

Macroeconomics Test 1 Study Guide

Chapter 1

Scarcity – Objective. Any good with a price. You can't get enough in nature, you can't get what you want.

Free Good – Opposite of scarce.

Resources – Anything used to produce other goods and services. Natural, human, or physical

Land – Actual place and “ingredients” needed to make good

Labor – Time and work invested in good

Capital – Money or wealth needed to start process of making good

Entrepreneurship – Actually selling the good

Poverty – Subjective. Personal opinion of whether someone meets an arbitrarily defined level of income.

Rationing – Allocating a limited supply of a good or resource among people who would like to have more of it.

Best way to ration is using price. It allows those to give up the most for the good.

Leads to a competitive behavior.

Economic Way of Thinking – a set of postulates and principles which makes clear the “cause-and-effect” manner of economics

1. There is always a tradeoff
 - a. We call it Opportunity Cost
 - b. The one most highly valued alternative that you give up when you do one thing rather than the other
2. People choose purposefully, therefore economically
 - a. If the cost is the same, you choose the one that they like the best
 - i. Known as “Utility”
 - b. Lowest Cost
 - c. Highest Utility
3. Incentives matter
 - a. Choice is influence in a predictable manner because of incentives
 - b. Motivation is the key
4. Economic thinking is marginal thinking
 - a. People make decision at the margin
 - b. Take things day by day
 - c. People choose right before buying what they want
 - d. We don't buy in total amounts
5. Information is a costly good
 - a. We pick and choose what we want to learn
 - b. We remain Rational Ignorance
 - i. If the cost of getting info is greater than the benefit of information
6. Remember the secondary effects
 - a. The indirect impact of an event or policy. They are most often unintended and overlooked
 - b. Increases in the money supply that give people more income but eventually result in higher inflation

7. The value of a good or service is subjective
 - a. What is something worth?
 - b. Whatever someone is willing to pay
8. The test of a theory is its ability to predict
 - a. Economics is a science, thus can be predicted

Positive Economics – attempts to determine “what is.” It involves potentially verifiable or refutable propositions

Simply must be testable

Normative Economics – attempts to determine “what ought to be.” Cannot be proven false because they are value judgments

What is desired?

Pitfalls to Avoid in Economic Thinking

Violating the *ceteris paribus* condition

C.P. – All things equal

A good is not only affecting by one thing

Good intentions do not guarantee good outcomes

Secondary effects are the main results

Even though it’s meant for good, it actually does harm

Statistical Murder

Association is not causation

Casual relationship exists simply because of the presence of statistical association cannot be considered automatically true

There exists more reasoning than just statistics

The fallacy of composition

What is true for the individual is not necessarily true for the entire group

This can be misleading when applied to the entire economy

Chapter 2

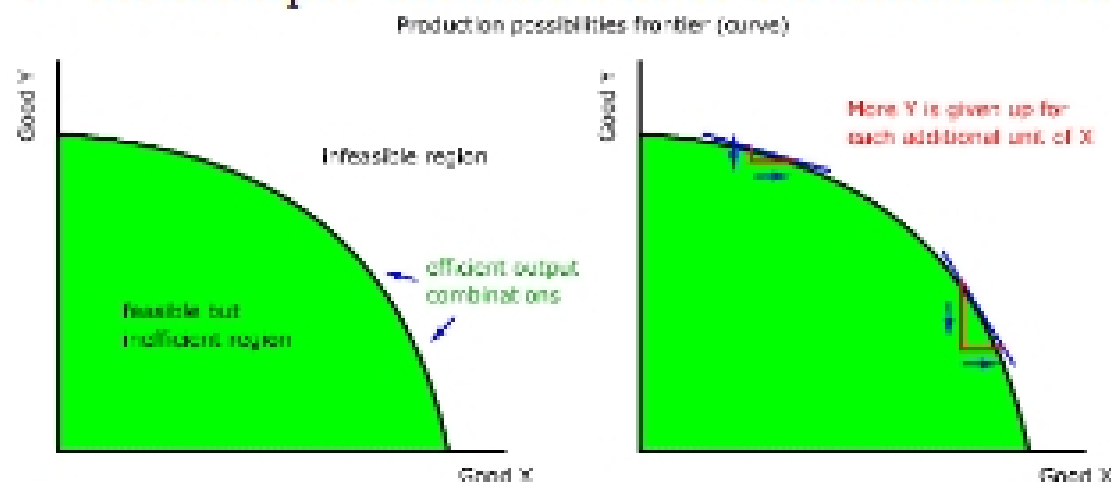
Tools of the Economist

1. Opportunity Cost – The choice do one thing is choice to not do something else. Subjective because depends on values of decision maker.
 - a. Time and Money
 - b. What could have been used to fund one thing, instead goes somewhere else, most of the time it goes to the wrong place
2. Trade Creates Value – One man’s garbage is another man’s treasure. Value of something depends on who is using it
 - a. Voluntary exchange
 - i. There is benefit being created
 - ii. Trade is not a zero-sum game; both parties are better made off
 - iii. Trades creates value
 - b. Transaction Costs – Barrier to trade
 - i. Any cost that results from buying something
 1. The time, effort, and other resources needed to search out, negotiate, and complete an exchange
 - ii. We spend less time exchanging

- iii. Middleman reduces transaction costs
 - 1. Reduces transaction costs

3. Property Rights

- a. Assumes free trade
 - b. Three elements
 - i. Right to exclusive use to your property
 - ii. Legal protection against other's using your property without permission
 - iii. Right to transfer, sell, exchange, or mortgage property
 - c. You can use property as long as you don't infringe on anyone's property rights
 - d. Good things that result from property rights
 - i. Property owners have the incentive to consider the desires of others and lose by not considering the rights of others (if not...increases OC)
 - ii. Strong incentive to use property in a way that benefits society
 - iii. Incentive to take care of your property to protect the value
 - iv. Tragedy of the commons
 - 1. People don't care about property if it's not theirs
 - v. Incentive to conserve, be careful with property, and improve property
- ### 4. Production Possibilities Curve (PPC) – Consumer (Y-Axis) vs. Investment (X-Axis)
- a. Linear – Equally well suited, Curved – Not equally well suited
 - b. Everything that can be produced in an economy
 - i. Amount of resources
 - ii. Always a trade off
 - iii. You can't get something for nothing
 - c. Shifting PPC
 - i. Outward means a greater amount of goods – reduce leisure time
 - 1. Increase Technology, Innovation, Entrepreneurship, Investment
 - ii. Inward means a less amount of goods
 - d. Inefficiency Point
 - i. You could produce more with resources without trade off



5. Comparative Advantage

- a. In the production of a good or service, the producer who produces at the lowest OC has the comparative advantage
- b. We want to TRADE at a HIGH OC
- c. We want to GET at a LOW OC
- d. Absolute Advantage – the ability of a party to produce more of a good or service than competitors, using the same amount of resources