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Basic Economic Concepts

What is Economics?

- **Economics** = the "science" of **scarcity**
  - **Scarcity** = the premise that resource availability is finite
  - Economic "actors" make decisions on how to allocate resources
    - Economics is also called the science of **choices**

A Note About This Class

- This class is about **Macroeconomics**
  - **Macroeconomics** = an aspect of economics concerned with the higher-level details of how markets operate
    - Especially how governments can affect market trends
- **Economics(textbook definition)** = a social science that deals with how to efficiently allocate scarce resources such that the "actor" in question attains maximum satisfaction
  - *Flawed premise?*

Micro vs Macro

- **Microeconomics** = an aspect of economics concerned with lower-level details of smaller economic units
  - Examples
    - *How do specific markets operate?*
    - *How do monopolies affect profit?*
- **Macroeconomics** = an aspect of economics concerned with higher-level details of the entire economy
  - Examples
    - *How do we best model economic growth?*
    - *How can international trade affect domestic industries?*
    - *How can government spending influence the market?*

How is Economics Used?

- In economics, the chasm between practical affect and theoretical affect is relatively large
  - Sometimes, economic theories do not have the intended consequences
  - **Theoretical Economics** = the use of economic methods of analysis to develop a coherent model of an aspect of the economy
  - **Policy economics** = an economic model in which theories are applied and modified to best seek certain economic outcomes
- **Positive Statement** = a matter-of-fact statement of what reality consists of
  - Ignores morality and ethics and expectation
- **Normative Statements** = an assessment of perceived societal ills and how to best address them
  - Less based in practicality–more theoretical

Five Economic Assumptions

1. People's desires are unlimited, and commodities are *scarce*
2. Because of scarcity, choices must be made
   - In addition, each choice had trade-offs due to **opportunity cost**
3. Actors make decisions to maximize their satisfaction
   - Everyone is fundamentally self-interested
4. Decisions are made by comparing **marginal costs** and **marginal benefits** of each prospective option
5. Economic situations can be illuminated via simiplified models and graphs

What are "Marginal" costs and benefits

- **Marginal** = a term that describes "additional"
  - *Think "margin"*
- **Marginal Analysis** = a methodology that relies on comparing value that stands to be created or destroyed as a result of certain actions
  - Think of *cost-benefit analysis*
- Premise: *people will continue to do something until the marginal costs are greater than the marginal benefits*

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Practice Choice

> You want to visit your friend for a week. You will return Sunday night.
>
> You work every weekday earning $100 per day
>
> There are three flights available - Thursday night flight($275) - Friday Early Morning flight($300) - Friday night flight($325)

Trade-offs vs Opportunity Cost

- **Trade-offs** = all the choices that we *don't* make
  - All choices have trade-offs, by definition
  - We no longer stand to accrue the value of any of the choices we do not make
- **Opportunity cost** = the most valuable of all potential trade-offs
  - Kind of a placeholder for the largest sum of value you lose out on by going with the best choice
  - Possible to be used in the plural: opportunity cost**s**
    - The most valuable subset of size n of the set of tradeoffs

Some Economic Terminology

- **Utility** = satisfaction
  - Very hedonist definition of utility
  - Philosophers might disagree with that
- **Marginal** = additional
  - A term that describes values or costs that accrue as a result of making a choice
- **Allocate** = distribute
  - What marxist nonsense

Price vs Cost

- **Price** = the value that **consumers** dispense of to obtain a product
  - Price is set by the **producer**
- **Cost** = the value that **producers** dispense of to create or refine a product

- Cost is set by the market

- **Investment** = the process by which producers dispense of value to increase production or efficiency
  - **Consumer Goods** = a product created for providing utility to the consumer
  - **Capital Goods** = the factors of production
    - The utility that **capital goods** provide is used to produce a **consumer good** that is of utility to the **consumer**

Four Factors of Production

1. **Land** = a catchall term for **capital goods** that do not originate from labor
   - Examples
     - Physical land
     - Drinkable water
     - Coal
     - Oil
2. **Labor** = the effort exerted to transform existing **consumer goods** into **capital goods**
   - Examples
     - Slave labor
     - Wage workers
3. **Capital**
   - **Physical Capital** = **capital goods** that are used to generate **consumer goods**
   - **Human Capital** = skills gained through practice
4. **Entrepeneurship** = individuals with the ideas and skill to create goods and services that are of value to the consumer
   - Role of Entrepeneurship
     - Takes initiative
     - Innovation
     - Assumes the risk of business ventures
   - Incentive is sweet, sweet **profit**
     - **Profit = Revenue - Costs**
       - **Revenue** = the sum of value obtained by selling the goods produced