Chapter 1 lecture notes

Literature, Russian Literature

ECON 1023 Fall 2011 Instructor: Gibson Nene Chapter 1 Lecture Notes: Limits, Alternatives and Choices The economic perspective or economic way of thinking takes the following concepts into consideration: * Scarcity and Choice * Purposeful Behavior * Marginalism: Benefits and Costs Scarcity and Choice Economics is about wants and means: * Society has the resources to make goods and services that satisfy our many desires. * However, our economic wants far exceed the productive capacity of our limited resources – our resources are scarce. Scarcity

Definition: means that society has limited resources and therefore cannot produce all the goods and services people want In other words economic resources are scarce and wants are infinite. What is the meaning of scarcity from the consumers' perspective? * Scarcity refers to limitations in consumption of the goods that are available because of limited income * Consumers have an income constraint. Because resources are scarce when we choose to produce something we simultaneously make the choice to forgo producing something else. * When a good is produced, the resources employed can no longer be used to make another good. We must decide what we will have and what we must forgo. Such sacrifices are referred to as opportunity costs. Opportunity cost Dfn: The value of the good, service or time forgone to obtain something else. When you choose to go to college, you forgo some potential income earnings. So Economics studies the choices made by individuals and societies to utilize scarce resources to satisfy unlimited wants. Purposeful behavior We make decisions to achieve desired outcomes * We are not always perfect in our choices Human behavior is assumed to reflect rational self-interest Economics assumes that individuals seek to increase or maximize their utility: pleasure, happinessor satisfaction * As consumers we assume you are purposeful in deciding what goods and services to buy. * You want to get the best out of their choices * Business firms are purposeful in deciding what products to produce and how. * Governmental entities are purposeful in deciding what services to provide and how tofinancethem. * In an nutshell, society seeks to get the best out of every choice. Does rational self-interest mean that individuals are selfish?

It turns out that a lot of people help society through charitable donations, expertise without expecting you to pay for the service. Marginalism: Benefits and Costs What is the meaning of Marginal in economics? Marginal means extra, additional a change in. A change from the staus quo. e. g. should I study an extra hour for the exam? Should I buy an extra pair of shoes? Every decision involves marginal benefits (MB) and because of scarce resources, marginal costs (MC). Which choice would make you better off? MB= MC, MB> MC, MB

Example shopping for a new car * You find a standard model that you like but you are considering additional features (a sunroof, leather interior, heated seats and alloy wheels). As long as the marginal benefit (greater satisfaction) exceeds the marginal cost (extra expenses) of the additional features, you will add them. Economics relies on the Scientific Method * Observing real-world behavior and outcomes. * Formulating possible explanations of cause and effect (hypothesis). * Testing hypothesis by comparing predicted and actual outcomes. * Accepting, rejecting, or modifying hypothesis. * Continuing the process.

Hypotheses > Theories > Laws and principles > Models Economic principles are statements about economic behavior that enable prediction of the probable effects of certain actions. * They serve as tools for ascertaining cause and effect (or action and outcome) within the economic system: * " Purposeful simplifications" – simplify complex reality * Generalizations – make statements about typical or average consumers, workers, or business firms * Ceteris paribus (Other things equal) – all variables except those under consideration are held constant * Graphical expression – many models are expressed graphically

Microeconomics versus macroeconomics Microeconomics studies individual decision-making units, such as a consumer, a worker, or a business firm. Macroeconomics studies the economy as a whole or it aggregates. The economic problem Individual's economic problem The economic problem faced by individuals can be summarized using a budget line What is a budget line? Suppose you received a $120 Barnes and noble gift card as a birthday present. The card expires soon, so you want to use everything on the card on books and DVDs. Your Budget here is $120 Two goods, DVDs Price $20 and Books Price $10

First step in constructing a budget line. Construct a table showing the alternative combinations of the two products that are available. Graphing the budget line What do we learn from the budget line? Trade-offs and Opportunity costs Implications of a straight-line budget constraint Choice Limited income forces people to choose what to buy and what to forgo to fulfill wants. What happens to the budget line when your income changes? A reduction or decrease in income: Suppose the gift card has $60 on it and prices do not change. You still want to buy the same two goods, DVDs Price $20 and Books Price $10.

The budget line associated with a reduction in income. An Increase in income: Suppose the gift card has $240 on it while prices of DVDs and books remain the same The budget line associated with income increase Society's economic problem * Economic resources are scarce * What are economic resources? The production possibility model * Assumptions Production possibilities table Lists the different combinations of two products that can be produced with a specific set of resources, assuming full employment. Assume a simple economy producing only Pizza and manufacturing equipment.

Type of Production| Production Alternatives| | | | | | | | A| B| C| D| E| | | | | | | Pizza(hundred 000s)Manufacturing equipment (thousands)| 010| 19| 27| 34| 40| | | | | | | Production possibilities curve The law of increasing opportunity costs A movement from point A to point B: Movement from point B to point C Movement from point C to point D Movement from point D to point E The shape of the curve PPF Example 2 Below is a production possibilities table for consumer goods (automobiles) and capital goods (forklifts): Type of Production| Production Alternatives| | | | | | | | A| B| C| D| E| | | | | | |

AutomobilesForklifts| 030| 227| 421| 612| 80| | | | | | | | | | | | | The PPF If the economy is at point C, what is the cost of one more automobile? Of one more forklift? Explain how the production possibilities curve reflects the law of increasing opportunity costs. If the economy characterized by this production possibilities table and curve were producing 3 automobiles and 20 forklifts, what could you conclude about its use of its available resources? What would production at a point outside the production possibilities curve indicate? What must occur before the economy can attain such a level of production?

Suppose improvement occurs in thetechnologyof producing forklifts but not in the technology of producing automobiles. Now assume that a technological advance occurs in producing automobiles but not in producing forklifts. Now draw a production possibilities curve that reflects technological improvement in the production of both goods. Optimal allocation of resources Marginal benefit curve The marginal cost curve The intersection of the two MB= MC MB> MC MC> MB PPFs and Unemployment, Growth, and the future Unemployment or underutilization of resources Economic growth

Present choices and future possibilities Investment in future goods such as capital goods, research, education, and medicine, promotes economic growth. An economy that invests more in these future goods versus one that invests in current goods. Presentville: more consumption today and less production of future goods Futureville: less consumption today and more production of future goods. Futureville will have a greater production capacity in the future and greater consumption in the future when compared to the one that favors present goods. Which economy made a better choice here?