Economics: The study of how to make choices to satisfy unlimited wants with limited resources.

Two broad fields within economics:

- Microeconomics: Decision-making on the level of individual decision-making agents, e.g., a person, household (explain why a household is an economic unit) or firm.
  1. Individuals/Households decide what to consume (given prices) and how much labor to supply (how much to work for given wages).
  2. Firms decide what & how much to produce, what inputs to use (how many workers to hire and how many machines to buy, given the price they can charge for their goods and how much they must pay for their machines & workers).

Basic microeconomic questions:

1. What goods & services to produce (ask what are services)
2. How to produce them
   (These two questions answered by the interaction of market forces in a capitalist economy, i.e., interaction of demand & supply. In turn, demand & supply depend on the decisions of individuals that maximize their utility, and the decisions of firms that maximize their profits).
3. For whom to produce
   (This is both a positive question and a normative one…. Say what you mean by positive ‘something that depends only on factors that can be empirically measured’… so you are a firm trying to maximize profit (say Mercedes-Benz), you produce only for customers who will be able to pay the price of your product.
   But supposing you were to try to answer this question normatively (ethically). Then you might decide that things should be produced for people who need them most, regardless of whether they are able to pay for them, i.e., regardless of whether they are rich or poor.
   So if you are the government, say, deciding on how much healthcare to provide to the people then you might decide on the same level of healthcare for both rich & poor
people. So you might tax the rich to provide a level of healthcare for the poor that they
cannot afford by themselves).

All these questions were answered in Econ 101 at the level of individual economic
agents e.g., a person, household or firm.

• Macroeconomics
Concerned with ‘aggregates’: How is the economy doing on the whole? Is average
income of people in our country increasing? Are more goods and services being produced
on the whole in our economy? What is the employment situation in the country like? Are
prices rising are falling on the whole (is there inflation in the economy)?
The above questions may be summarized into ‘three broad questions’ (…underline and
write in capitals…):

1. What is the standard of living in the economy & how to improve it?
(Ask question: Can you think of something that would measure the standard of living of a
country--- per capita (average) income, per capita consumption).
2000 figures: Average income/ person in the US: $ 95/ day, World average: $ 20/ day,
Africa: $ 5/day.

2. What is the cost of living in our country (is it rising or falling) and how do we
regulate it?
(Ask: How do you measure changes in cost of living in a country: by looking at the
inflation/deflation rate: is your dollar worth more or less tomorrow compared to today?

3. Measurement of fluctuations in the economy & how to control these fluctuations?
(The economy undergoes cycles over time. Sometimes it does well (economic expansion)
and sometimes it does not. What do we mean by ‘doing well’: unemployment is low,
production levels are high, and inflation is not ‘too much’. When it does not do well
(economic depression), many people are jobless, firms cannot sell their products (things
lie unsold in show rooms as people cannot afford to buy them), or the prices of goods
skyrocket). Talk about Great Depression, 1929, as the biggest instance in the US
economic history of an economic depression.
• **The macroeconomist’s job:** The job of the macroeconomist is to measure these three things (standard of living, cost of living, economic fluctuations) understand what is causing them, and suggest policy measures to fix them.

• The government’s role in managing the macro-economy (Perhaps the single largest macroeconomic player)

The government plays a big role in management of the macro-economy --- rather the economists working for the government do. (Ask question: Can you name in the news all the time who does this: Allan Greenspan).

So what they basically do is try to find answers to these three big macroeconomic questions. And when they find the answers, they have two macroeconomic policy tools they can use to try and fix the problems:

1. Fiscal Policy (that’s what people working for the US Treasury department can use, things like tax cuts).

2. Monetary policy (that’s what people working for the US Federal Reserve can use, things like changes to the interest rate, like Greenspan does from time to time to boost the economy).