

Part One: Introduction

Chapter 1: What is Economics?

A. Definition of Economics

- All economic questions arise because we want more than we can get
- Our inability to satisfy all our wants is called scarcity.
 - ↳ We cannot get every thing we want
 - ↳ Because we face scarcity, we must make choices.
- The choices we make depend on the incentives we face.
- An incentive is a reward that encourages an action or penalty that discourages an action.
 - ↳ prizes act as incentives
 - ↳ incentives help in making choices

Economics is the social science that studies the choices that individuals, businesses, government and entire societies make as they cope with scarcity and the incentives that influence and reconcile those choices.

- ↳ Microeconomics is the study of choices that individuals and businesses make, the way those choices interact in markets, and the influence of government
- ↳ Macroeconomics is the study of the performance of the national and global economies

B. Two Big Economic Questions

- ① How do choices end up determining what, how and for whom goods and services get produced?
- ② Do choices made in the pursuit of self-interest also promote the social interest?

ECONOMIC QUESTION 1: What, How and For whom
 Goods and services are the objects that people value and produce to satisfy wants.
 ↳ physical objects
 ↳ tasks performed for people

WHAT?

- what we produce varies across countries and changes over time
- how do choices end up determining the quantity of each item produced?

HOW?

- goods and services are produced by using productive resources that economists call factors of production:

① Land - the "gifts of nature" that are used to produce goods / services
 - natural resources

② Labor - the work time and work effort that people devote to producing goods and services
 - quality of labor depends on human capital, which is the knowledge and skill that people obtain from education, on-the-job training and work experience

③ Capital - the tools, instruments, machines, buildings and other constructions that businesses use to produce goods and services
 - ex. money, stocks and bonds

④ Entrepreneurship - the human resource that organizes land, labor and capital

FOR WHOM?

- Who gets the goods and services depends on the income that people earn
 - land earns rent
 - labor earns wages
 - capital earns interest
 - entrepreneurship earns profit

ECONOMIC QUESTION 2: Do choices made in the pursuit of self-interest also promote the social interest?

- Self-interest - choices that you make thinking it's best for you
- Social interest - choices that are best for society as a whole
- An outcome is in the social interest if it uses resources efficiently and distributes goods and services fairly.
- one choice for self and social interest → is that possible?

The Economic Way of Thinking

How do economists think? Key Ideas:

- a choice is a tradeoff
- people make rational choices by comparing benefits and costs
- benefit is what you gain from something
- cost is what you must give up to get something
- most choices are how much choices made at the margin.
- choices respond to incentives

Choices and Tradeoffs

- the economic way of thinking places scarcity and its implications, choice, at center stage.
- every choice is a tradeoff - an exchange - giving up one thing to get something else

Rational Choice - a choice that compares costs and benefits and achieves the greater benefits over cost for the person making the choice

Opportunity Cost

- the opportunity cost of something is the highest-valued alternative that must be given up in order to get it.
- the highest valued alternative we give up to get something else

Choosing at the Margin

- people make choices at the margin, which means that they evaluate the consequences of making incremental changes in the use of their resources

• Marginal Benefit - the benefit from pursuing an incremental increase in an activity.

• Marginal Cost - the opportunity cost of pursuing an incremental increase in an activity.

Responding to Incentives

- our choices respond to incentives
- for any activity, if marginal benefit exceeds marginal cost, people have an incentive to do more of that activity.
- if marginal cost exceeds marginal benefit, people have an incentive to do less of that activity.
- incentives are also the key to reconciling self-interest and social interest.

D. ECONOMICS AS A SOCIAL SCIENCE AND A POLICY TOOL

Economists distinguish between two types of statements:

- ⊙ Positive statements - "what is" statements; facts → can be tested by checking against facts
- ⊙ Normative statements - "what ought to be" statements → cannot be tested

CETERIS PARIBUS - controlled experiment.

ECONOMIC MODEL - a simplified representation of a real-life situation that is used to better understand real-life situations.