Economics 601: Basic Economic Analysis

Introduction to the Course

What is Economics?

• Definition: Economics is a social science concerned chiefly with the way society employs its limited resources, which have alternative uses, to produce goods and services for present and future consumption. We can rewrite this to be:

• 1) Economics is the study of the choices people make to cope with scarcity. --OR--

• 2) Economics is the study of how people cope with the problem of limited resources and unlimited wants.

2 main branches of economics

• Macroeconomics – A broad perspective - national/global economy - way various sectors of the economy relate to each other

• Microeconomics – A close-up view - concentrate on decisions by individual consumers and firms
What is the economy?

• Definition: The economy is a mechanism that provides us the method to allocate these scarce resources among the possible uses.

Economic Modeling: How do we go about studying the “problem”

• 2 types of statements that we will be dealing with

  Positive statement – “what is”
  • - can be correct/incorrect
  • - can be tested scientifically
  • - “value free”

  Normative statement – “what ought to be”
  • - based on faith/values
  • - cannot be tested scientifically

How do we go about solving these problems?

1) Develop Economic Models - theoretical framework
   - relationship between variables
   - based on assumptions
   - simplify real-world

2) Develop Theories
Decisions/Decision Makers

Who makes the above decisions in the economy?

1) Households
2) Firms
3) Governments

What decisions?

1) Who?
2) What?
3) Where?
4) When?
5) How?

Where do they make these decisions?

Definition: A market is any agreement that allows buyers and sellers to do business.

The major markets that we will be dealing with in this course are:

• 1) goods market
• 2) factor (of production) market
Spectrum of Economic Systems - Market Coordination

1) Pure market economy
2) Command economy
3) Mixed economy

These systems determine the decisions made by each market participant

Economic Policy/Goals

• Every economy has a set of objectives - goals that it wishes to meet
• Economic Policy - government action to improve the attainment of these goals

• Economic Goals
  1) Economic efficiency
  2) Equity
  3) Stability
  4) Growth

Factors of Production

• 4 main factors of production
  1) Land
  2) Labor
  3) Capital
  4) Entrepreneurial talent
Factors of Production II

- Each of these factors is "paid" to be used/consumed - this is called the "return to the factor of production"
- 1) Land - rent
- 2) Labor - wages
- 3) Capital - interest
- 4) Entrepreneurial talent - profit

Opportunity cost

- From our definition of economics, we know that when we make choices, we face costs

- Definition: **Opportunity cost** is the cost in choosing in the face of scarcity - it is the value of the benefit that is forgone by choosing one alternative rather than another.

Opportunity Cost II

- Note:
  1) Opportunity cost is NOT money cost
  2) Opportunity cost includes the value of time
  3) Opportunity cost does not always remain the same

Note: The principle of substitution states that, as opportunity costs change, individuals may choose to substitute one action for another action that has a lower opportunity cost.