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ECON 202—Montgomery College

TOPIC 01: INTRODUCTION

I. What is economics?
   a. The study of choice
   b. The study of optimality (or how to get the most out of life)
   c. The study of scarcity
      i. What is not scarce? (No scarcity, no markets.)
   d. The importance of scarcity
      i. *Cost-benefit analysis*—a process of weighing the total costs of an action against the benefits of that same action and proceeding if benefits exceed costs
      ii. This sort of analysis seems too obvious to need to be pointed out but it serves as a helpful guide. Certain policies or events carry so much emotion that we forget to weigh the costs against the benefits.

II. Sunk cost fallacy
   a. While cost-benefit analysis can seem obvious, it has some unexpected insights. For example, the Vince Lombardi line "winners never quit and quitters never win" doesn't exactly ring true in economics because of the existences of sunk costs.
   b. *Sunk cost*—a cost that cannot be retrieved. Such costs incurred—such as specialized equipment which can't be resold—shouldn't be a factor in decisions since that money is lost regardless of what you do.
   c. This is noteworthy because people often want to consider them when they shouldn't. This is called the *sunk cost fallacy*—continuing a behavior based on incurred costs that can't be retrieved.
      i. A business owner might buy a custom piece of equipment for a business venture. After starting the business, she discovers a related business would be more profitable. But this new venture wouldn't require this piece of equipment.
      ii. Because the equipment costs are gone regardless of what's done, it shouldn't be a factor in her decision. But she's likely to continue on her original plan because she doesn't want to "waste" the money.
   d. As a result, economists are bigger fans of quitting than most. People who "refuse to quit" can get stuck in a bad project or job or marriage. Quitting may free you up to "win" at something achievable.

III. Thinking about economics

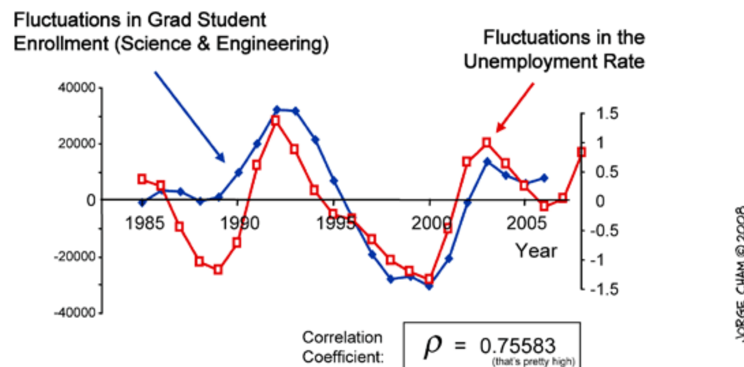
   a. Economists draw a distinction between two common ways people think about economics.
   b. *Positive economics* focuses on description. It uses economic logic and facts to describe how people act.
   c. *Normative economics* focuses on assigning value. It makes value judgments on if certain results are good or not.
   d. It's one thing to say what the effects of increasing the minimum wage would be. It's another thing to say if increasing the minimum wage is a good idea.
   e. Sometimes normative economics looks like positive economics because advocates for one position or another will highlight the positive economics that support his or her view.

IV. Fundamental Idea One: incentives matter

   a. This is because people are *rational*—choosing the best action given their preferences and constraints.
   b. Because incentives matter, choosing the right incentives changes everything. This has enormous implications for policy and economic development.
   c. The institutions, the rules of the game, should align self-interest with social interest.

V. Fundamental Idea Two: there are always opportunity costs

   a. *Opportunity cost*—the net gain of the next best option.
      i. Note this is net gain: include the costs as well as the benefits.
      ii. When the opportunity cost is high, that means you are sacrificing a lot; when it is low, you are sacrificing little.



   b. Accounting framework
      i. Benefit – Expenses = Accounting Profit
      ii. Ex: If I make $50 selling apples and it costs $40 bringing them to market, my profit is $10.

c. Economic framework
    i. Accounting Profit – Opportunity Cost = Economic Profit
    ii. Ex: If, instead, I could have spent $45 selling candy apples for a total of $60, my opportunity cost is $15
    iii. Since $10 – $15 = -$5, I have negative economic profits. In other words since I could have made more selling candy apples I actually made a loss. My opportunity cost was high.