2 Economic Fallacies, Theories, and Laws

Learning Goals

Once you have completed this chapter, you should be able to:

- Realize the importance of economic fallacies, theories, and laws
- Understand the purpose and benefit of economic thinking
- Begin using graphs to support economic thinking and to explore patterns and relationships in the economic world
- Use simple models to understand and explain economic principles at work

Key Terms

- Fallacy
- fallacy of composition
- post hoc fallacy (or cause-and-effect fallacy)
- fallacy of single causation
- Origin
- inverse relationship
- direct relationship
- opportunity cost
- production possibilities curve
- trade-off
- consumer goods
- capital goods
- relative cost
- law of increasing relative cost
- Frontier
- Output
- law of diminishing returns
- Input
- law of increasing returns to scale

Identifying Economic Fallacies

A ***Fallacy*** *is a hypothesis that has been proven false but is still accepted by many people because it appears, at first glance, to make sense.*

- **The Fallacy of Composition**: A mistaken belief that what is good for an individual is automatically good for everyone, or what is good for everyone is good for the individual.
- **The Post Hoc Fallacy (also know as the "cause-and-effect" fallacy):** A mistaken belief that what occurs before some event is logically the cause of it.
- **The Fallacy of Single Causation:** A mistaken belief, based on oversimplification, that a particular event has one cause rather than several.

Examples

Fallacy of Composition

If one student in the class gets a perfect score by studying late at night, then everyone in the class should study late at night to get perfect scores.

Explanation:

What works well for one student (studying late at night) might not work for others. People have different learning styles, schedules, and energy levels, so assuming it will benefit everyone is a fallacy

Post Hoc Fallacy (Cause-and-Effect Fallacy)

After wearing my lucky socks, my team won the game. Therefore, my lucky socks caused the victory.

Explanation:

The fact that the team won after wearing the socks does not mean the socks caused the win. The victory likely depended on factors like skill, strategy, or teamwork, not the socks.

The Fallacy of Single Causation:
The stock market crashed because of one CEO's poor decision.

Explanation:
While the CEO's decision may have played a role, it is an oversimplification to attribute the entire stock market crash to that single cause. Other factors, such as global economic conditions, interest rate changes, investor behavior, and geopolitical events, likely contributed to the crash. Focusing on just one cause ignores the complexity of interconnected factors.

Reading time

Read examples of fallacies from book page 14 and 15.

Opportunity Cost

- **Opportunity Cost:** The value or benefit that must be given up to achieve something else. For example, by choosing to produce item A, a business gives up the benefit that it could have gained from producing item B using the same resources.

Example

- **Lani's Dilemma:** Lani must choose between working extra hours at her job, attending a concert with her friends, or working on a major assignment for school. Whichever option Lani chooses, she will have to do without the other two. The opportunity cost of attending the concert is based on the satisfaction lost from the "next best" alternative use of her time and effort.

Opportunity cost= ***RETURN ON OPTION NOT CHOSEN - RETURN ON OPTION CHOSEN***

Example

Investors are always faced with options about how to invest their money to receive the highest or safest return. The investor's opportunity cost represents the cost of a foregone alternative.