

ECONOMICS: The Social Science of Decision Making

Unit 1 - What is Economics, Economic Thinking, Basic Terms and Definitions:

Economics (from Gr.: οἰκονόμος (oikonomos) = "house keeping") - The study of how decisions are made in the face of the universal **problem of scarcity**

Positive Economics - Describes what is, how things currently work

Normative Economics - Describes how things ought to be (value judgments)

Branches of Economic Study:

Microeconomics - The study of individual producers and consumers, their reactions to **incentives**, and how **markets** operate under different systems

Macroeconomics - The study of how the economy operates as a whole and the role of the **public sector** in the economy (**fiscal policy (taxes and spending)**, **monetary policy (money supply, inflation and interest rates)**, etc.)

Econometrics - The use of statistical analysis to understand the economy

International Trade and Finance - How the global economy operates

Why study economics? - To find answers:

- Why are some countries rich and some countries poor?
- Why do women earn less than men?
- How can data help us understand the world?
- Why do we ignore information that could help us make better decisions?
- What causes recessions?
- Economics is a broad discipline that helps us understand historical trends, interpret today's headlines, and make predictions about the coming years.

What do economists do?

- Professors, government advisors, consultants, and private sector employees.
- Evaluate programs, study human behavior, and explain social phenomena.
- Applications include health, gender, the environment, education, and immigration.

Why should I care about economics?

Learning about economic concepts can help you to understand the news, make financial decisions, shape public policy, and see the world in a new way.

Key Concepts:

Scarcity - The basic problem which forces human beings to make decisions is that all **resources are limited** and **human wants and needs are unlimited**

Resources - Elements which, when combined in the process of **production**, are used to create **useful things (products)**. There are three types of resources:

- **Natural Resources (aka Land)** - all resources which exist in nature (minerals, water, fertile land, plant and animal life, etc.)
- **Human Resources (aka Labor)** - people and their talents available for production
- **Entrepreneurship** - some economists believe the ability to foresee the needs of others, to organize and combine resources effectively and market and distribute products is a special category of human resource
- **Man Made Resources (aka Capital)** - all tools and machinery (**capital goods**) used in production and the **money** necessary to acquire resources (**financial or liquid capital**)

Human Desires Compete for Resources:

- **Needs** - A **general expression** for any product which can serve to fulfill a **basic human desire** ex. food, clothing, shelter, communications, transportation, entertainment, education, etc.
- **Wants** - Any **specific product (good or service)** which can be used to satisfy a need ex. food is a need, pizza is a want
- **Demands** - Wants which are **available and affordable by the consumer** to satisfy a need (ex. shelter is a need, a house, apartment or rented room is a want)

Production - The process whereby **resources are combined** to create **economic products**.

All products are either **good or services**:

Good - anything tangible, useful, scarce and transferable

Service - anything intangible, useful, scarce and transferable

Free Products - Some economists believe that there are certain useful things that are either so abundant as to be considered available to all or lacking in transferability and therefore not liable to be bought or sold ex. sunlight, air. Others argue that everything is scarce and therefore nothing is free ex. sunlight can be blocked by pollution or natural phenomena

Producers by their **cumulative and collective decisions** generate the market force of **Supply**

Consumption - The process whereby **products are used** to satisfy a want or need. The amount of satisfaction a consumer derives from using a product is called **utility**. A product's **value** is derived from the **degree of utility** it confers, its **relative scarcity** and the **availability of substitutes**.

Consumers by their **cumulative and collective decisions** generate the market force of **Demand**

The Problem of Scarcity - Because human wants and needs are unlimited and resources are limited, the world faces certain realities. The Problem of Scarcity means:

1. That there are never enough resources to produce everything that everyone would like produced.
2. That some people have to do without some of what that they want or need.
3. That doing one thing, producing one good, performing one activity, forces society to give up something else.
4. That the same resources cannot be used to produce two different goods at the same time.

Thus every society has to answer **Three Basic Questions**:

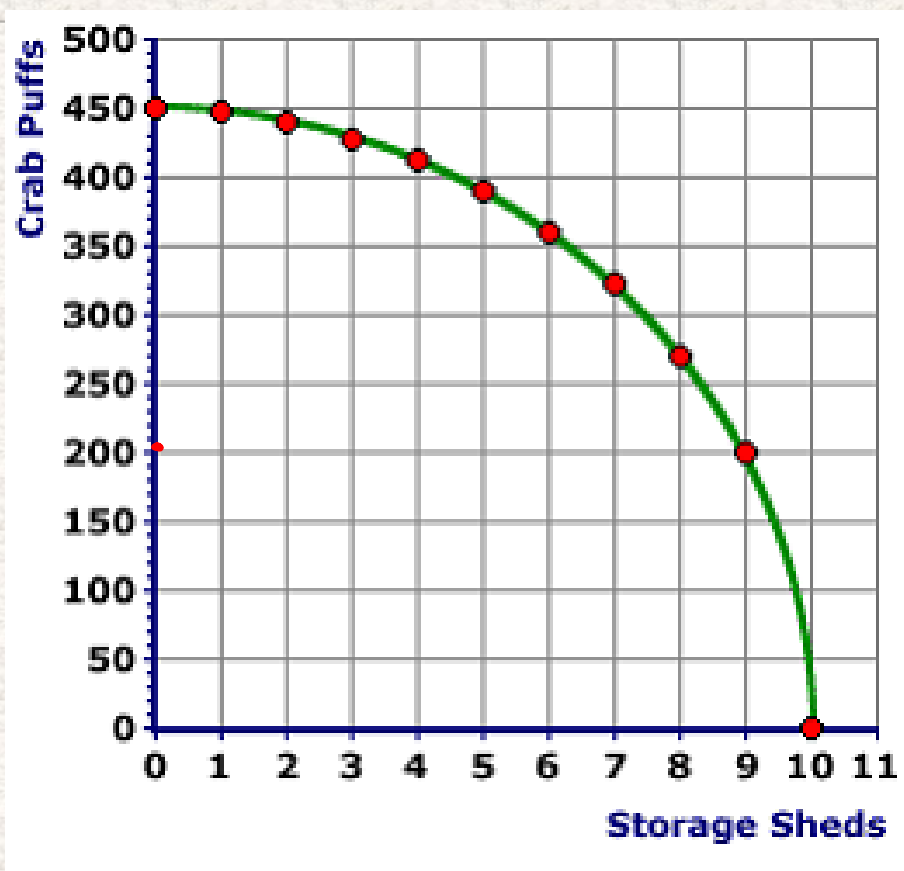
1. What goods and services to produce?
2. How to produce those goods and services?
3. For whom to produce those goods and services?

FUNDAMENTAL PRINCIPLE - OPPORTUNITY COST

The idea that the pursuit of one activity means foregoing the pursuit of another

i.e. Resources used for one aspect of production may not be used for another; therefore, choices MUST be made as to production possibilities AND methods must be used which maximize the efficiency of production

The Production Possibilities Frontier or The Problem of "Guns" and "Butter"



Capital Goods - goods used in the process of production (indirectly satisfy consumer needs and wants) ex. machine tools, jet airliners etc.

Consumer Goods - goods used directly by consumers to satisfy their needs ex. coffee maker, food, etc.

Functionality and Use - whether a good is a capital or consumer good depends on its use ex. a washing machine in a home is a consumer good, in a laundromat, a capital good

Depreciation - capital goods wear out and break down over time and must be replaced; as they are a resource, a society that fails to match depreciation with new investment will, over time, see a reduction in its production possibilities frontier. Similarly, if **investment > depreciation**, an **increase in productive capacity** will follow. Thus, the PPF represents a **choice between immediate and deferred gratification** of human wants and needs

Addressing the Problem of Scarcity

Other than the reduction of human needs and/or access to unlimited resources (neither a likely scenario), dealing with scarcity can be made easier by:

1. Technological Advances - Over the past few centuries, industrialized nations have made gains that have drastically raised the **standard of living** in their societies through technology. In general, technology has:

- given **access to previously unavailable resources** (ex. improved mining techniques)
- maximized the **efficient use of existing resources** (ex. **Green Revolution** pioneered by **Norman Borlaug** has increased crop yields tremendously)
- **increased the versatility and value of existing resources** (ex. **George Washington Carver's** development of uses for peanuts, use of biodiesel fuels, etc.)
- created new demands for **resources previously thought to have little use** (atomic power plants' use of **uranium**)

2. Productivity Gains - Increasing the **ability to create products more efficiently from existing resources** (technology, education, skill development)

3. Conservation and Recycling - Increasing the life term of non-renewable resources to maintain their availability and reduce the demand for alternative resources to fill that need (ex. fossil fuels) or **reducing waste and inefficiency in resource use** (ex. **super conductivity** to limit electric power lost in transmission)

4. Increased Availability of Resources / New Resources - Accessing previously unavailable resources (ex. deep water oil drilling, fracking, urban farming on rooftops, etc.), **creating new uses for known resources** (cold fusion, hydrogen fuel cells, viable geothermal or wave/tide generated power), or **opening new sources of resources** (ex. exploiting mineral wealth in Antarctica or other planets)

An **efficient economic system** is a vital key in maximizing efficient use of resources and the production of those goods most useful to meeting society's needs. All systems must help answer these core questions:

What to produce?

How to produce?

For whom to produce?

Resource Allocation

The Basic Questions force us to face the necessity of making good choices in allocating available resources. There are two ways to make those choices:

- 1. Voluntary: Market Exchanges** - The **free and rational interaction of buyers and sellers** determine **prices** for resources and products. The price acts as an **incentive** for both producers and consumers.
- 2. Involuntary: Government Action** - The **coercive powers** of government (**regulations, taxes, spending, etc.**) can supersede the free market and impose decisions regarding resource allocation, production choices and the distribution of wealth on a society.

Modern economies use both methods to organize their economies.

General Types of Economic Systems

Traditional - Decisions are made based on custom and tradition

- * Predetermined Decisions - Feudalism
- * Primitive Societies
- * Ritual Behavior

Market - Decisions are made by individual producers and consumers

- * Free Market
- * Mixed Market
- * Regulation and Ownership

Command - Decisions are made by some central authority

- * Mercantilism
- * State Capitalism
- * Communism
- * Socialism

Mixed Economies combine a predominantly free market mechanism with some elements of a command economy.

* In Europe, parties that support a greater degree of command intervention and government ownership of major industries are generally known as **Democratic Socialist** parties (**Revolutionary Socialist** parties are **Marxist** and support some version of

Communism - a system which **entirely rejects private property rights and democratic government**). Socialists can vary from moderate to radical but share a belief in the efficiency and justice of central government planning and control.

* In the United States, there are no Socialist parties per se (though 2016 Presidential Candidate **Bernie Sanders** (VT) is a self-described Democratic Socialist and sought the **Democratic Party's** nomination; some Democrats now describe themselves as Democratic Socialists).

- **Democrats or Liberals** generally support more government regulation of the economy while

- **Republicans or Conservatives** generally support a greater degree of pure **Capitalism** (a **free market** economic system which **guarantees property rights, relies on decentralized decision-making and calls for the least amount of government interference with markets as the most efficient way to manage resources** ("Laissez-faire" or "the invisible hand")).

Private Property is not just the physical items of wealth that an individual, household or corporation owns, it implies **the right of all to benefit from their individual abilities and talents** and the need for the consultation of the populace before any property is seized by the state for the common good (**taxes, eminent domain, a draft**, etc.). For this reason the dominant mixed economic system in the world today is often referred to as **Democratic Capitalism**.

Profit Motive - The **basic incentive** to be productive in a free market society is the idea that one will be rewarded for productive behaviors. A person will choose to do those things (ex. college education, career choice, willingness to work hard, etc.) that will lead to rewards and at the same time provide for the satisfaction of others' needs. To the degree that the profit motive is weakened (taxation, wage-setting, etc.) the economy will become less efficient and less productive.

Firms cannot be profitable unless they provide goods and services in demand to satisfy consumer needs AND use available resources in an efficient manner to produce those desired products.

The Circular Flow Model of Income and Output

