Introduction to Economics

1. *Scarcity and Opportunity cost and the Basic tasks of an Economy*
2. *Microeconomics versus Macroeconomics.*

   Positive analysis versus Normative analysis
3. *The Economic Way of reasoning: Models and Marginal analysis*

The Economy

- *The economy is the mechanism through which resource use is organized to satisfy the desires of people living together in a society.*

The economic resources are all in some way limited. The wants we seek to satisfy are seemingly unlimited.

Two Basic Concepts

1. **SCARCITY**

The imbalance between our desires and the means of satisfying those desires.

Economics is the study of how human beings make choices to use scarce resources as they seek to satisfy their seemingly unlimited wants.

Two Basic Concepts

2. OPPORTUNITY COST

The sacrifice of the next best alternative use of resources when those resources are used for a specific purpose.

Economic Decisions

- *In any economy, decisions must be made to determine:*
  1. *WHAT will be produced*
  2. *HOW it will be produced*
  3. *TO WHOM it will it be distributed*

Economic Decisions

1. WHAT

Choices must be made about which goods and services to make available and which to forgo

2. HOW

There's more than one way to accomplish any given objective

3. TO WHOM

People with higher incomes will enjoy more and better products and services than people with lower incomes.

The distribution of material well-being is never perfectly equal.

Two Main Branches of Economics

- ***MICROECONOMICS*** *Analyzes choices made by individual participants in an economy, with special emphasis on how prices are determined and how prices influence decisions.*

Microeconomics analyzes the ways individuals choose among various courses of action by weighing the benefits and costs of alternatives available to them.

Microeconomics is sometimes called price theory.

Two Main Branches of Economics

- ***MACROECONOMICS*** *Analyzes the overall performance of an economy--its total production, price level, rate of inflation, employment, unemployment, and rate of growth.*

  Macroeconomists seek to explain the causes of economic fluctuations and to suggest policies that will make the fluctuations less abrupt.

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The unemployment rate is the number of jobless workers who are actively looking for work or who have been laid off from a job and are looking for work, expressed as a percentage of the total labor force.

Inflation is a general yearly increase in the average level of prices for a broad spectrum of goods and services.

Positive Analysis versus Normative Analysis

Positive analysis *seeks to predict the impact of changes in economic policy on observable items such as production and income, then tries to determine who gains and who loses as a result of the changes.*

Normative analysis *evaluates the desirability of alternative outcomes according to value judgments about what is good or bad.*

A **theory** is a framework that helps us understand the relationships between cause and effect.

Economic variables are quantities or dollar amounts that can have more than one value.

An economic model is a simplified way of expressing how some sector of the economy functions.

Economic Models

- *An economic model is a means of explaining how a sector of the economy functions.*
- *Models consist of:*
  1. *Economic variables*
  2. *Assumptions*
  3. *Implications.*
- *Economic models are abstractions that use logic to establish cause-and-effect relationships among economic variables.*

The phrase *other things being equal,* or its Latin equivalent, ***ceteris paribus***, is used to acknowledge that influences other than the one whose effect is being analyzed must be controlled for testing the hypothesis.

Behavioral assumptions establish the motivations of individuals so we can understand cause-and-effect relationships among economic variables.

Marginal Analysis

- *In economics, “marginal” means “extra.”*
- ***MARGINAL BENEFIT*** *The value placed on an extra (one more) unit of an item.*
- ***MARGINAL COST*** *The value of the sacrifice made to obtain an additional unit of an item.*

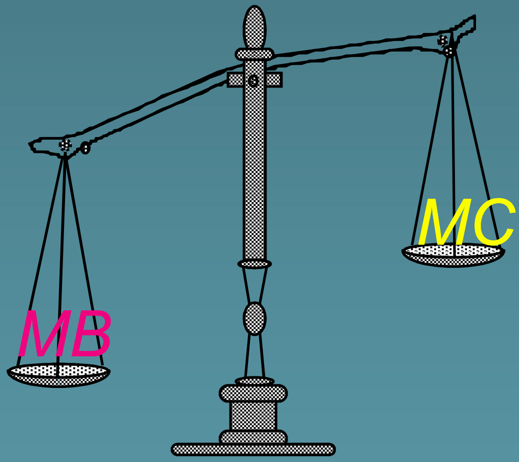
Rational Behavior

- *Occurs when individuals seek net gains by undertaking actions for which marginal benefit (MB) exceeds marginal cost (MC).*

- *When marginal benefit exceeds marginal cost of an activity, a rational person will undertake more of that activity.*

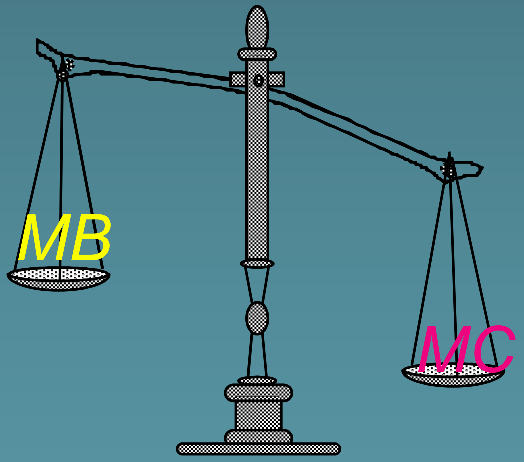
Decisions involve weighing marginal benefit against marginal cost.

- *When the marginal benefit outweighs the marginal cost, the decision will be YES!*
- *MB > MC means GO FOR IT!*



Decisions involve weighing marginal benefit against marginal cost.

- *When the marginal cost outweighs the marginal benefit, the decision will be NO!*
- *MC > MB means AVOID IT!*



Box 1. Marginal Analysis

Box 1 **Marginal Analysis**

A net gain is possible when the marginal benefit of an item exceeds its marginal cost. The consumer buys compact discs until the marginal benefit falls to equal the price of the compact discs.

Monthly Purchases, Marginal Benefit, Marginal Cost, and Net Gain

Number of compact discs purchased	Marginal benefit of discs	Price = Marginal cost of discs	Net gain from the additional disc (marginal benefit minus marginal cost)
1	\$20	\$11.99	\$8.01
2	16	11.99	4.01
3	14	11.99	2.01
4	12	11.99	0.01
5	10	11.99	–1.99
6	8	11.99	–3.99
7	6	11.99	–5.99