

Principles of Macroeconomics
ECO2013
Prof. Joab Corey

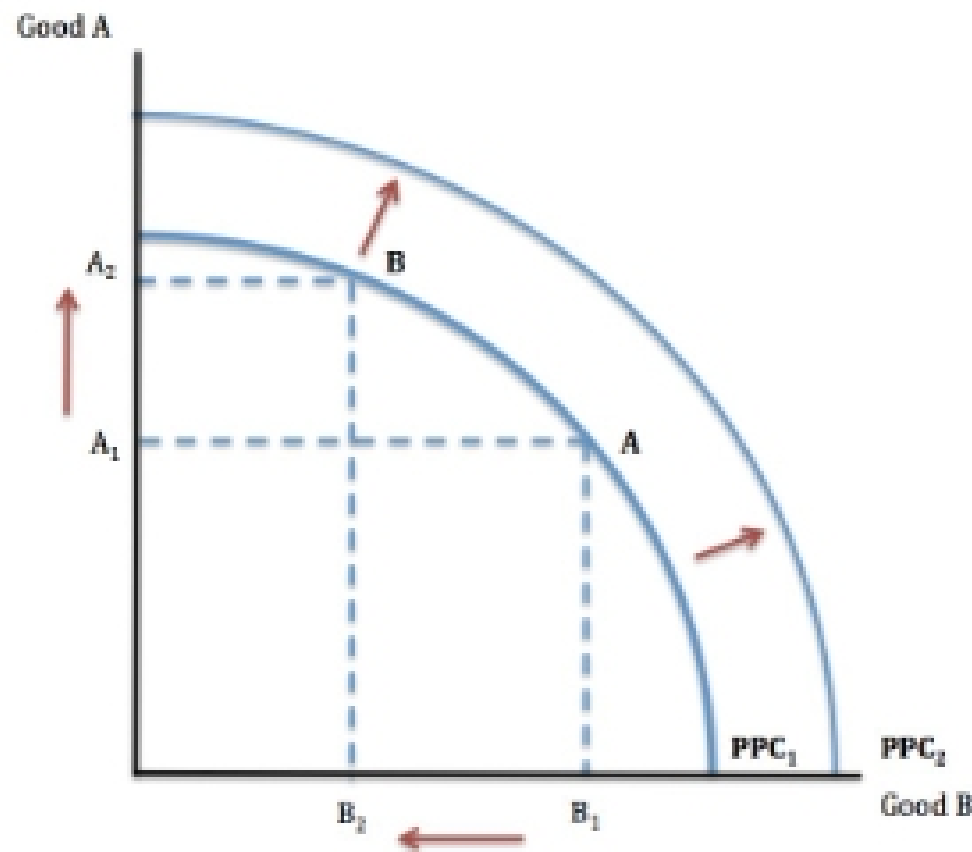
Exam Study Guide

Economics: the study of how we make choices under scarcity

- Scarcity: The concept that there is less of a good freely available in nature than we would like
 - Scarcity necessitates rationing
 - Rationing: the allocation of scarce goods to those who want them
 - Scarcity leads to competitive behavior
- Resources: an input used to produce an economic good
 1. Human Resources (Human capital)
 2. Physical Resources (Physical capital)
 3. Natural Resources
- The Economic way of thinking
 1. Resources are scarce so decision makers must make tradeoffs
 - o Opportunity Cost: the highest valued alternative that is and must be sacrificed when making a decision
 2. Individuals are rational: they try to get the most from their limited resources
 3. Incentives matter: choice is influenced in a predictable way by changing incentives
 4. Individuals make decisions at the margin
 - o Marginal: describes the effect of a change in a current situation
 5. Information helps us make better decisions, but information is costly
 6. Beware of secondary effects: economic actions generate both direct and indirect effects
 7. The value of a good or service is subjective: worth different amounts to different people
 8. The test of a theory is its ability to predict
- Positive vs. Normative Economics
 - Positive: The scientific study of what is (testable)
 - Normative: Judgments about what ought to be (not testable)
- 4 Pitfalls to avoid in Economic Thinking
 1. Violation of the Ceterus Paribus principle
 - Ceterus Paribus: All other things constant
 2. The belief that good intentions guarantee desirable outcomes
 - Nirvana Fallacy: The logical error of comparing the actual situation with its idealized counterpart rather than the actual alternative.
 3. The belief that association is causation
 - Just because two things happen together, they do not cause each other

4. Fallacy of composition: the fallacious belief that what is true for one is true for all
Ex. Standing at a football game
- Microeconomics vs. Macroeconomics
 - Microeconomics: focuses on how human behavior affects the conduct of affairs within individually defined units such as households or firms (trees)
 - Macroeconomics: focuses on how human behavior affects outcomes in highly aggregated markets such as the nations market for labor (forest)
 - Importance of Property Rights
 - Property rights include
 1. The right to exclusive use of the property
 2. Legal protection against invasion from other individuals
 3. The right to sell, transfer, exchange, or mortgage the property
 - 4 Incentives of Private Property Rights:
 1. Incentive to use resources in ways that are considered beneficial to others
 2. Private owners also have an incentive to care for and manage what they own
 3. Private owners have an incentive to conserve for the future
 4. Private owners have an incentive to make sure their property does not damage your property
 - Production Possibilities Curve: outlines all possible combinations of total output that could be produced assuming-
 1. A fixed amount of productive resources
 2. A given amount of technical knowledge
 3. A full and efficient use of resources
 - The slope of the curve indicates the amount of one good we must give up to produce more of the other good

Productions Possibility Curve



- 1) A move along the PPC curve is demonstrated from point **A** to point **B**. At these new levels of production, less alcohol is produced, however, the *new allocation of resources* has resulted in an increased G.P.A..
- 2) A shift of the PPC curve itself is demonstrated by the move from PPC_1 to PPC_2 . An outward shift, such as this, could be caused by (1) an increase in the level of technology, (2) a positive change in the resource base, (3) an increase an investment, or (4) a positive change in the rules that govern the functions of the economy.

- Factors:
 1. A change in an economy's resource base
 - Increase-> shift outward
 - Decrease-> shift inward
 2. Changes in technology
 3. A change in the rules under which the economy functions
 4. Change in work habits

-Law of Comparative Advantage: The total output of a group of individuals, an entire, economy, or a group of nations will be greatest when the output of each good is produced by whoever has the lowest opportunity cost
- Economic Organization
 - Every economy faces 3 questions:
 1. What will be produced?
 2. How will it be produced?
 3. For whom will it be produced?
- Socialism: