I. What is Economics?

Need a careful definition — people often have misconceptions about what it is.
Not the study of how to run a business or accounting or stock market analysis.
What does economist study? Tries to figure out what factors determine:
what goods get bought and sold, how much of these goods get bought and sold
and why the price of the good is what it is

Economics – the study of the prices and quantities of goods produced and consumed

Not as narrow as first seems — many possible aspects of prices and quantities
how goods distributed among people – why rich and poor
how much labor is used – what is the wage
could more of a good be produced – if so at what cost

Textbook definition: "Economics is the science that studies the *choices* that people make when wants exceed the available resources—when resources are *scarce*."

so there is: "Scarcity, therefore choice, therefore opportunity cost"

Opportunity cost is the real cost of any commodity. It is what is given up to get the commodity and is the real price paid (e.g. suppose a textbook costs $80 and a movie costs $20 then the real cost of a textbook is 4 movies, not $80)

Example: "Paradise island" where everything is readily available. You just sleep and eat coconuts. Seems neither sun, sleep or coconuts scarce. BUT Must give up sun and sleep to get coconuts and vice versa. One is opportunity cost or price of other. So they really are scarce. SO:

Price means scarcity (in example, choice must be made because time is limited)
Scarcity means price (if something is limited we must make choice)
so words price and scarcity almost interchangeable

An economic good is anything which is relatively scarce, (i.e. has an opportunity cost (price)). Coconuts in the example are an economic good. A free good has no opportunity cost so not scarce (e.g. air – no opportunity cost to breathing).

By knowing what price really is, we've said same thing in our definition as book's.
Simple Definition helps us avoid unnecessary aspects of problems for economics.

Examples

1. Household – description of household may seem too simplistic BUT only need just enough to explain how it chooses particular quantity at particular price
2. Firm – Avoid many aspects of firm which people think are important. We only want to explain the outcome for price and quantity when firm responds to some change in business environment. Simplest description of firm which works is best
   a. Managerial structure may be very important to those working in a firm but it doesn't help us understand price and quantity better ∴ ignore it
   b. Advertising sometimes effects price and quantity, sometimes not

Book definition tempts you to bring too much into everything we will analyze.
The simple definition: Will help you avoid unnecessary complexities in the course
Understand why economists do things the way they do

II. Where does economics come from?

Adam Smith (Scottish philosopher) –1776 with publication of The Wealth of Nations
Smith was curious how commodity buyers wishes met by firms i.e. why the economy functions with no controls – might expect chaos but order existed. This paradox prodded his curiosity and economics was born. For Smith prices did everything – they changed until amount firms wished to sell was approximately equal to what buyers wished to buy. ∴ Microeconomics often called price theory.
Smith analyzed with careful use of logic and as did most other famous economists (even Karl Marx). Economists examine prices and quantities using logic.

III. How are Price and Quantity Determined?

In markets primarily (at least in countries like Canada and U.S.)
Market – the process by which buyers and sellers negotiate the exchange of some commodity. A market need not be defined by a geographic area (although often is) e.g. market for autos in Canada is not "Canada" but that autos are sold (or not sold). So a market is a process – communication and signals are important, as is the manner in which these are transmitted.

Who participates in determining prices and quantities in markets? Who are the buyers and sellers? We'll focus on the role each decision-maker plays in the market negotiation process using just enough detail to explain price and quantity.

1. Households – treat household as a single-minded family unit. Ignore decisions made within household. We want "just enough" detail for price and quantity.
2. Business Firms – single-minded unit – "it" has goals, acts as unit to achieve goals
   Ignore managerial structure
   (business administration discusses how to set up business to achieve goals)
   e.g. firm wants to increase sales or profit– ignore what it does "inside"– it appears on market trying to do it, then we see what effect is on price and quantity
3. Government (central authority) – single-minded unit – "it" has goals, acts
   Political Science, not Economics, looks at internal structure of govt.

Which are buyers, which are sellers? (we'll look at three types of markets).

1. Final product markets
   Firms are producers and sellers (suppliers) and households are buyers (demanders)
2. Labor markets – firms cannot produce without labor
   Households are sellers of labor (suppliers) firms are buyers of labor (demanders)
3. Factor markets: Factor – anything used in production process. So labor is a factor, but type 3 looks at non-labor factors (materials, equipment, buildings, energy)

Government's roles in markets (five types of roles)

1. As buyer simplest role – negotiates like other buyers (e.g. buying autos or paper)
2. As rule-maker truth in lending, no false advertising, control monopolies
3. As price **OR** quantity setter price controls, rationing
4. As price **AND** quantity setter (with some negotiation)
   e.g. Marketing boards – allow some negotiation between buyers and sellers, then sets price and quantity

5. Command market – govt. sets both price and quantity allowing no negotiation
   Buyers must buy exactly what government sets, no more or less
   Sellers must sell exactly what government sets, no more or less
   Govt. believes it knows what is best. Extreme in intervention
   Command Economy – all markets in an economy command.
   Free Market – government is buyer, rule maker, doesn't set prices or quantities

U.S. and Canada often called mixed economies – have some elements of all 5 roles

Which is better, command markets or free markets? Can't say – advantages to both depending on society's goals. Free market can be more flexible, respond more quickly (buyers and sellers react quickly in attempting to do the best for themselves).

Socialism – government owns firms
   need not be command – can have socialist free market (govt merely owner)

IV. What is the difference between Microeconomics and Macroeconomics?

Microeconomics – prices and quantities in individual markets
   examples: Final product markets – (autos, beef), Labor markets – (auto workers)

Macroeconomics – prices and quantities in national markets
   (looks at "the" market for all Canadian goods at once – Gross Domestic Product)
   (looks at "the" market for all Canadian labor at once – e.g. 8.1% unemployment)

V. How will we study markets?

Scientific Theories

Science – sorts facts about the world so we can understand the world better

Theories – connect statements in a sequence using logic. The sequence tries to explain a fact. Scientific theories are not the only way to study prices and quantities but the way that most economists use.

Advantage to theoretical approach

You use just those aspects that are needed to explain just that fact – it simplifies

Road map analogy – road map simplest way to determine alternative routes between two points. Powerful because it simplifies. But map leaves out tremendous amount of useful and interesting info. Theoretical approach also has this disadvantage.

Other approaches: historical analysis, classification, analysis of institutions

Someone constructs a theory, picking out what is considered important and explains well. The theory is tested and modified over time. Since Adam Smith, economists have continued to use the theoretical approach because it has worked so well, and been so useful, in the kinds of problems we analyze in economics.

Graphs We're studying prices and quantities – both can be measured and plotted on a graph. Rather than give a complex verbal description of a person, instead show a photo. Our graphs, like the photo, are a compact wayto show a theory and to remember it. Theories can't all be graphed but ours will.

Nearly all our graphs have price on the vertical axis and quantity on the horizontal as shown here.

VI. How can we measure "Price"?

Very difficult to measure true opportunity cost for an actual situation because:
1. A person making a decision may have many alternative goods in mind
2. The alternatives may change quite frequently
3. The person may have not have any specific alternative in mind – they may be thinking somewhat vaguely OR they may think "there are other things I may wish to buy tomorrow but I'm not sure what yet."

Therefore, economists often use a substitute for opportunity cost called relative price.

We now have two ways to measure the price of a good:
   Absolute price – actual dollars paid for a unit of a good.
   Relative price – absolute price compared to the price of some other good.

Example: P_B = absolute price of textbook = \$80
   P_M = absolute price of a movie = \$20

$$\begin{pmatrix}\text{Relative price}\\ \text{of book}\end{pmatrix} = \left(\frac{P_B}{P_M}\right) = \left(\frac{\$80}{\$20}\right) = 4$$ (question – 4 what?)

How might relative price of book fall? (i.e. book gets relatively cheaper)

How?	P_B	P_M	Rel. Price
P_B falls P_M same	40	20	2
P_B same P_M rises	80	40	2
P_B,P_M both rise P_M rises more than P_B	120	60	2

Relative price is not the opportunity cost but only an approximate measure of it.

Difficult to know what "other" price is best to use for the comparison.
   (in macro we will compare to a sort of group average of "typical other goods.")

In micro, when we look at how and why the price of a good changes, we should really be looking at the relative price. However, since absolute price is easier to measure and understand, and it is what we see every day, we will use it. Indirectly we are assuming that we are looking at the changes in the price of one good with little or no changes in other relevant comparison goods. This is fine in times of low inflation like now, but was trickier in times of high inflation like early 80's.