

Chapter 1: What Economics is About



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In This Lesson:

Vocabulary:

- "Goods" and "Bads"
- Resources
- Scarcity
- Opportunity Costs
- Costs and Benefits
- Decisions Made at the Margin



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In This Lesson

- Efficiency
- Incentives
- Unintended Effects
- Exchange
- The market and the Government
- Ceteris Paribus
- Theory
- Economic Categories

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**Abundance & Scarcity**



Ideal: Infinite Resources



Reality: Finite Resources



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**Building A Definition of Economics**  
~ Goods and Bads ~

- Good - Anything from which individuals receive utility or satisfaction
- Utility - The satisfaction one receives from a good
- Bad - Anything from which individuals receive disutility or dissatisfaction
- Disutility - The dissatisfaction one receives from a bad

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**Building A Definition of Economics: Resources**

**Land** - All natural resources, such as minerals, forests, water, and unimproved land


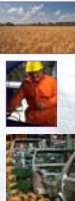
**Labor** - The physical and mental talents people contribute to the production process

**Capital** - Produced goods that can be used as inputs for further production, such as factories, machinery, tools, computers, and buildings

**Entrepreneurship** - The particular talent that some people have for:

- organizing the resources of land, labor, and capital to produce goods
- seeking new business opportunities
- developing new ways of doing things

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# Scarcity

The condition in which our wants are greater than the limited resources available to satisfy those wants



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# Economics, the Science of Scarcity

The science of how individuals and societies deal with the fact that wants are greater than the limited resources available to satisfy those wants.



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# Scarcity's Effects

1. The Need to Make Choices
2. The Need for a Rationing Device
3. Competition



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# Rationing Device

A rationing device is a means of deciding who gets what of available resources and goods. An example of a rationing device would be the 'dollar price'. The people who pay the dollar price for a new car end up with one



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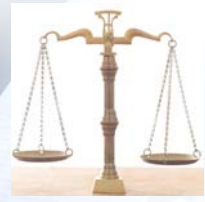
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# Opportunity Costs



- The most highly valued opportunity or alternative forfeited when a choice is made.
- Economists believe that a change in opportunity cost can change a person's behavior.
- The higher the opportunity cost of doing something, the less likely it will be done.

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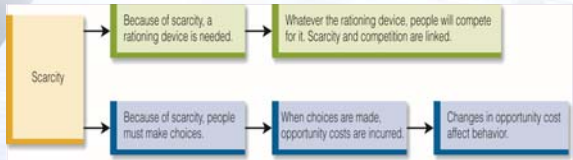
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# Scarcity, Choice and Opportunity Costs



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# Marginal Benefits

Additional benefits. The benefits connected to consuming an additional unit of a good or undertaking one more unit of an activity.

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# Marginal Costs

Additional costs. The costs connected to consuming an additional unit of a good or undertaking one more unit of an activity.

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# Decisions at the Margin

Decision making characterized by weighing the additional (marginal) benefits of a change against the additional (marginal) costs of a change with respect to current conditions

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### Study or Play



### Benefit

### Cost

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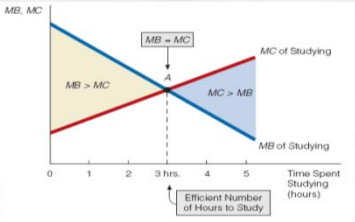
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### Efficiency

$MB$  = marginal benefits and  $MC$  = marginal costs. In the exhibit, the  $MB$  curve of studying is downward sloping and the  $MC$  curve of studying is upward sloping. As long as  $MB > MC$ , the person will study. The person stops studying when  $MB = MC$ . This is where efficiency is achieved.



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### Incentives

Something that encourages or motivates a person to take an action.



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# Unintended Effects

- A positive or negative outcome that was not anticipated



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# Exchange/Trade

The process of giving up one thing for another.



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# The Market and Government Addressing Issues

- Financial problems in the banking sector
- The economic effects of falling real estate prices
- Growing federal budget deficits
- A fall in economic activity, as measured by the total output of goods and services produced in the country
- Rising unemployment
- The looming crisis in Social Security
- Health-care issues
- Issues related to climate change and the environment
- The proper role of monetary policy
- The proper role of government regulatory policy in the economy, and much more

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# The Market and Government

When it comes to economic problems, the national debate usually proceeds along these lines:

- **First**, the problem is identified and defined or described.
- **Second**, individuals attempt to identify the cause of the problem.
- **Third**, individuals propose solutions to the problem.

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# The Market and Government

With respect to both the cause and the solution, we often hear two words mentioned: the "market" and "government."

- **Either**: The market (or capitalism) is the cause of the problem.
- **Or**: The government is the cause of the problem.
- **Either**: The market (or capitalism) is the solution to the problem.
- **Or**: The government is the solution to the problem.

# Ceteris Paribus

A Latin term meaning "all other things constant" or "nothing else changes."

**Ceteris Paribus** is an assumption used to examine the effect of one influence on an outcome while holding all other influences constant.

[Click to return to "The Lesson"](#)



# Theory

Economists build theories to answer questions that do not have obvious answers.



Theory is an abstract representation of the real world designed with the intent to better understand the world.

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# Abstract

The process (used in building a theory) of focusing on a limited number of variables to explain or predict an event.



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# Economic Categories: Positive vs. Normative Economics

**Positive** - The study of "what is" in economic matters.



**Normative** - The study of "what should be" in economic matters

Judgment and Opinion

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## Economic Categories: Microeconomics

**Microeconomics** deals with human behavior and choices as they relate to relatively small units—an individual, a business firm, an industry, a single market.



[Click to return to 'In This Lesson'](#)

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## Microeconomic Questions:

- How does a market work?
- What level of output does a firm produce?
- What price does a firm charge for the good it produces?
- How does a consumer determine how much of a good he or she will buy?
- Can government policy affect business behavior?
- Can government policy affect consumer behavior?

[Click to return to 'In This Lesson'](#)

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## Economic Categories: Macroeconomics

**Macroeconomics** deals with human behavior and choices as they relate to highly aggregate markets (e.g., the goods and services market) or the entire economy.



[Click to return to 'In This Lesson'](#)

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# Macroeconomic Questions

- How does the economy work?
- Why is the unemployment rate sometimes high and sometimes low?
- What causes inflation?
- Why do some national economies grow faster than other national economies?
- What might cause interest rates to be low one year and high the next?
- How do changes in the money supply affect the economy?
- How do changes in government spending and taxes affect the economy?

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**Sources of Information & Economic News:**  
provide real life examples of macro economic activities (including micro). Check today's issue to see the most current news.

The Wall Street Journal - <http://www.wsj.com>

New York Times -  
<http://www.nytimes.com/pages/business/index.html>

Financial Times - <http://www.ft.com/home/us>

The Economist - <http://www.economist.com/index.html>

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