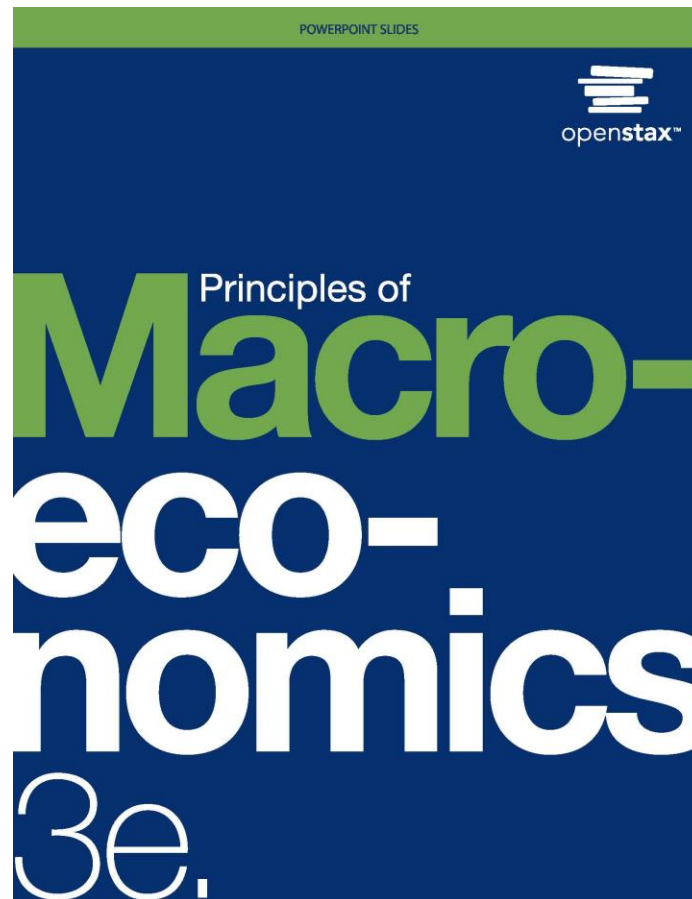


Principles of Macroeconomics 3e

Chapter 1 WELCOME TO ECONOMICS!

PowerPoint Image Slideshow



Ch.1 OUTLINE

- 1.1: What Is Economics, and Why Is It Important?
- 1.2: Microeconomics and Macroeconomics
- 1.3: How Economists Use Theories and Models to Understand Economic Issues
- 1.4: How Economies Can Be Organized: An Overview of Economic Systems

1.1 What Is Economics, and Why Is It Important?

- **Economics is the study of how *humans* make *decisions* in the face of *scarcity*.**

Scarcity

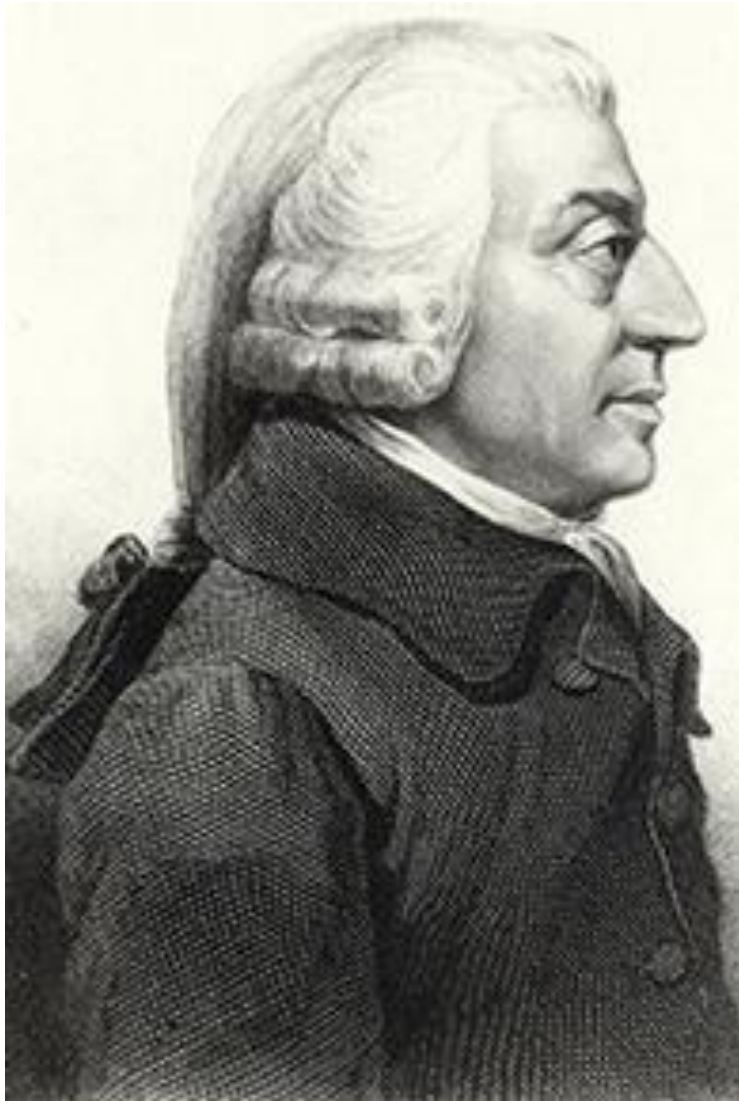


Want is a growing giant whom
the coat of have was never large
enough to cover.

~ Ralph Waldo Emerson

AZ QUOTES

Scarcity means that human wants for goods, services and resources exceed what is available.



- Solution? Produce more!
- Adam Smith introduced the idea of dividing labor into discrete tasks, in his famous 1776 book, titled *The Wealth of Nations*.

Credit: "Adam Smith" by Cadell and Davies (1811), John Horsburgh (1828), or R.C. Bell (1872)/Wikimedia Commons, Public Domain)

The Division of and Specialization of Labor



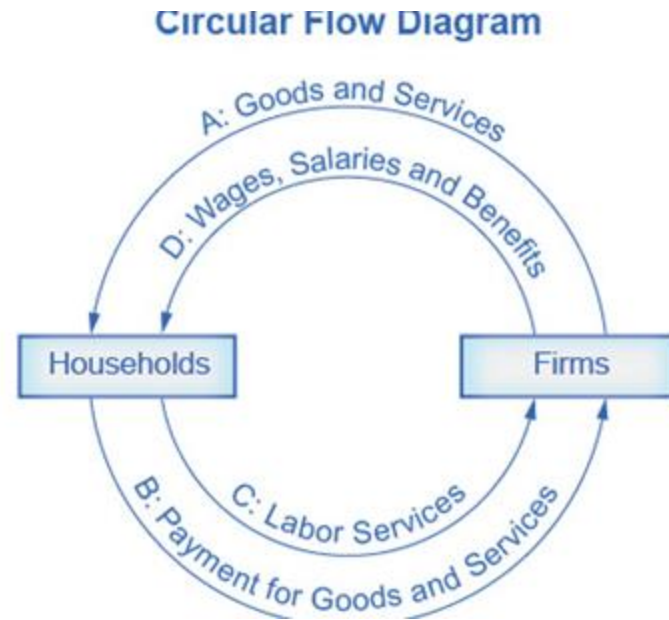
- **Division of labor** - the way in which different workers divide required tasks to produce a good or service.

Workers on an assembly line are an example of the divisions of labor. (Credit: "Red Wing Shoe Factory Tour" by Nina Hale/Flickr Creative Commons, CC BY 2.0)

Why the Division of Labor Increases Production

- Dividing and subdividing the tasks involved with producing a good or service, produces a greater quantity of output.
- WHY???
- **Specialization** - when workers or firms focus on particular tasks for which they are well-suited within the overall production process.

Circular Flow Diagram



- The **circular flow diagram** shows how households and firms interact in the goods and services market, and in the labor market.
 - The direction of the arrows shows that in the **goods and services market**, households receive goods and services and pay firms for them.
 - In the **labor market**, households provide labor and receive payment from firms through wages, salaries, and benefits.

1.4 How Economies Can Be Organized: An Overview of Economic Systems

- HOWEVER...
- There are at least three ways that societies organize an economy:
 - 1) **Traditional economy** - typically an agricultural economy where things are done the same as they have always been done.
 - Oldest economic system
 - Used in parts of Asia, Africa, and South America
 - Occupations tend to stay in the family
 - What you produce is what you consume
 - Little economic progress or development
- Why???

An Overview of Economic Systems



- 2) **Command economy** - an economy where economic decisions are passed down from government authority and where the government owns the resources.
 - Government decides what goods and services will be produced and what prices it will charge for them.
 - The government decides what methods of production to use and sets wages for workers.
 - The government provides many necessities like healthcare and education for “free”.
 - Examples:
 - Communism
 - Currently, Cuba and North Korea

An Overview of Economic Systems



Nothing says “market” more than The New York Stock Exchange. (Credit: work by Erik Drost/Flickr Creative Commons, CC BY 2.0)

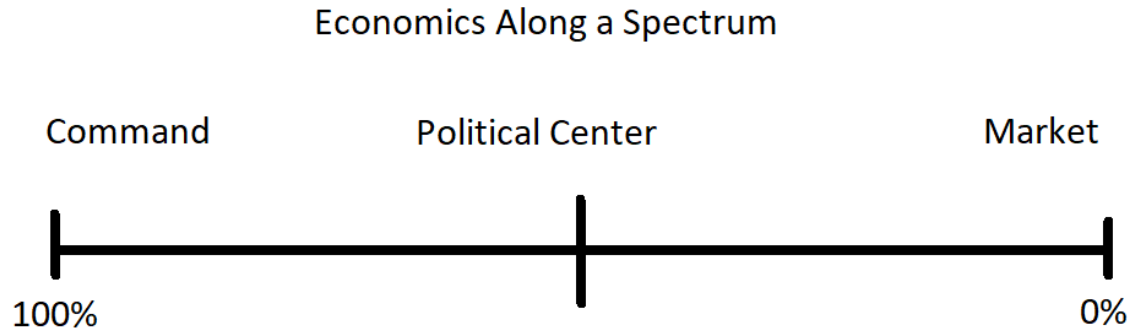
- **3) Market economy** - an economy where economic decisions are decentralized, private individuals own resources, and businesses supply goods and services based on demand.
- **Market** - interaction between potential buyers and sellers; a combination of demand and supply.

- Most economies in the real world are mixed. They combine elements of command, traditional, and market systems.
 - The U.S. economy is positioned toward the market-oriented end of the spectrum.
 - Many countries in Europe and Latin America, while primarily market-oriented, have a greater degree of government involvement in economic decisions than the U.S. economy.
 - China and Russia, while they have moved more in the direction of having a market-oriented system, remain closer to the command economy end of the spectrum.

Regulations: The Rules of the Game

- There is no such thing as an absolutely free market.
- Regulations always define the “rules of the game” in the economy.
- Economies that are primarily market-oriented have fewer regulations—ideally just enough to maintain an even playing field for participants.

Economics Along a Spectrum

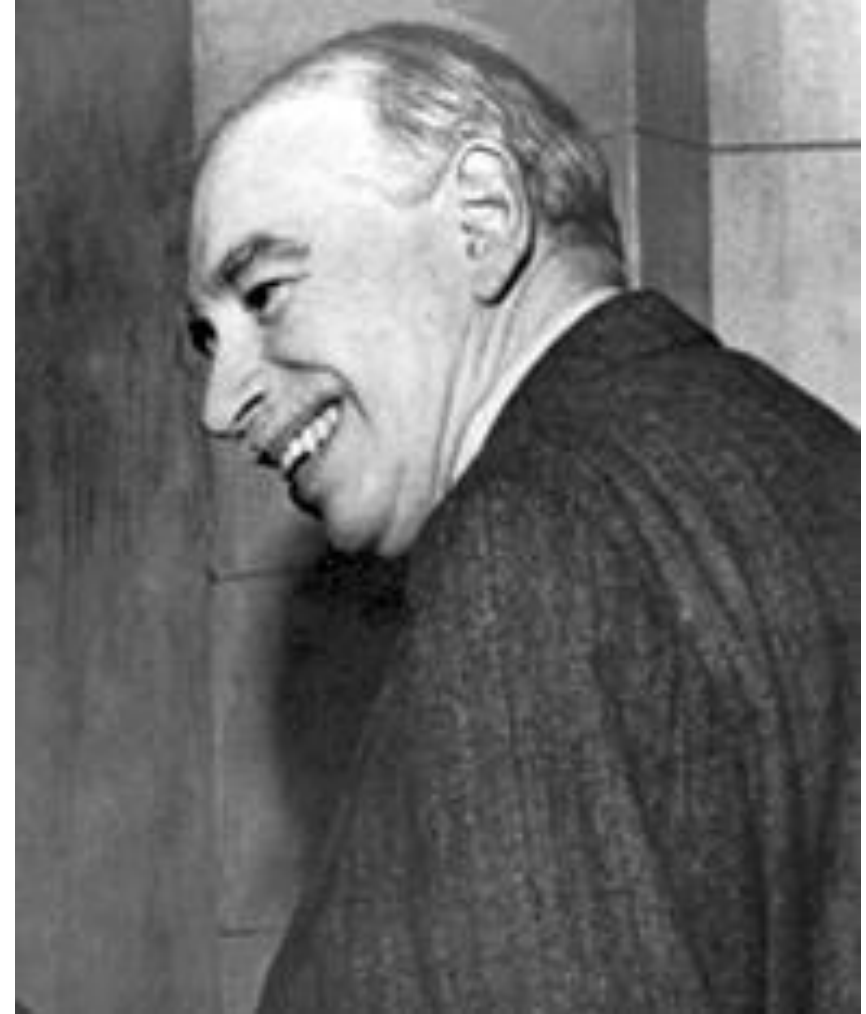


1.2 Microeconomics and Macroeconomics

- Two areas of Economics:
 - **Microeconomics** focuses on the actions of individual agents within the economy, like households, workers, and businesses.
 - **Macroeconomics** is the branch of economics that focuses on broad issues such as growth, unemployment, inflation, and trade balance.
 - (Fiscal & Monetary Policies will be covered in detail in a later chapter.)

1.3 How Economists Use Theories and Models to Understand Economic Issues

- One of the most influential economists in modern times was John Maynard Keynes (1883-1946).
- Keynes thought that economics teaches you how to think, not what to think.



(Credit: "John Maynard Keynes" by IMF/Wikimedia Commons, Public Domain)



The Rise of Globalization

- **Globalization** - the trend in which buying and selling in markets have increasingly crossed national borders.
- **Exports** - the goods and services that a nation produces domestically and sells abroad.
- **Imports** - the goods and services that are produced abroad and then sold domestically.
- **Gross domestic product (GDP)** - measures the size of total production in an economy.