

Economics – Chapter 2 – Trade, Tradeoffs, and Economic Systems

Economics is based mainly on logic. You should know from common sense that businesses want to make money, while consumers want to save money. You should know, at least vaguely, the law of supply and demand. Watch the news, read the papers, **use your head**, memorize these terms, and you'll be fine.

1. **Exchange** – the process of trading one thing for another
2. **ExAnte** – Phrase that means before, as in before an exchange.
 - a. Both sides must feel that the exchange will benefit them for the exchange to take place
3. **The Point of Exchange** – duh
 - a. Both sides are still happy with the exchange that's taking place
4. **ExPost** – the period after the exchange
 - a. One, or both sides, may be happy, may regret the exchange
5. **Consumers' Surplus (CS)** – the difference between the max price a buyer is willing to pay for a good or service and the price actually paid
 - a. Example: If you're willing to pay \$10 to see a movie, and the theater charges only \$5, the CS is \$5
6. **Producers' Surplus (PS)** – the difference between the price receives for a good and the minimum price that they would have sold it for
 - a. If you want AT LEAST \$20 for a CD player, but end up getting \$30 for it, the PS is \$10
 - b. The CS is NOT the same as the manufacturing cost of the CD player. You can have a PS of 0 and still make a profit
7. **Terms of Exchange** – refer to how much of one thing is traded for how much of something else
 - a. Example: My \$20 for your CD Player
8. **Transaction Costs** – the costs associated with the time and effort needed to search out, negotiate, and consummate an exchange
 - a. Example: If someone in NYC has a \$20 CD Player and I'm in LA, then the mailing fee is considered a transaction cost
 - b. If transaction costs are too high, the exchange will not take place
9. **Comparative Advantage** – the situation where someone can produce a good at lower opportunity cost than someone else
 - a. If you can make a TV for \$10, and your friend can make one for \$15, then you have the comparative advantage
 - b. Generally, specializing in one product will lower costs, giving you a better chance to have the comparative advantage. It's usually more profitable to produce many TV's and trade half of them for computers than to make both the TV's and computers yourself.
10. **Production Possibilities Frontier (PPF)** – a graphical representation of the possible combinations of two goods that an economy can produce in a certain period of time, under the conditions of a given state of technology, no unemployed resources, and efficient production
 - a. **Straight line PPF's** – the two goods are produced in constant ratios.
 - i. You can make 100 TV's and 0 computers, 50 of each, or 100 computers and 0 TV's
 - ii. The cost of making a TV or computer remains constant, regardless of number produced
 - b. **Curved PPF's** – the opportunity costs of making a certain product increase as the number produced increases
 - i. This can occur if the company is not as good at making one product than another
 - ii. Example: You can make 50 computers and 0 television sets
If you make only 40 computers, you can make 20 television sets
In this case, you gave up 10 computers, and got back 20 television sets
However, if you make 25 computers, you can make 40 television sets
In the 2nd case, you gave up another 15 computers, but still got back only 20 TV's
If you make no computers, you get 60 television sets
In the 3rd case, you gave up 25 computers, but still only got back an extra 20 TV's
This can be due to numerous reasons
11. **Law of increasing opportunity costs** – as more of a good is produced, the opportunity costs of producing that good increase. See above
12. **Efficiency** – in terms of production, the condition where the maximum output is produced with given resources and technology. It implies the impossibility to make gains in one area without losses in another
13. **Inefficiency** – in terms of production, the condition where less than the maximum output is produced with given resources and technology. Implies the possibility of gains in one area without losses in another
14. **Technology** – the body of skills and knowledge concerning the use of resources in production. An advance in technology commonly refers to the ability to produce more output with a fixed amount of resources or the ability to produce the same output with fewer resources
 - a. In manufacturing, most of the time "resources" relate to time and labor, not physical resources

15. **Economic System** – the way in which society decides which goods to produce, how to produce them, and for whom the goods will be produced
16. **Capitalism** – an economic system which promotes free trade and private ownership
17. **Socialism** – an economic system which promotes government control of all business and ownership
18. **Mixed Capitalism** – an economic system characterized by largely private ownership of the factors of production, market allocation of resources, and decentralized decision-making. Most economic activities take place in the private sector in this system, but government plays a substantial economic and regulatory role.
19. **Vision** – one's sense of how the world works
20. **Competition** – Capitalists think of competition as a way to force businesses to provide the highest quality services for the lowest cost. Socialists feel that free markets are controlled by big businesses and the government to manipulate and oppress the general public
21. **Private Property** – Capitalists feel that if land were yours, you'd take better care of it than if it was the governments. Socialists feel that the government can do a better job at taking care of the land than the common citizen can
22. **Exchanges** – Capitalists feel that both sides of an exchange benefit from the exchange. Socialists believe that one side will gain an advantage at the expense of the other side

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1. We can produce inside or on the PPF, but not beyond it
2. The opportunity cost of producing one good is stated in terms of another good that could have been produced
3. **Marginal cost** – opportunity cost of producing one more unit
4. Preferences – a person's likes and dislikes
5. **Marginal benefits** – benefit received from consuming one more unit of a good or service
6. **Marginal Cost and Benefit curve** – two curves that show costs and benefits
7. **Principle of decreasing marginal benefit** – as we get more of a good, we don't appreciate it as much
8. **Allocative Efficiency** – cannot produce more of any good without giving up some other good that we value more highly
9. **Production efficiency** – producing on a point on the PPF
10. **Economic growth** – expanding the PPF, but there's a standard of living tradeoff as we can't spend more now. If we build more machines to make butter, we can't make as much butter now
11. **Technological Change** – development of new goods and of better ways of producing goods and services.
12. **Capital accumulation** - the growth of capital resources, including human capital
13. Growing countries generally put more towards machines than producing now
14. **Absolute advantage** – can produce more goods with a given amount of resources, usually due to better technology, more capital. Just because a nation has an absolute advantage doesn't mean both nations can't benefit from the comparative advantage
15. **Dynamic comparative advantage** – the advantage is learned from doing the same thing many times
16. **Property rights** – social arrangements that govern ownership, use, and disposal of resources, goods, and services. Property rights strengthen and encourage comparative advantages and trade
17. **Market** – any arrangement that enables buyers and sellers to get info and do business w/ each other, which promotes trade amongst billions of traders
18. **Goods markets** – goods and services are bought and sold
19. **Factor markets** – factors of production are bought and sold
20. **Efficiency** – we're efficient if marginal benefits \geq marginal costs. If the value of a pizza is \$20 and it only costs \$10, then we're using our money more efficiently by making the pizza, so we're efficient
21. Consumers think value/price. Value is the same as marginal benefit. A demand curve is a marginal benefit curve
22. Producers think cost/price. Cost is the marginal cost, a supply curve is a marginal cost curve
23. Competitive marketplace is efficient
24. Price ceilings, floors, taxes, subsidies, quotas, min wage, monopoly, etc hurt competition and upset the MC/MB balance
25. **public good** – good or service consumed simultaneously even if they don't pay for it. Think defense
26. **External costs and benefits** – cost that is the burden of other people. Cost of pollution, for example
27. These factors often lead to overproduction or underproduction, which decreases the total surplus
28. **Deadweight loss** - the decrease in consumer surplus and producer surplus that results from an inefficient level of production. This loss is not on one consumer, social loss
29. **Its not fair is the result isn't fair** – doesn't work - can't give everyone the same money because we lose efficiency. Think communism, and why it has never worked too well
30. **Its not fair if the rules aren't fair** – Symmetry principle – people in similar situations be treated similarly. Basically law of equal opportunity. State should enforce laws that establish and protect private property, and that property may be transferred from one person to another only by voluntary exchange.
31. **Efficient doesn't always equal fair** – too bad
32. Taxes are an involuntary transfer of private property, so officially they're "unfair"