

## Thinking Like an Economist

### Course Information

### Three Principles of Decision Making

The Scarcity Principle

The Cost-Benefit Principle

The Incentive Principle

### Examples

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## Today's News Article Is Puzzling

**The New York Times**

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August 9, 2009

### Unpaid Work, but They Pay for Privilege

By GERRY SHIH

With paying jobs so hard to get in this weak market, a lot of college graduates would gladly settle for a nonpaying internship. But even then, they are competing with laid-off employees with far more experience.

So growing numbers of new graduates — or, more often, their parents — are paying thousands of dollars to services that help them land internships.

Call these unpaid internships that you pay for.

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## Course Information

Copies of the syllabus, course calendars, Power Point slides, and assignments are available on the course web page: [www.unc.edu/~salemi](http://www.unc.edu/~salemi)

Graded work with the clickers begins today. If you have not yet done so, register your clicker.

Make sure your *eInstruction* student ID is your UNC PID. No hyphen please.

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## Recitations Have Begun

Most of you have already attended your first recitation.

Your recitation assignment for next week is to read the excerpt from *The Wealth of Nations* which is available on the web page.

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## Review

The *Opportunity Cost* of a decision is the decision maker's next best alternative to the chosen decision.

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## Review: Survey Results

Statement to which students responded "true" or "false".	Percent "True"	
	Before	After
The best things in life are free.	52	24
The biggest college cost is tuition and fees.	37	10
Anything worth doing is worth doing well.	83	84
Life should be sustained at any cost.	28	13

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## The Scarcity Principle:

Because resources are scarce, choices entail costs.

Your "Reservation Price" is the most you would pay to obtain a good or service.

Your "Surplus" in a transaction is the difference between your reservation price and what you actually pay.

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## Reservation Price

What is the most you would be willing to pay right now for a package of Oreo cookies and permission to eat them in class?

That amount is your reservation price for those cookies at this moment.

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## Surplus

Suppose I offer you a package of Oreo cookies for \$0.60.

What is your economic surplus?

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## Two Types of Clicker Questions

Graded Questions provide students and incentive to stay alert and engaged during lectures.

Non-Graded Questions provide students an opportunity to work together to meet more difficult challenges. These questions will show up on exams.

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Use Your Clickers To Answer  
The Following  
Graded Question

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It is hot at the football game and Joe is thirsty. He would pay up to \$5.00 for a 20 ounce cola. He goes to the concession stand and finds that he can buy a 20 ounce cola for \$3.00. Joe's economic surplus from the transaction is...

- A. \$0.00.
- B. \$3.00.
- C. \$2.00.
- D. \$5.00.

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Use Your Clickers To Answer  
The Following  
Non-Graded Question

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You won a free ticket to an Eric Clapton concert (which has no resale value). A Bob Dylan concert on the same night is your next-best alternative activity. Tickets to see Dylan cost \$40. You would be willing to pay up to \$50 to see Dylan. There are no other costs.

What is your opportunity cost of the Clapton Concert?

- A. \$0
- B. \$10
- C. \$40
- D. \$50

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Using the Scarcity Principle to make sense of the answer.

What are the scarce resources involved in the concert decision?

What do you give up when you decide to attend the Clapton concert?

Why is the opportunity cost of the Clapton concert \$10 rather than \$40 or \$50?

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## Cost-Benefit Principle

*Marginal Cost* is the cost of doing a little bit more of an activity.

*Marginal Benefit* is the benefit that derives from doing a little bit more of an activity.

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## Cost-Benefit Principle

To a decision maker, the relevant costs and benefits are *marginal costs and marginal benefits* where marginal means "incremental."

Most decisions involve choosing a little bit more or less of a good or activity. Few decisions are all or nothing decisions.

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## Cost Benefit Principle

The *Cost-Benefit Principle* says that an individual should undertake an activity if and only if the benefits are greater than the costs and only up to the point where the marginal benefit equals the marginal cost.

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## Exercise

Raleigh politicians have built a new convention center.

How could "marginal cost" and "marginal benefit" be used to decide how much money to spend on it?

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### Chairs

Your chair is the foundation of a productive, healthy workspace, so it's important to find the right one. Staples offers many different chairs all at great prices.

Executive Chairs	Manager's Chairs	Custom Order Chairs
 Relax, larger chairs with higher backs are right here.	 It's all about you and your high-quality, stylish needs.	 Choose from dozens of different leather and fabric colors.
Fabric Executive Leather & Chrome Executive Leather & Wood Executive Leather Executive Mesh Executive Top 10 Executive Chairs	*****HOT BUYS***** Big & Tall Ergonomic Fabric Managerial Leather Managerial Mesh Managerial Top 10 Managerial Chairs	Custom Order Leather Chairs Custom Order Managerial Chairs Custom Order Task Chairs Custom Order Reception Chairs

### What Kind of Chairs Should Be Chosen for the Convention Center?

- Plastic at \$50 per chair
- Padded vinyl at \$100 per chair
- Steel (leather seats) at \$150 per chair
- Padded leather at \$200 per chair
- Hand tooled cowhide at \$400 per chair

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### The Cost-Benefit Principle

You are about to buy a \$25 computer game at the UNC Ram Shop when a friend tells you the same game is on sale for \$15 at University Mall (30 minutes away by bus).

- Where would you buy the game?
- What sort of student is more likely to buy the game at the Ram shop?

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### The Cost-Benefit Principle

- What is the benefit of buying the game at University Mall?
- What is the cost of buying the game at University Mall?
- For what sort of student is the benefit of the trip to University Mall likely to be greater than the cost?

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### The Cost-Benefit Principle

You are about to buy computer equipment at the Ram shop for \$1000 when a friend tells you the same equipment is available at University Mall for \$990.

- Where would you buy the computer equipment?
- Should your answer be different for the game and for the computer equipment? Why or why not?

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## Use Your Clickers To Answer The Following Graded Question

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You can buy a game for \$25 at the Ram shop or \$15 at University Mall. You can buy a computer for \$1000 at the Ram shop or \$990 at University Mall. Should your “where to buy” decision be the same or different in the two cases?

- A. Different because buying the game at U Mall provides a greater percentage discount.
- B. The same because the marginal costs and marginal benefits are the same in each case.
- C. Different because the computer is a higher surplus item.
- D. The same because the opportunity cost of buying at the Ram shop is zero.

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## The Incentive Principle

A person (or firm or group of people) is more likely to take an action if the benefits of the action rise.

A person is less likely to take an action if the costs of the action rise.

People, firms and groups respond to incentives.

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## The Incentive Principle

Residents of your city are charged a fixed weekly fee of \$6 for garbage collection. They are allowed to put out as many trash bags as they wish. The average household disposes of three trash bags of garbage per week under this plan.

Suppose that your city changes to a “tag” system. Each trash bag to be collected must have a tag affixed. Tags cost \$2 each and are not reusable.

What effect will introduction of the tag system will have on the total quantity of garbage collected in your city?

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## The Incentive Principle

How does the tag system change the marginal benefit and marginal cost of disposing of a trash bag?

What are some alternatives to putting out another trash bag?

What incentive has the tag system created?

Do you agree that people are likely to respond to the incentive?

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Use Your Clickers To Answer  
The Following  
Graded Question

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The Tag System is likely to \_\_\_\_\_ the quantity of garbage collected because \_\_\_\_\_.

- A. Reduce, because the marginal cost of discarding garbage is higher.
- B. Reduce, because the marginal benefit of discarding garbage is lower.
- C. Leave unchanged, because the marginal benefit of discarding garbage is the same.
- D. Leave unchanged, because there are no substitutes for trash removal.

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What Have We Learned?

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## Thinking Like an Economist

### The Scarcity Principle

Because resources are scarce, having more of one good or service means having less of another.

### The Cost-Benefit Principle

An individual should take an action if and only if the extra benefits from taking the action are at least as great as the extra costs.

### The Incentive Principle

A decision maker is more likely to take an action if its benefits rise and less likely to take it if its costs rise.

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