

Macro Study guide exam 1

1. Chapter 1

- a. Economics is the study of how we make choices under scarcity
 - i. Scarcity
 - 1. the state of being scarce or in short supply; shortage
- b. 8 guideposts to economic thinking (the **DO** list)
 - i. Resources are scarce, so tradeoffs must be made (Know the concept of opportunity cost)
 - 1. The cost of an alternative that must be forgone in order to pursue a certain action. Put another way, the benefits you could have received by taking an alternative action.
 - ii. Individuals are rational: They try to get the most from their limited resources
 - iii. Incentives matter
 - iv. Individuals make decisions at the margin
 - v. Information helps us make better choices but is costly
 - vi. Beware of secondary effects
 - vii. The value of a good or service is subjective
 - viii. The test of a theory is its ability to predict
- c. Positive vs normative economic statements
 - i. **Positive economics** is objective and fact based, while **normative economics** is subjective and value based. **Positive** economic statements do not have to be correct, but they must be able to be tested and proved or disproved. **Normative** economic statements are opinion based, so they cannot be proved or disproved.
- d. 4 pitfalls to avoid in economic thinking (The do **NOT** do list)
 - i. Violation of the ceteris paribus principle
 - 1. Ceteris paribus means "all other things remaining equal"
 - a. Important because in economics the real world is usually hard to isolate all the different variables
 - ii. The belief that good intentions equal desirable outcomes
 - 1. Good intentions can easily lead to bad outcomes in an economic or business standpoint
 - iii. The belief that association is causation
 - 1. Things can be associated with each other but actually not be caused by one another, another variable may be at play
 - iv. The fallacy of composition
 - 1. when one infers that something is true of the whole from the fact that it is true of some part of the whole

2. Chapter 2

- a. Voluntary trade creates value and ultimately leads to economic progress
 - i. The candy game
 - ii. One perception of value for a specific good may differ from another's, thus the value for each may be perceived as different. Allowing people to trade for what they want leaves everyone significantly happier than if trade barriers were in place or were forced to trade.

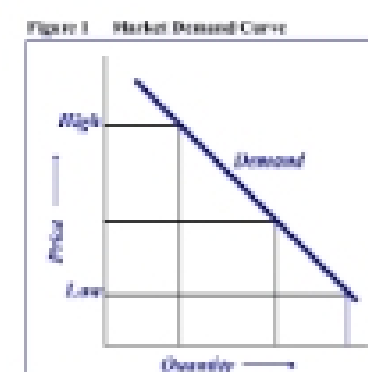
- b. Characteristics and (4) incentives of private property rights
 - i. Incentive to use resources in ways that other people value
 - ii. Incentive to care for and manage what you own
 - iii. Incentive to conserve for the future
 - iv. Incentive to make sure your property does not damage someone else's property
- c. Production possibility curve (PPC)
 - i. Efficient= on the line
 - ii. Inefficient= under the line (within the original line)
 - iii. Unattainable= over the line
 - iv. Only have a specific number of resources so giving more to one specific good will reduce the amount given in another. Only have so many resources to use.
- d. 4 factors that shift the PPC
 - i. Change In resource base
 - ii. Change in technology
 - iii. Change in rules/laws under which an economy operates
 - iv. Change in work habits
- e. The law of comparative advantage and calculation of opportunity cost
 - i. Law of comparative advantage
 - 1. The ability of a firm or individual to produce goods and/or services at a lower opportunity cost than other firms or individuals
 - 2. Choosing one thing or another, but not both. We must choose one
 - ii. Calculating opportunity cost
 - 1. Can produce 1 pound of rice vs producing 2 pounds of corn
 - a. Which is better, it's for you to decide
 - b. But producing 2 pounds of corn has an opportunity cost of 1 pound of rice (in this hypothetical situation)
- f. 3 questions every economy faces
 - i. What are we going to produce
 - ii. How we are going to produce it
 - iii. For whom will it be produced (who gets it once it's made)
- g. Socialism vs capitalism
 - i. Socialism
 - 1. Redistribution from rich to poor, used to ensure equality within opportunities and outcomes
 - 2. Government intertwined in businesses
 - 3. Argued that this leads to inefficiencies because workers and managers lack any incentives to be innovative or do anything to cut costs
 - 4. Employment is almost guaranteed even if workers are not doing anything productive
 - ii. Capitalism
 - 1. Argues that inequality is essential to encourage innovation and economic development
 - 2. Private businesses will be owned by private individuals and government has very little role in economy

3. Profit incentives encourages businesses to be more efficient, cut costs, and innovate new products that people want
4. In times of recession employment rates tend to be high
5. Prices are determined by market forces and not by government
- iii. Capitalism works better at creating economic growth and prosperity due to its innovative and driving nature
 1. Continuously striving to be better and not complacent

3. Chapter 3

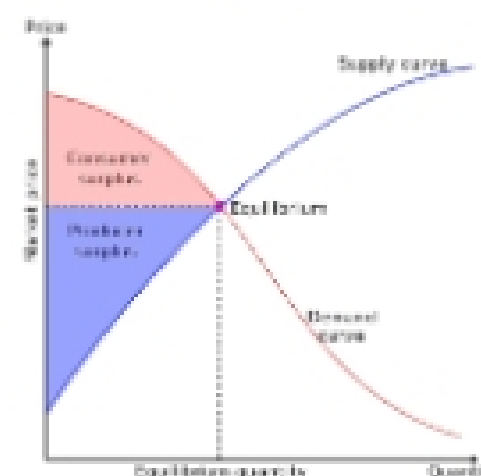
a. Law of demand

- i. States that, all else being equal, as the price of a product increases (\uparrow), quantity demanded falls (\downarrow); likewise, as the price of a product decreases (\downarrow), quantity demanded increases (\uparrow).



b. Consumer surplus

- i. Is the difference between the total amount that consumers are willing and able to pay for a good or service (indicated by the demand curve) and the total amount that they actually do pay (i.e. the market price).



1. Calculated by

- a. Form a triangle with the maximum quantity desired as your triangle base, the maximum price limit as the triangle height and the demand equation as the triangle hypotenuse. Calculate the area of your triangle using the formula $\frac{1}{2} \times \text{height} \times \text{base}$. This calculates the total consumer surplus from your equation.

c. Difference between the change in quantity demand vs a change in demand

i. Quantity demanded

1. a movement along the curve caused by a change in the price of the good in question

ii. change in demand

1. a shift of the curve caused by anything other than the change in price of the good in question

d. shifters In demand (P=price, D=demand, I=income)

i. Change in Consumer Income:

1. Normal Goods: $I \uparrow \rightarrow D(\text{normal}) \uparrow$
2. Inferior Goods: $I \uparrow \rightarrow D(\text{inferior}) \downarrow$

ii. Change in the Number of Consumers: $\# \text{ Consumers} \uparrow \rightarrow D \uparrow$

iii. Change in the Price of a Related Good:

1. Substitutes: $P(\text{substitutive}) \uparrow \rightarrow D \uparrow$
2. Compliments: $P(\text{compliments}) \uparrow \rightarrow D \downarrow$

iv. Change in Expectations

1. Expected Price: $P(\text{future}) \uparrow \rightarrow D(\text{current}) \uparrow$