Chapter 1 Review
What is (Micro) Economics About?

Readings  Chap. 1: all

Outline

I. What is Economics?
   A. Definitions
   B. Scarcity
   C. What is microeconomics?
      1. Def: the economic study of individual ______
      2. Examples (what we’ll study)

II. Ten Principles of Economics
   How People Make Decisions
   1. People face tradeoffs
   2. Opportunity Cost: the cost of something is what (the best alternative) you give up.
      Opportunity costs: the (value of) the next best alternative you give up.
   3. Good decision making often requires thinking at the margin.
      marginal: small steps or increments
   4. People respond to incentives.

   How People Interact
   5. Voluntary trade can make all participants better off.
   6. Markets are usually a good way to organize an economy
      Adam Smith’s “Invisible Hand”
   7. Sometimes markets will not work well and government intervention can improve
      outcomes

   How the Economy as a Whole Works
   8. A country’s standard if living ultimately hinges on its productivity (output/worker hour)
   9. (macro) printing too much money causes inflation
   10. (macro) In the short-run there is a tradeoff between inflation and unemployment.

Questions from the Textbook

Questions for Review (from the text, p 16)
all but 9 and 10
Other Questions

1. You favorite uncle, Buck has gotten a job as President of Ozark Computer Consultants. The company employs 100 people all of whom are salaried (i.e. they are not paid by the hour). Buck decides wants to have a 1 hour meeting with all of the company’s employees once a week every week. Auntie Mae, the company’s Vice President, opposes the weekly because it will cost the company too much. Buck states: “The meeting will not cost the company a thing because the employees are salaried. I do not have to pay them anymore if they come to the meeting.”

   • Is Buck correct in stating that the meetings will not cost the company? Explain your answer. Assume the meetings do not hurt morale.

2. Ahhhh! Its time for vacation. You go to, arguably everyone’s vacation paradise, Ozark, Missouri. While there, you stay with your Cousin Clint. He leaves you with a draft of his Economics paper. Clint has quit his job and gone back to school for a year to earn an associates degree. In his paper, he is trying to calculate the returns to his education. He has estimated the following data:

<table>
<thead>
<tr>
<th>Costs of Education/year (paid in ’00)</th>
<th>(estimated) Returns to Education</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tuition: $2,525</td>
<td>Salary increases by $2,500/year</td>
</tr>
<tr>
<td>Fees: $600</td>
<td>(every year beginning in ’01)</td>
</tr>
<tr>
<td>Books &amp; Supplies: $460</td>
<td></td>
</tr>
<tr>
<td>Transportation &amp; misc: $140</td>
<td></td>
</tr>
<tr>
<td>Total $3,725/year</td>
<td></td>
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</tbody>
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   Clint has correctly calculated that if one were to deposit $3,725/year in 2000 at a bank paying a 67.1% interest rate, one would earn $2,500/year off of interest beginning in the year 2000. Clint concludes his education is paying a 67.1% rate of return. Clint taunts you with “Let’s see you get a 67% rate of return on anything fancy pants!”

   Is Clint correct? Is he really getting that good of a rate of return on his investment? (Hint: Assume Clint estimated the above costs and returns correctly. He also did the math correctly.)

3. President Eisenhower once stated; “Every gun that is made, every bomb and missile, signifies a theft from those who are not fed.”

   • Explain what he meant by this using the concepts we learned in this class. Use a production possibilities curve (or more than one if needed) to illustrate his point.

   • Under what, if any, circumstances are more bombs and missiles not a “theft from those who are not fed”?

4. It’s the late 1800s and you are in a board meeting of Edison Electric (later to become GE). Thomas Edison, the CEO is looking for advice. The question is whether or not to sell light bulbs in Europe. Edison Electric is already selling light bulbs in the U.S. for a good profit.
Advisor 1\(^1\) states; “Don’t do it boss! Look, our market analysts estimate we can sell light bulbs in Europe for $0.30 a piece. Our engineers estimate that our plant’s average cost per light bulb will be $0.35 a piece, including shipping, etc., if we scale up production for this. That’s a $0.05 loss per unit! Our people are good at what they do. Both our engineers and markets analysts have been dead on almost every time before. I trust their data and know that we’ll loose our butts if we do this.”

Advisor 2\(^2\) replies; “Now Mr. Edison, I really think you ought to sell in Europe. Like Advisor 1 said, our market analysts estimate we can sell light bulbs in Europe for $0.30 a piece. However, the same engineers have estimated that the cost of producing (including shipping, etc.) the additional bulbs for Europe will only be $0.25 per bulb. That’s $0.05 profit per unit! I say sell in Europe!”

Mr. Edison now turns to you. He states; “Well ________________, can you help me out here. First tell me why one advisor is saying I’ll loose $0.05 per unit and one is telling me I’ll gain $0.05 per unit. Then, tell me whether or not I should sell in Europe. Finally, explain why I should in Europe. I’ve always needed a right hand man/woman/child/hermaprodite to help me run my company and share the profits and I’m hoping you’re the one.”

- **Answer Mr. Edison.**

(Based on a true story)

5. Which of the following is true?
   a. Scarcity and poverty (common definition., not government. definition.) are basically the same thing.
   b. Scarcity can be eliminated if material living conditions rise high enough.
   c. Scarcity will always be present as long as people tend to always want more.
   d. Scarcity is the result of prices being set above equilibrium.
   e. both a & b

6. _____ Assume you have completed 3 and 1/2 years of college. You have one semester to go before earning your Economics & Finance degree. If you used marginal analysis to make the decision on whether to attend the last semester of college, you would:
   a. compare the total costs of your 4 years of education against the total benefits a degree will give you.
   b. compare the costs of 1 more semester, against the benefits you gain from having a degree vs only 3 1/2 years of college.
   c. Not use marginal analysis. Many of the costs and benefits are implicit (i.e. non $ costs or benefits), something marginal analysis does not consider.
   d. Not use marginal analysis. Marginal analysis making does not apply when 2 time periods (now vs future) are being considered.
   e. Both c & d

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\(^1\)Poor guy. He is still mad at his parents for not giving him a better name. Oh well. You ought to hear what his brother and sister are named.

\(^2\)His real name is Frank. He just goes by the name of “Advisor 2” to keep Advisor 1 from feeling too threatened.