

Introduction

- Human wants are unlimited; greediness
 - Partially satisfied by producing and consuming G&S.
- We analyze nature of:
 - Production activities - theory of firm
 - Consumption activities - theory of consumer
 - Exchange activities - theory of markets
- Two primary types of economic actors who interact within markets of capitalist economy:
 - Consumers
 - Producers
- Economy: an institution in which these actors produce, consume, and exchange.
- Any economy produces G&S by combining resources into technology of production:
 - Land: natural resources or any derivative thereof
 - Crops, minerals, land itself
 - Labour: human effort
 - Capital: something used to make something else (not altered; may depreciate)
 - Structures, vehicles, machinery

Scarcity

- These resources available only in limited quantities
 - Unlimited wants, limited means to produce them
- Scarcity causes consumers & producers to make choices (faces all economies)
- All choices involve incurring opportunity cost
 - The value of the option that was not selected (highest forgone alternative)
 - No scarcity, no choices → no choices, no opportunity cost
- Free good: when there's no opportunity cost, BUT:
 - No such thing; everything has cost in terms of resources foregone
 - Politicians: higher living standards without giving up anything in return
- Must examine preferred option to alternatives, not just \$ value
 - Not always scarce resources should be allocated to it
 - Construction of Olympic venues incur opportunity cost (may be useful elsewhere)

Market Economy

- Different types of economies:
 - Robinson Crusoe, tribal, feudalistic, command, free-market, social democratic
- Three coordination tasks:
 - What G&S should be produced, and in what quantities?
 - How should they be produced? What is the technology?
 - For whom are the goods and services produced?
- Market economy responds: resources allocated to highest and best use
 - Those that are profitable, production of unprofitable G&S discontinued
 - Least costly technique of production
 - G&S distributed according to the ability to pay

- Key features:
 - Its decentralized fashion where consumption, production, exchange ideas made
 - Primary allocative mechanism used is price system.
 - Inegalitarian
 - Generates winners and losers (very cruel to losers)
 - Distribution of rewards/penalties unequal
 - Efficient where shortages eliminated and production of G&S maximized w/ wants
 - Left say produces wrong things
 - Dynamic: quickly adjusts to changes in tech, consumer tastes, demography

Command Economy (antithesis of market)

- Key Features:
 - Executes 3 essential tasks in centralized fashion (allocation decisions at headquarters)
 - Central planning bureau sets output quotas for production units
 - Central planning bureau allocates the inputs and specifies the technique
 - Central planning bureau allocates the G&S to workers via rationing
 - Egalitarian as it rewards all agents equally
 - Inefficient as there are many shortages and surpluses
 - Static as it doesn't rapidly adjust to change (very long chain of command)

Summary

- Economics is about:
 - Why are prices what they are?
 - Why are quantities what they are?
- Economic models: used as primary analytical tool for economic events and behaviour
 - Not designed to imitate reality with exactness; to describe workings of economy
 - Gross simplifications; based on unrealistic assumptions
 - Consists of premises rather than unqualified predictions
- Forecasting & predictions a very small part of their job
 - Usually apply microeconomic analysis to events (ie. obesity epidemic)