Econ 101:
Introduction to Microeconomics

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Outline

Topics:

- Definitions relating to economics
- Basic principles of
  - Individual Choices
  - Interaction of individual choices

Readings:

- Chapter 1: p3-p12
- Appendix to Chapter 2

Keywords: Scarcity, Opportunity cost, Equilibrium, Pareto Efficiency

Economics

Economics is the study of __choice with constraints__

An economy chooses

- to employ resources that could have alternative uses,
- to produce goods and services, *(what, how, how many?)*
- and to distribute them, (now or in the future) among various individuals and groups in society

Scarcity: A good, service, or resource is _scarce_ if there is less of it freely available from nature than people want

Examples: Petroleum, lumber, intelligence

__*economics* *is the study of how people to use limited resources to satisfy*

Goods, Services, and Resources

A good is a tangible object that satisfies your desires

Examples: an iPad, a pair of shoes, an economics textbook

A service is intangible, but satisfies your desires

Examples: an economics lecture, a haircut, a TV show

A resource is anything that can be used directly or indirectly to produce goods and services.

Examples: Land, labor(time of workers), capital (physical capital and human capital), natural resources

Scarcity, Choices and Tradeoffs

1. Choices are necessary and people face _Tradeoffs_

Resources are scarce—the quantity available is not large enough to satisfy all productive uses

To get one thing, we usually have to _give up____ another thing

Examples:
- Food vs. clothing
- Leisure time vs. work
- Equity(equality) vs. Efficiency

Making decisions requires trading off one goal against another

Opportunity Cost

2. The _real cost__ of an item is its opportunity cost

Opportunity cost is what you must give up in order to get something
(Also sometimes it is defined as the value of the next best alternative)

Opportunity cost is crucial to understanding individual choice

Key features of opportunity costs:

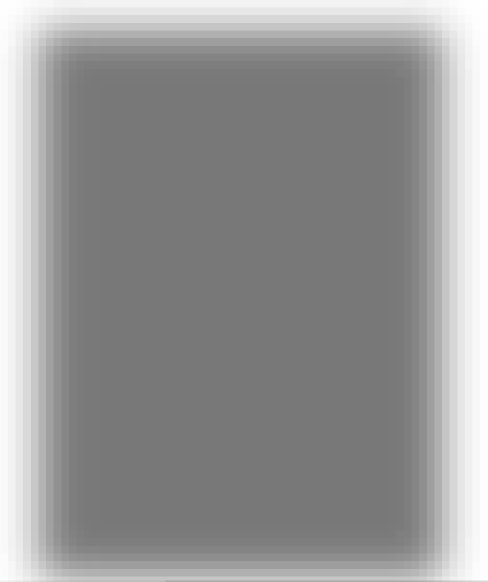
- Costs are incurred whenever choices are made
- Costs are subjective and __differ__ across people

Question: What is the opportunity cost of taking Econ 101?

Opportunity Cost: Example – Mark Zuckerberg

Example: The cost of attending the economics class is what you must give up to be in the classroom during the lecture.

Sleep? Watching TV? Rock climbing? Work?
All costs are ultimately _opportunity costs_



Marginal Analysis

3. “How much” is a decision _at the margin__

Rational people make decisions by comparing _costs and benefits__ at the margin

Many decisions are not “either–or” but instead “how much.”

Marginal decision: decision made at the margin of an activity about whether to do a bit more or a bit less of that activity
Examples: Studying one more hour, eating one more cookie, buying one more CD, etc.

Exploiting Opportunities

4. People respond to _incentives_

Incentive: anything that offers _rewards_ to people who change their behavior

Marginal changes in costs or benefits motivate people to respond

The decision to choose one alternative over another occurs when that alternative's marginal benefits exceed its marginal costs!

Gains from Trade

5. __Trade___ can make everyone better off

Trade: individuals provide goods and services to others and receive goods and services in return

There are gains from trade
: people can get more of what they want through trade than they could if they tried to be self-sufficient

_Specialization___: when each person specializes in the task that he or she is good at performing

Market Economy: Equilibrium

6. Markets move toward __EQUILIBRIUM___

A market economy is an economy that allocates resources through the __DECENTRALIZED___ decisions of many firms and households as they interact in markets for goods and services

- Households decide what to buy and who to work for
- Firms decide who to hire and what to produce

Equilibrium: an economic situation in which no individual would be better off doing something different. Because people respond to incentives, markets move toward equilibrium.

Any time there is a change, the economy will move to a new equilibrium.

Market Economy: Efficiency

7. Resources should be used efficiently to achieve society's goals

_____: There is no way to make some people better off without making at least one individual worse off
(Efficiency: taking all opportunities to make some people better off without making other people worse off)

Should economic policy makers always strive to achieve economic efficiency?

Equity: a condition in which everyone gets his or her "fair share." (There are many definitions of equity.)

Market Economy: Invisible hand

8. Markets usually lead to efficiency

Famous insight by Adam Smith in *The Wealth of Nations* (1776):

Each of these households and firms acts as if "led by ________________" to promote general economic well-being.

The invisible hand works through the price system:

- The interaction of buyers and sellers determines prices.
- Each price reflects the good's value to buyers and the cost of producing the good.
- _____ guide self-interested households and firms to make decisions that, in many cases, maximize society's economic well-being.

Government Intervention for Society's Welfare

9. Governments can sometimes improve market outcomes

Sometimes markets fail and need correction

Why do markets fail?

Individual actions have side effects not taken into account by the market (____________)

One party prevents mutually beneficial trades from occurring in the attempt to capture a greater share of resources for itself (___________)

Some goods cannot be efficiently managed by markets (public goods)