

Definitions that you'll never, ever see again

Economics – insert your favorite definitions. According to O'Sullivan, Economics is the study of choices made by people when there is scarcity. Economics is largely about the choices people make given the constraints they face. It is about incentives they have. It is about the trades people make. We will learn about markets and competition. This class won't teach you how to run a business, and it won't be about money. I will try to teach you to "think like economists", whatever that means. As such, you should learn about scarcity and opportunity costs this semester, about the "gains from trade", and how to think "marginally". See chapters 1 and 2 in O'Sullivan for a preview.

Microeconomics – unit of analysis is the individual. Looking at one person's behavior, one firm's choice, do you have a job, the price of a pez dispenser, how many hours your work a week, how many juiced baseballs does Rawlings produce, etc. Here we look at the trees.

Macroeconomics – considers economy-wide aggregates. Looks at overall unemployment rate, overall level of output, average price level in the economy etc. Here we look at the forest.

Models – how do you do Economics? Economists do it with models?!?!?

With models? Not the economists I know (except Mick Jagger)? Economic models are simplified representations of the world (theories). The world is a complicated place, so it would be nice to use some models to attempt to simplify and understand it. Economics is a social science, thus it attempts to explain people's behavior. Unfortunately we can't do too many controlled lab-type experiments on people (as those in the natural sciences do). We can't put people in a test-tube and subject them to experiments like lab rats because people object to this. Consider the experiment I have in mind to take away half of your wealth and give it to your roommate and then see who buys more steak dinners. Would you be in favor of this? (Incidentally, those experiments that are done are done on college students and lab rats.) As such, economists try to learn about the world by using models - making assumptions, developing a model, then testing the model statistically, to determine if it accurately predicts. If it works, we keep them, if not we toss them out. All social sciences use models. Models can be mathematical, graphical, or verbal.

Desirable characteristics of models (Economic models, that is)

1. Simple – easy to understand
2. General – apply to a number of situations
3. Useful – accurately predict observed behavior

Simple is straightforward. It doesn't make any sense to make up a model that you don't understand. General means that it applies to a number of situations. If a model only works at 9:00 AM on Thursdays when it's raining and the Dukes of Hazard is on TV, its not going to be too helpful. Useful means that it predicts behavior correctly.

Of course, to simplify matters, we will have to make assumptions. You may take exception to some of the assumptions we'll make. Ultimately, we will judge our models not based on how realistic the assumptions are, but instead based on how well they predict observed behavior. A good model is a model that predicts behavior correctly. All other things being the same, of course, we would prefer the most realistic of assumptions. But again, if a model predicts behavior accurately, it's a good model.

Economists often assume that people are **rational**. It proves to be an extremely valuable assumption. In short, we can define rationality in the following fashion. People do the best they can based on their own values and information, under the circumstances they face. Notice this allows for people to have different values and different perceptions. People maximize their own welfare (happiness) as they conceive it. Are criminals rational? Crack addicts? Methodists? We'll read a chapter about criminals in Miller, Benjamin, and North, if time permits. Ask me about ACC basketball players after you read that chapter.

Rationality doesn't preclude people making bad choices from time to time. People make choices based on limited information. Assuming that people are rational suggests that people learn from their mistakes and don't repeat the same simple mistake (Homer and Butterfingers). At the time, based on your limited information, it may have been a wise decision to sign up for an 8:00 class, but this may have turned out to be a mistake. This would not make you irrational. Repeatedly signing up for 8:00 classes however, and thus making the same mistake over and over again, would be irrational.

Your textbook talks about self-interest. Very much akin to rationality is the assumption that people are motivated only by their self-interest. Also, we'll assume firms maximize profits. You can make your own decision about whether or not these assumptions are reasonable, but nonetheless, they'll be very helpful. They'll give us models that predict well.

Supposing we were trying to develop a model that predicts scores on the final exam in Econ 211, how would an economist go about it? First, we would then think about and collect the relevant data (variables) to include in consideration of our model. We'd ask – what types of things would effect 211 grades? Things that might help would be the number of hours you studied, whether or not you did the homework, your blood alcohol content (in which direction I don't know), your major, sex (females at Clemson have higher GPRs than men), and whether or not I was in a good mood when I wrote it? We probably wouldn't expect the color of your socks, the relative humidity to be relevant, and thus we wouldn't worry about these variables.

We take all the variables, maybe assume that people try to maximize their grade, make up a model, stir it up, and there you have it. If it predicts scores well, we'll keep it. If not, back to the drawing board.

Some jargon you'll see once on the first exam, but can forget after that

Positive Statements – statements of facts, of what is, or what would occur if something else were to happen. Must be either true or false. Example: Michael Jackson is a musician. If Al Gore shaves off his beard, he will get more votes in election.

Normative Statements – express value judgments. They state what should be. Cannot be true or false, just opinion. Dead give away is the word “should” or “ought”. Example. Michael Jackson should not be allowed to work in a day care center. Al Gore should allow Chad to spend more time with his daughters.

We shall mainly be concerned, as budding economists, with positive statements. As economists, we should talk about the statements of facts, and let you all make your own value judgments based on these facts. More later...

Some fallacies you'll see once on the homework and then the first exam, but can forget after that.

These are examples of some logical mistakes that are commonly made.

Fallacy of composition – occurs when someone says what is true for one person must be true for the whole (group). While it might be true for one person, it isn't necessarily true for everyone. Example – standing up at a football game allows one person to see better, so it must be the case that if everyone stands up, everyone would be able to see better. If you said this, you'd be committing a fallacy of composition. Slipping \$100 under my door will improve your grade, so if everyone does, everyone will get a better grade (If I grade on a strict curve, this statement would be fallacious. Keep the money coming, though.)

Post-hoc fallacy – occurs when someone says since event A occurred before event B, it must be the case that event A caused event B. This is obviously not always the case. Example – you send Xmas cards before Xmas, thus sending Xmas cards causes Xmas. If you said this, you'd be committing a post-hoc fallacy. I walk into the bathroom before I “tinkle”, thus walking in to the bathroom causes me to tinkle. You can have some fun here on the homework.

Other conditions fallacy – occurs when someone says since two events occurred together in the past, they will continue to occur together in the future. Conditions change, and thus they may not occur in the future. Example – All season long on 4th down, the team punts. Thus, in the future, when it is 4th down, the team will punt. This may not occur late in the championship game. In the past when you turned the ignition of your car, your car has started. Thus, tomorrow, when you turn your ignition, your car will start. May not occur if your battery is dead.

Misleading comparison – boring. Sometimes people make comparisons in a way that does not reflect their true differences. Back when I was a whippersnapper, candy bars cost a nickel, and I was happy to work for \$1 an hour. Now, they're an outrageous \$0.69. Of course, all prices have risen over time. Or, for another example, gasoline prices are at an all time high. Hogwash, need to adjust for inflation. The big one here is failing to account for inflation.

*****Selection bias** – occurs when people use data that are not typical, but instead are selected in a way that biases results. Suppose I was asked to find out how many alcoholic beverages the typical CU student consumes in a given evening. If I conduct the survey in the gutter outside TTT at 2:00 on a Friday morning, I will get a different result than if I conduct the survey at the library at 9:00 the next morning. Neither place is typical. Coke learned about this one the hard way when it came to their taste testing of New Coke (ask a marketing major). If you ask a person how much money they spend on movies, and you do the surveying outside a movie theatre, do you think you'll get a higher number than the true average?

Finally, some real Economics??

Scarcity ⇒ Conflict ⇒ Choices ⇒ Costs (Opportunity costs)

Scarcity – limited resources, but unlimited wants. Everyone wants to be able to allocate the productive resources. If I were Czar of Clemson, my office is getting bigger, will have more windows, and a bar (for serving juice). Sistine would have a batting cage in the basement with live pitching (perhaps Mitch Williams could serve up some BP), I'd have 3 assistants, and Don Rickels would be my greeter. I'd also have a green room. And certainly class wouldn't be at 8:00. There wouldn't be as much room for computer labs and classes, but hey, those are the breaks. Waitresses on roller-skates, anyone? And how about leather recliners for my students? The first floor could be an elaborate miniature golf course. Get the drift?

When I talk about limited resources, I think this is obvious. When I talk about limited resources here, I mean the productive resources – those things that are used to make stuff. These are things like labor, oil, lumber, engineers, forklifts, etc. There is only so much of this stuff to go around, so many hours in the day. When I talk about unlimited wants, I mean that everyone wants the right to allocate productive resources (decide how the various resources are used). It isn't necessarily greed (Mother Theresa?). Very loosely, everyone wants to decide how to use the resources the way that makes him or her the happiest.

Scarce goods -

If good X is a scarce good for you, then you are willing to give up something of value in exchange for more of good X (need not be money). Could be time, a baseball hat, a friendship, etc.

Another way you can ask the question is the following – do you want more of the good than is freely available? If so, the good is scarce. Most everything you can think of, at least from a societal point of view, is a scarce good. Exceptions might be air and water, though clean air and clean water are scarce. Some of you may also think of things like trash and pollution. We call trash and pollution economic “bads” as opposed to “goods”. While surely trash isn't scarce, we would consider “trash removal” and “pollution abatement” goods, and thus they are scarce.

However, what might be a scarce good for you might not be scarce to me. You might be willing to give up \$15 for a Brittany Spears album, thus for you the BS album is scarce. However, I would not give up anything of value for a BS album, and thus for me, BS albums aren't scarce. BS calendars however, are a

different story. A date with Heather Locklear would be a scarce good for me, as I would be willing to give up my left arm and first born.

The unlimited wants and limited resources (**scarcity**) put our wants in **conflict** (my ideas vs. your ideas vs. Billy Bob Thornton's ideas), and thus we must make **choices** about how we will use our resources.

Somewhere in the middle of all this we should talk about **competition**. We have all of this conflict about how we are going to use resources. My plan to put a batting cage in Serrine is in conflict with your plan to turn it into a roller derby arena, which is conflict with Billy Bob Thornton's plan to make it a tattoo parlor. How do we make the choices? Competition is the process of conflict resolution. Take for instance, A's in Econ 211. A's are a scarce resource. Everyone wants one and is willing to give up something of value to obtain one. However, unfortunately, there are only so many to go around. How do I decide who gets them? You all compete for them. We could have the competition occur many different ways. Competition determines the rules of the game. I could give them away based on height. We could have a footrace to decide who gets the A's. We could play cricket on the dartboard in my office. Or rock scissors paper? Or perhaps we could have quizzes and tests – that's sounds like a good way, let's do that? Markets will be key here in real world US.

Opportunity cost – the highest valued foregone alternative. To determine the opportunity cost of activity X, answer the following: What would I have done instead if I hadn't done X?

Every time a choice is made, a cost (opportunity cost) is incurred. The cost need not be monetary, and usually won't be. What's the opportunity cost of buying a baseball hat? Maybe it's a sandwich and a movie ticket. What is the opportunity cost of coming to class? It is likely an hour of sleep for many of us. Maybe it was going to the gym and working out. Maybe it is an hour of work at your job. We don't add up all the alternatives, only the highest valued (the one we would have chosen). The opportunity cost of an action is the real cost we should consider. Only you know your opportunity cost, as only you can tell what activities you would have engaged in. The rest of the semester when I talk about cost, I am referring to opportunity costs.

What is the opportunity cost of you coming to college? What does it include? Don't stop after tuition and books!!

What should I be reading?

O' Sullivan

Chapter 1 – read it. It's dry at times, but what are you going to do? It's not bad for Chapter 1.

Chapter 2 – read it. It goes over some very important concepts very briefly. Focus on the marginal principal. It will come up over and over again this semester. And then some more, and then some more after that. We'll go over a lot of this chapter in more detail later.

Chapter 3 – read the first part, but don't worry about the fluff regarding the global economy. Lost of jargon, not much substance there.

Miller, Benjamin, and North – Chapter 1 and 2.