Thinking Like and Economist

Economics: The study of how people make choices under scarcity and the results of these choices for society.

The Scarcity Principle: We have boundless wants, but resources are limited. Having more of one good thing usually means having less of another.

No Free-Lunch Principle: There is no such thing as a free lunch (even if it did not cost anything tangible it took time away from something else you could be doing).

- ➔ Scarcity Principle Examples:
    - ◆ Global Warming
    - ◆ Political Elections
    - ◆ Career Choices
    - ◆ Buying Bottled Water

Cost Benefit Principle: Take an action if and only if the extra benefits are at least as great as the extra costs. (Costs/Benefits are not just money)

- ➔ Assume people are rational.
    - ◆ A rational person has well defined goals and tries to fulfill those goals as best they can
- ➔ Would you walk to town to save $10 on an item?
    - ◆ Benefits are clear ($10)
    - ◆ What are the costs of "walking to town"?
- ➔ Hypothetical auction
    - ◆ Would you walk to town if the savings were $1000?
    - ◆ How about savings of $500? $100? $50?
    - ◆ If you would walk to town for savings of $9, but not for savings of $8.99, then your costs of walking must be $9

- The economic surplus of an action is equal to its benefit minus its cost

Opportunity Cost is the value of what must be foregone in order to undertake an activity.

- ◆ Consider explicit and implicit costs
- ◆ Examples:
    - Give up and hour of babysitting to go to the movies
    - Give up watching TV to walk to town
- ◆ Caution: NOT the combined value of all possible activities
    - Opportunity cost considers only your best alternative

- ➔ Simplifying assumptions
    - ◆ Which aspects of the decision are absolutely essential?
    - ◆ Which aspects are irrelevant?
- ➔ Abstract representation of key relationships

- The **Cost Benefit Principle** if a model
    - If costs of an action increases, the action is less likely
    - If benefits of an action increase, the action is more likely

Marginal Costs is the increase in total costs from one additional unit of an activity.

Average cost is total cost divided by number of units

Marginal Benefit is the increase in total benefit from one additional unit of an activity

Average Benefit is total benefit divided by the number of units.

Normative economic principle says how people *should* behave

- People shouldn't pollute so much
- SpaceX should launch as many rockets as possible

Positive Economic Principle predicts how people *will* behave

- People will pollute less if you tax pollution
- SpaceX will choose to launch rockets that it thinks will turn a profit on.

Benefits: Actions are more likely to be taken if their benefits rise

Costs: Actions are less likely to be taken in their costs rise.

Microeconomics studies choice and its implications for price and quantity in an individual markets

- Sugar
- Carpets
- House cleaning services

Macroeconomics studies the performance of national economies and the policies that governments use to try and improve that performance

- Inflation
- Unemployment
- Growth