Chapter 1

What is Economics?

Economics, Scarcity, and Choice

- Economics
  - Word “economics” comes from Greek word “oikos” (house) and “nomos” (custom/law)
  - Rules of household
  - Social Science, seeks to explain something about society
- Definition:
  - Economics is the study of choice under conditions of scarcity
- Scarcity
  - Situation in which the amount of something available is insufficient to satisfy the desire for it

Scarcity and Individual Choice

- Scarcity
  - Individuals are faced with limited resources and unlimited wants (agree?)
    - Scarce time & Scarce spending power
  - Limitations force us to make choices
- Economists study choices and consequences
  - Fraction of high school graduates choosing to attend college will be record high (consequence?)
  - As population ages... health care for elderly? (Ex: Old continents: Europe or Japan)

Scarcity and Social Choice

- Society faces a scarcity of resources
- Goals of society:
  - High standards of living for our citizens
  - Clean air
  - Low crime rates
  - Good healthcare
- Categories of resources:
  - Labor
  - Capital – Physical, Human
  - Land/natural resources
  - Entrepreneurship
Continued…

- Labor?
  - the time human beings spend producing good and services - that means ‘labor hrs’.

- Capital?
  - something produced that is ‘long-lasting’ and make us produce other goods and services – a good rule of thumb is that capital should last at least a year
  - useful to distinguish two different types of capital
    1) Physical capital.. example?
    2) Human capital – skills and knowledge possessed by workers (it is produced through what?)

Continued…

- Capital stock: is the total amount of capital at a particular point in time – consists of all the physical capital and human capital made in previous period that is still productively useful
- Land/ Natural resources ? Pre-existing ‘gifts of nature’..example?
- Entrepreneurship ? Individuals ability (and the willingness to use this ability) to combine the other resources into a productive enterprise.
  - May be an innovator, may be a risk taker
  - ...An example which includes all?

Continued…

- Scarcity of resources might cause the scarcity of all goods and services (we desire) produced out of them.
- Misallocation of resources? Possible
- Every society has some method of allocating its scarce resources
  - The idea of optimum allocation of resources.
    - early 90’s debate on Soviet Union
    - Never ending debates between Democrats and Republicans about tax rates, government services etc

Continued…

- Scarcity and Social Choice

  - Hence, society has to choose:
    - What to produce/ what not to produce?
    - How much to produce?
    - How to produce? (Notion of efficiency)
Scarcity and Economics

Economists study the decisions made by households, firms, and governments to
- Explain how our economic system operates
- Forecast the future of our economy,
- Suggest ways to make that future even better

Economics - Some Distinctions that we make

- By the level of detail
  - Microeconomics – study of the behavior of individual households, firms and govs.; the choices they make; and their interactions.
  - Macroeconomics – study of the behavior of the overall economy

Economics - Some Distinctions that we make

- By our purpose of analysis:
  - Positive economics deals with how the economy works – bare facts.
  - Normative economics deals with what should be – used to make judgments about the economy, identify problems and prescribe solutions

Why Economists disagree?

- The difference of opinion may be positive in nature
  - Facts are being disputed
- The disagreement can be normative
  - Facts are not being disputed
- When economists have different values, they may arrive to different conclusions
- Disagreement - over goals and values