

Introduction to Economics



Definition of Economics

- The social science concerned with the efficient use of limited or scarce resources to achieve maximum satisfaction of human material wants.
- Human wants are unlimited, but the means to satisfy the wants are limited.

The Economic Perspective

- Scarcity and choice
 - Resources can only be used for one purpose at a time.
 - Scarcity requires that choices be made.
 - The cost of any good, service, or activity is the value of what must be given up to obtain it. (opportunity cost).
- Rational Behavior
 - Rational self-interest entails making decisions to achieve maximum fulfillment of goals.
 - Different preferences and circumstances lead to different choices.
 - Rational self-interest is not the same as selfishness.
- Marginalism: benefits and costs
 - Most decisions concern a change in current conditions; therefore the economic perspective is largely focused on marginal analysis.
 - Each option considered weighs the marginal benefit against the marginal cost.
 - Whether the decision is personal or one made by business or government, the principle is the same.
 - The marginal cost of an action should not exceed its marginal benefits.
 - There is "no free lunch" and there can be "too much of a good thing."

Why Study Economics?

- Economics for citizenship.
 - Most political problems have an economic aspect, whether it is balancing the budget, fighting over the tax structure, welfare reform, international trade, or concern for the environment.
 - Both the voters and the elected officials can fulfill their role more effectively if they have an understanding of economic principles.
- Professional and personal applications
 - The study of economics helps to develop an individual's analytical skills and allows students to better predict the logical consequences of their actions.
 - Economic principles enable business managers to make more intelligent decisions.
 - Economics can help individuals make better buying decisions, better employment choices, and better financial investments.
 - Economics is however, mainly an academic, not a vocational subject. Its primary objective is to examine problems and decisions from a social rather than personal point of view. It is not a series of "how to make money" examples.

Economic Methodology

- Economists use the scientific method to establish theories, laws, and principles.
 - The scientific method consists of:
 - The observation of facts (real data).
 - The formulations of explanations of cause and effect relationships (hypotheses) based upon the facts.
 - The testing of the hypotheses.
 - The acceptance, reject, or modification of the hypotheses.
 - The determination of a theory, law, principle, or model.
 - Theoretical economics: The systematic arranging of facts, interpretation of the facts, making generalizations.
 - Principles are used to explain and/or predict the behavior of individuals and institutions.
 - Terminology-Principles, laws, theories, and models are all terms that refer to generalizations about economic behavior. They are used synonymously in the text, with custom or convenience governing the choice in each particular case.
 - Generalization-Economic principles are expressed as the tendencies of the typical or average consumer, worker, or business firm.
 - "Other things equal" or ceteris paribus assumption-In order to judge the effect one variable has upon another it is necessary to hold other contributing factors constant. Natural scientists can test with much greater precision than can economists. They have the advantage of controlled laboratory experiment. Economists must test their theories using the real world as their laboratory.
 - Abstractions-Economic principles, theories or models are abstractions, simplifications, which attempt to find the important connections and relationships

- of economic behavior. These models are useful precisely because they strip away the clutter and complexity of reality.
 - Graphical Expression-Many economic relationships are quantitative, and are demonstrated efficiently with graphs. The "key graphs" are the most important.
- Policy economics applies economic facts and principles to help resolve specific problems and to achieve certain economic goals.
 - Steps in formulating economic policy:
 - State goals.
 - Recognize various options that can be used to achieve goals.
 - Evaluate the options on the basis of specific criteria important to decision-makers.
 - Economic goals widely accepted in our economy.
 - Economic growth
 - Full employment
 - Economic efficiency
 - Price level stability
 - Economic freedom
 - Equitable distribution of income
 - Economic security
 - Balance of trade
 - Goals may be complementary (full employment and economic security).
 - Some goals may conflict (efficiency and equity). (Key Question 6)
 - All goals cannot be achieved, so priorities must be set.

Macroeconomics and Microeconomics

- Macroeconomics examines the economy as a whole.
 - It includes measures of total output, total employment, total income, aggregate expenditures, and the general price level.
 - It is a general overview examining the forest, not the trees.
- Microeconomics looks at specific economic units.
 - It is concerned with the individual industry, firm or household and the price of specific products and resources.
 - It is an examination of trees, and not the forest.
- Positive and Normative Economics.
 - Positive economics describes the economy as it actually is, avoiding value judgments and attempting to establish scientific statements about economic behavior.
 - Normative economics involves value judgments about what the economy should be like and the desirability of the policy options available.
 - Most disagreements among economists involve normative, value-based questions.

Pitfalls to Objective Thinking

- Biases-Preconceptions that are not based on facts.
- Loaded terminology.

- Terms that contain the prejudice and value judgments of others.
- It is very difficult for a person to describe economic behavior without letting their opinions about that behavior creep into their discussion. The distinction between positive and normative statements is not always clearly apparent.
- Often, however, there is a deliberate attempt to sway opinion by using loaded terminology. (greedy owners, obscene profits, exploited workers, mindless bureaucrats, costly regulations, creeping socialism)
- Definitions
 - Economics is a second language.
 - It is often difficult for students to recognize terms as new vocabulary that needs to be studied as diligently as though they had never before encountered the words.
 - Students in a physics class encountering terms like erg, ohm, or foot-pound recognize the need to investigate. Students that are reading a text filled with words like rent, capital, or investment assume that they already have an adequate working definition.
- Causation Fallacies
 - Post hoc fallacy: When two events occur in time sequence, the first event is not necessarily the cause of the second event.
 - Correlation versus causation: Events may be related without a causal relationship.
 - The positive relationship between education and income does not tell us which causes the increase in the other. (Which is the independent variable and which is the dependent variable?)
 - It may be that the increase in income that occurs with increased education is due to some other third factor that is not under direct consideration.

A Look Ahead

- Chapter 2 builds the production possibilities model that visually demonstrates the basic economic principles of scarcity, choice, opportunity cost, and the law of increasing costs.
- Chapter 3 builds the supply and demand model for individual markets.
- Chapter 4 combines all the markets in the economy and observes the coordination of economic activity through market prices.
- Chapters 5 and 6 examine the important sectors of the economy (households, businesses, government, and the international sector) discussing their role and interaction.

LAST WORD: Fast Food Lines-An Economic Perspective

- People choose the shortest line to reduce time cost.
- Lines tend to have equal lengths as people shift from longer to shorter lines in effort to save time.
- Lines are chosen based on length without much other information-cost of obtaining more information is not worth the benefit.
 - Imperfect information may lead to an unexpected wait.
 - Imperfect information may cause some people to leave when they see a long line.

- When a customer reaches the counter, other economic decisions are made about what to order. From an economic perspective, these choices will be made after the consumer compares the costs and benefits of possible choices.