

REVIEW OF ECONOMICS
For
Managerial Economics, ECON 3800-001

Spring 2002

Tuesday and Thursday, 10:00 AM
Roskens Hall 208

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Reasonable Expectations

1. A student's life outside of class is **independent** of the workload for the class.
2. One way college is different than high school is the amount of **independent study** a student must complete.
3. College students are expected to knowledgably **participate** in classroom discussions.
4. College level **concepts** can be very difficult to grasp.
5. Rote memorization, while extensive, is limited to the **tools of analysis**.
6. Students are encouraged and expected to ask **questions** based on the readings, especially contemporaneously with the lecture on those readings.

Critical Thinking is analysis that goes deeper than the surface. Usually surface analysis will see no more than the symptoms, and will not see the underlying causes of the symptoms.

All analysis is flawed. Some of the most likely culprits of flawed analysis are:

- post hoc ergo propter hoc*;
- correlation is causation;
- unintended consequences,
- complex causation;
- bounded rationality;
- acting as if an open system is a closed system;
- and
- believing the analysis is completed.

Memorization

Lead off comments: items you can not change, you merely can work around them.

- [1] Some items will be easy to learn and other items will be difficult.
- [2] Sometimes, but not always, this difference in ease and difficulty is genetic and/or reflects hardwiring in your brain due to prior experience.
- [3] Your ability to create a relevant context will aid your development of memory.
- [4] Ease of committing to memory is reflected by the frequency characteristics of required repetitions.

MEMORIZATION

Now let's examine some memorization techniques.

- [A] Use one sequence.
- [B] Use your fingers.
- [C] Repeat your repetitions.
- [D] Stop lying to yourself.
- [E] Avenues of input matter.
- [F] Mnemonics.
- [G] Increase the complexity.

Major Forces of Change

Approximately
the year
1500

**GUN POWDER
NEW WORLD
PRINTING PRESS
RURAL
LABOR SHORTAGE**

Approximately
the year
2000

**FISSION
ONE WORLD
COMPUTER
URBAN
LABOR SURPLUS**

CAPITALISM

ELEMENTS (means) and FUNCTIONS (ends)

private property	embody self interest
prices	measure self interest
markets	coordinate self interest
competition	regulate self interest
government	facilitates p.p., p., m., & c.

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CAPITALISM

ELEMENTS and FUNCTIONS

private property	embody self interest subjective made objective
prices	measure self interest voluntary transactions
markets	coordinate self interest information

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CAPITALISM

ELEMENTS and FUNCTIONS

competition "large" # of buyers and sellers free entry and exit	regulate self interest alternatives
government public sector failure no profit motive special interests vote trading clear benefits and hidden costs	facilitates p.p., p., m. & c. define rights property contract torts criminal set transaction costs

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PUBLIC SECTOR FAILURE

lack of efficiency motive

every bureaucracy

do YOU get a paycheck or a dividend?

special interests

large benefit for small group

(per member),

small cost for large group

(per member)

vote trading (a.k.a. log rolling)

special interest vote trading

clear benefits and hidden costs

what of

"hidden benefits and clear costs"?

PROFIT = π = TR - TC

TR = P * Q

TC = FC + VC

TC_E = land+labor+capital+entrepreneurial ability

= rent+wages+interest+normal profit

TC_A = land+labor+capital

= rent+wages+interest

Normal Profit = π_E

**= amount necessary
to attract AND to keep
entrepreneurial ability**

**subjective reaction to
TR - TC_A**

$$\begin{aligned}
 \text{Accounting Profit} &= \pi_A \\
 &= TR - TC_A \\
 &= TR - (\text{rent} + \text{wages} + \text{interest}) \\
 &= \pi_A \geq \pi_N
 \end{aligned}$$

$$\begin{aligned}
 \text{Economic Profit} &= TR - TC_E \\
 &= \pi_A > \pi_N
 \end{aligned}$$

$$\begin{aligned}
 \text{Economic LOSS} &= TR - TC_E \\
 &= \pi_A < \pi_N
 \end{aligned}$$

SHUT DOWN RULE

$$\begin{aligned}
 TR < VC & \text{ which is the same as} \\
 & TR/Q < VC/Q \\
 & \text{ which is the same as} \\
 & P < AVC
 \end{aligned}$$

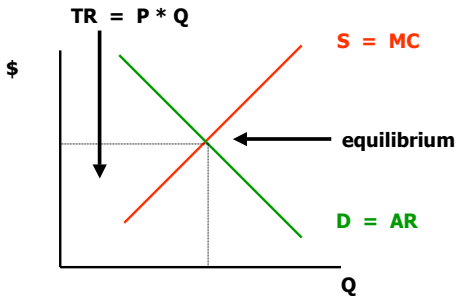
DESTRUCTIVE COMPETITION

TR
is persistently
less than TC,
but more than VC

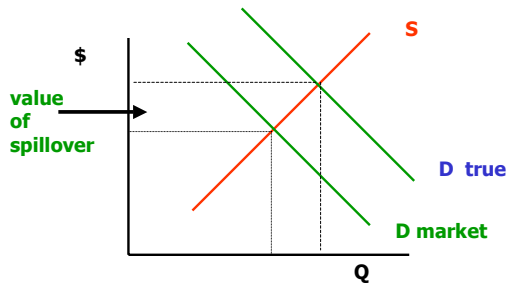
HISTORY OF CAPITALISM

pre 1500	PRE-CAPITALISM (FEUDALISM) self sufficient manor
1500 - 1800	MERCANTILISM self sufficient nation
1750 - 1890	FREE CAPITALISM self sufficient individual
1860 - 1920	INDUSTRIAL CAPITALISM self sufficient firm
1890 - 1930	FINANCIAL CAPITALISM self sufficient industry
1915 -	RESPONSIVE CAPITALISM
1930 -	REGULATED CAPITALISM
2000 -	???

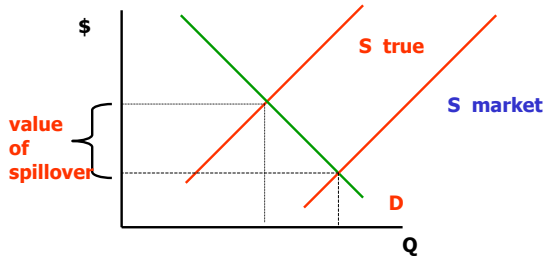
Supply and Demand curves



spillover benefits: get more than buy & pay less



spillover costs: buy more, pay less



Note: the boxes are not the same as spillover benefits

HISTORY OF CAPITALISM

pre 1500
(FEUDALISM)

PRE-CAPITALISM

labor tied to land
no markets
self sufficient manor

1500 - 1800

MERCANTILISM

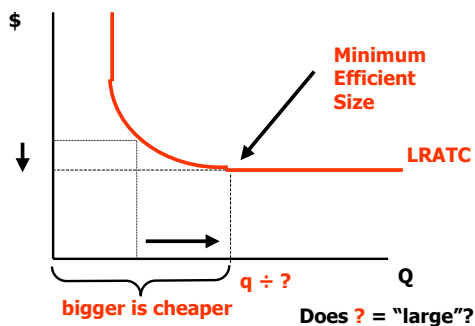
self sufficient nation
king-granted monopolies
colonization
separation in place
and time

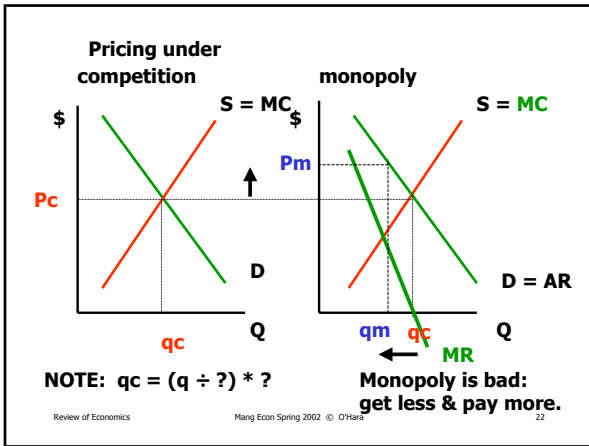
1750 - 1890 FREE CAPITALISM

self sufficient individual
(Family?)
mythical core of the U.S.

small MES
absolute
and
relative

MES curve





1860 - 1920 INDUSTRIAL CAPITALISM

- self sufficient firm
- mass production and mass distribution
- increasing MES
- railroads
- erosion of social relationships
- victims

technology
is an intangible asset
idea plus physical embodiment

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1890 - 1930 FINANCIAL CAPITALISM

- self sufficient industry
- concentration of "ownership"
- leveraging

rapidly increasing MES
new technology is adopted faster than scheduled depreciation

ATC new < AVC old
versus
ATC new < ATC old

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1915 - RESPONSIVE CAPITALISM
social responsibility
AND
profit maximization

person, as well as system,
responsible for cost minimization

private decision maker,
but public impact

incentive to be irresponsible

1930 - REGULATED CAPITALISM
substitution of government
for the individual decision maker

group impact = group decision ?

inefficient regulation

NON-PRICE DETERMINANTS OF SUPPLY

number and size of sellers
horizontally sum
costs for inputs
prices of related goods
substitutes (A or B)
compliments (A and B)
taxes
technology
expectations

NON-PRICE DETERMINANTS OF DEMAND

- number and size of buyers
horizontally sum
- income
- prices of related goods
 - substitutes (A or B)
 - compliments (A and B)
- tastes
- expectations

NON-PRICE DETERMINANTS OF

SUPPLY DEMAND

- | | |
|-------------------------|-------------------------|
| # & size of sellers | # & size of buyers |
| horizontally sum | horizontally sum |
| costs for inputs | income |
| prices of related goods | prices of related goods |
| substitutes (A or B) | substitutes (A or B) |
| compliments (A and B) | compliments (A and B) |
| taxes | tastes |
| technology | expectations |
| expectations | |

Technology is dynamic.
Expectations are volatile.

Unless the **buyer** is **WILLING AND ABLE** to pay the purchase price there is no demand (e.g., poor people have no demand for food).

Unless the **seller** is **WILLING AND ABLE** to sell at the purchase price there is no supply (e.g., there is no supply of clean air).
