

ECO2013 Final Exam Study Guide

Chapter 1: What Is Economics About?

- Economics is about choice, and moreover, it is about the choices that individuals make, as the subject of **Economics** is, by definition, *the study of human behavior*.
- All economic/human behavior (all the decisions that we make involving money) is affected by the constraints of **Scarcity**.
- **Scarcity** is the fundamental concept of economics. Economists believe that virtually everything we use in life is scarce (air and seawater are 2 rare exceptions).
 - Everything's scarce because our desires in life are virtually unlimited, which is why a more specific definition of Economics (Exam 1 Q&Answer) is that economics is *the allocation of scarce resource to satisfy virtually unlimited wants*.
 - Our time is even scarce: when studying for finals you must make the decision should I get an extra hour of sleep or instead, an extra hour of studying?

Chapter 1: Outstanding Economist: The Importance of Adam Smith, the Father of Economic Science

- Adam Smith is regarded as the father of capitalism. In 1776 he published *An Inquiry into the Nature and Causes of the Wealth of Nations* or put simply, "Wealth of Nations". As the title implies, his objective was to explain why certain nations are wealthier than others.
- He revolutionized conventional thinking about wealth by arguing that a country's wealth has little or nothing to do with how much gold and silver a country holds, but it is determined according to the goods and services a country produces and consumes.
- He also argued against a centralized style of government using his
- **Invisible hand theory**: *a free and competitive market place where individuals are allowed to act freely and pursue their own self-interest offers the greatest benefit to a society*.
- The Scottish philosopher's argument laid the foundation for capitalism and landed him the title of "the father of modern economics".

Chapter 1: The Economic Way of Thinking

- The common expression, which is regarded as, a cornerstone in economic thinking, “**There is no such thing as a free lunch**” means exactly that *the use of resources required producing any good has an opportunity cost because of scarcity*.
- Moreover there is **ALWAYS** a cost associated with everything we do and every decision we make for the same reason that there’s always an opportunity
- Taking the expression literally, if your friend treats you to lunch it is still **NOT** free, because while you aren’t losing any money (your friend’s highest O.C.) you are still giving up your time- which theoretically could have been spent doing any number of different other things other than eating lunch.

Chapter 1: The Economic Way of Thinking

- Economists make the assumption that “**People are rational decision makers**”.
 - This may sound slightly confusing at first since we all know people that tend to make incredibly irrational decisions at times, but you need to see these examples as outliers. People being rational essentially means that *individuals make purposeful decisions with an aim of maximizing their utility (means happiness level) in a given task*.
- Rational decision making involves **thinking at the margin**, which simply means that *action takes place (a decision is made) whenever the marginal (additional) benefit of their action exceeds its marginal cost*.

Chapter 1: The Economic Way of Thinking

- **Incentives Matter** – basically means that an individual’s choice is influenced in a predictable manner by means of a change in incentives.
- **Normative VS Positive Statement**: Difference is
 - **Normative** = Based on Opinion
 - **Positive Statement** = Based on Fact

Chapter 2: What Shall We Give Up?

- In each and every decision we make in life there will **ALWAYS** be an **Opportunity Cost**: *the cost of losing the 2nd best choice when we make a decision*. In other words it’s our best alternative. Money is an easy alternative cost to understand. Every time you purchase anything money is deducted from your bank account, because you have decided that the item you are purchasing (i.e. this study guide) offers greater value to you than having \$10 additional dollars in your bank account. However, don’t think just money, opportunity costs are

everywhere. The most likely example of O.C. on the final will probably deal with "Time". The example I mentioned earlier to explain scarcity applies here as well:

- *When studying for finals you must make the decision should I get an extra hour of sleep or instead, an extra hour of studying?*
 - If you're sleep deprived and think you are adequately prepared for the test: you'll probably choose the extra hour of sleep. Then if you score an 89% on the exam, you'll probably wish you stayed up that extra hour- and not receiving an "A" on the exam is your opportunity cost.
 - If you say fuck getting 8 hours of sleep and choose to study late into the night, which leads to you getting an "A" on the final exam then you're "A" in the class is your most desired choice, making your sleep deprived state (having an incredible shitty feeling body the next day) the greatest alternative you passed over or the highest **opportunity cost** that comes with receiving an "A" in the class.

Chapter 2: Trade Creates Value

- The Key term here is **Transaction Cost** – The time, effort, and other resources needed to complete an exchange.
 - The best example I can think of is how people often hire a realtor as opposed to selling their house on their own. A realtor's commission of say 5% is costly, but the time, effort, and energy involved in selling your house on your own are also costly.
 - Often time's people see the transaction costs associated with selling their house as greater than the commission they pay a realtor.
 - Following this realty example further, when your realtor informs you that a prospective buyer has offered \$180,000 on a \$200,000 listing price, you may choose to sell your house at that price even though you're forgoing \$20,000 of additional money.
 - You are going to choose to sell your house at that price because the transaction costs involved with waiting may include 6 more months of open houses and mortgage and utility payments in addition to having no guarantee that the next offer will be any better than \$180,000.
- In other words, you sell your house, because the transaction costs of not selling exceed the transaction costs of selling (which is \$20,000)

Chapter 2: The Importance of Property Rights

- **Property Rights** the right to use, control, and obtain benefits from a good or resource. When exchange occurs it is really the exchange of property right from one person to another.
- **Private Property Rights** are rights that are exclusively held by an owner which allows for the exclusive use of the property and protected against invasion by others. Private property can be transferred, sold, or mortgaged at the discretion of the owner.