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
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?)
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?
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
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 govt.; 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