit or satisfaction a person expects from a choice or course of action
 - i. Highest utility for the lowest cost is desired
- d. Rational choice isn't always the "right" choice
 - i. Motorcyclists can not wear a helmet because they don't like helmet hair, economists still say this is a rational choice

3. Incentives Matter

- a. People respond to incentives in predictable ways
- b. Ex: does FSU want us to park in handicapped spots? How do we know?
Fines = disincentives.
- c. As personal cost of an option increases, person is less likely to choose it

4. Economic thinking is marginal thinking.

- a. People make decisions at the margin (living incrementally)
- b. When making a choice between two alternatives, individuals generally focus on the difference in the costs and benefits between alternatives
- c. Marginal - term used to describe the effects of a change in the current situation.
Example: A producer's marginal cost is the cost of producing an additional unit of a product, given the producer's current facility and production rate.
- d. Additional = substitute word for "marginal"

5. Information is a costly good

- a. Rational ignorance (cost of knowing is greater than the benefit)

- b. TIME needed to gather info is scarce, making info costly
 - c. Ex: we research a lot more when buying a car vs. buying a pen
- 6. Remember Secondary Effects**
- a. EX: requiring passengers to purchase extra seat for baby to make them safe is a lot more expensive so families choose to drive instead. Risk of car accident is a lot higher than risk of plane crash, so ultimately child is less safe in the car. Airlines did not implement new policy.
- 7. Value of a good or service is subjective**
- 8. The test of a theory is it's ability to predict**
- a. Economic thinking is Scientific Thinking: developing a theory from basic principles and testing it against events in the real world. Good theories are consistent with and help explain real world events. Theories that are inconsistent with the real world are invalid and must be rejected
 - b. Positive economics: The scientific study of "what is" among economic relationships
 - i. Positive economic statements involve potentially verifiable or refutable propositions
 - 1. Ex: "if the price of gas goes up. People will buy less". We can statistically analyze, investigate, and estimate the correctness of that statement. It does not need to be correct, it NEEDS TO BE TESTABLE.
 - ii. Normative Economics: Judgments about "what ought to be" on economic matters. Normative economic views cannot be prove false bc they are based on value judgments.
 - iii. ex: "we should have fewer parking spaces and more green on campus" - normative

Pitfalls to avoid in Economic Thinking

1. Violating the "ceteris paribus" condition: control variables, avoid drawing the wrong conclusion.
 - a. "ceteris paribus" is a Latin term meaning "other things constant" that is used when the effect of one change is being describes. Recognizing that is other things changes, they could also affect the result.
 - b. Economists often describe the effects of one change, knowing that in the real world, other things might change and also change effect.
2. Good intentions do not always guarantee good outcomes keeping in mind secondary effects
 - a. One of the great mistakes is to judge policies and programs by intentions rather than results.
3. Association is not causation.
 - a. EX: Umbrellas do not cause rain—they are associated with rain.
4. The fallacy of composition
 - a. What is true for one is not necessarily true for all.