# CHAPTER 1 – LIMITS, ALTERNATIVES, AND CHOICES

**Economics**:

* The social science dealing with the use of scarce resources to obtain the maximum satisfaction of society’s virtually unlimited economic wants.
* The study of how society chooses to allocate its scarce resources to the production of goods and services in order to satisfy unlimited wants.

Examples of scarce resources—limited resources:

1. land –any natural resource provided by nature.
2. capital-tools, machinery, equip. used to produce goods & services.
3. labor-mental & physical talent of workers to produce g/s.
4. entrepreneurial ability-the creative ability of individuals to seek profits by taking risks and combining resources to produce innovative products.

Land, capital, labor, and entrepreneurial ability are also called the **factors of production.**

**Economic Perspective**—economic way of thinking.

3 Elements: 1. Scarcity and Choice—choices involve cost--opportunity costs.

2. Purposeful Behavior—rational behavior, utility.

3. Marginal Analysis—marginal benefits and marginal costs.

Economic Methodology—economics relies heavily on the scientific method to create theories and principles to explain the likely effects from different actions. The scientific method consists of the following elements: --observation of facts—real-world data.

* Hypothesis—requires initial testing, explanation of cause and effect.
* Theory—been tested, requires further testing.
* Law, Principle, Model—well tested and widely accepted theory.

Example-- law of demand

-- law of supply

**Economic Principle**—a statement about economic behavior or the economy that enables predictions of the probable effects of certain actions.

1. Generalizations
2. Other-Things-Equal Assumption-*ceteris paribus.*

**Theoretical economics**—involves formulating theories, laws, or principles and using them to understand and explain economic behavior and the economy.

**Policy economics**—involves using theories to fix economic problems or promote economic goals. Policy is a course of action.

Example of an economic policy: Federal Reserve reduces interest rates to prevent a recession.

Steps In Policymaking:

1. State the goal---example: economic goal of full employment.
2. Determine the policy options—example: use fiscal or monetary policy.
3. Implement and evaluate the policy that was selected.—example: did a change in fiscal or monetary policy alter the level of employment?

**Macroeconomics**—examines either the economy as a whole or its basic subdivisions or aggregates such as the government, household, and business sectors. Aggregate—a collection of specific economic units treated as if they were one unit. Example: millions of consumers—“consumers”.

--total output, total employment, total income, aggregate expenditures, general level of prices in analyzing various economic problems.

**Microeconomics**—the part of economics concerned with such individual units as industries, firms, and households and with individual markets, specific goods and services, and product and resource prices.

The difference between macroeconomics and microeconomics is that macroeconomics examines the economy as a whole; microeconomics focuses on specific economic units.

Macroeconomics and Microeconomics each contain elements of positive economics and normative economics:

**Positive economics**—focuses on facts and cause-and-effect relationships. It includes description, theory development, and theory testing—theoretical economics.

* Deals with factual statements, “what is”?

**Normative economics**—incorporates value judgments about what the economy should be like. **---**what particular policy actions should be recommended to achieve a goal.

* Deals with a statement of opinion, “what ought to be”.

Example of a Positive statement: The unemployment rate in several European nations is higher than that in the United States.

Example of a Normative statement: European nations ought to undertake policies to reduce their unemployment rates.

Economic Goals:

1. Economic Growth—GDP—Gross Domestic Product

2. Full Employment

3. Economic Efficiency

4. Price-Level Stability

5. Economic Freedom

6. Equitable Distribution of Income

ECONOMIZING PROBLEM—1. SOCIETY’S ECONOMIC WANTS ARE UNLIMITED. 2. ECONOMIC RESOURCES ARE LIMITED-SCARCE.

**UTILITY**—THE WANT-SATISFYING POWER OF A GOOD OR SERVICE—THE SATISFACTION OR PLEASURE A CONSUMER OBTAINS FROM THE CONSUMPTION OF A GOOD OR SERVICE.

NECESSITIES---FOOD, CLOTHING, SHELTER.

LUXURIES---BOAT, FANCY CAR, PERFUME.

THE OBJECTIVE OF ALL ECONOMIC ACTIVITY IS TO FULFILL WANTS.

PRODUCTION POSSIBILITIES MODEL

FULL EMPLOYMENT---THE USE OF ALL AVAILABLE RESOURCES—NO WORKER SHOULD BE OUT OF WORK IF THEY ARE WILLING AND ABLE TO WORK.

FULL PRODUCTION---ALL EMPLOYED RESOURCES SHOULD BE USED SO THAT THEY PROVIDE THE MAXIMUM POSSIBLE SATISFACTION OR OUR MATERIAL WANTS.

FULL PRODUCTION IMPLIES 2 TYPES OF EFFICIENCY:

A. **PRODUCTIVE EFFICIENCY**—THE PRODUCTION OF ANY PARTICULAR MIX OF GOODS AND SERVICES IN THE LEAST COSTLY WAY. EX: CD PRODUCTION

B. **ALLOCATIVE EFFICIENCY**—THE PRODUCTION OF THAT PARTICULAR MIX OF GOODS AND SERVICES MOST WANTED BY SOCIETY. EX: COMPUTERS, CD’S.

**PRODUCTION POSSIBILITIES TABLE**—LISTS THE DIFFERENT COMBINATIONS OF 2 PRODUCTS THAT CAN BE PRODUCED WITH A SPECIFIC SET OF RESOURCES.

**PRODUCTION POSSIBILITIES CURVE**---A CURVE SHOWING THE DIFFERENT COMBINATIONS OF 2 GOODS OR SERVICES THAT CAN BE PRODUCED IN A FULL EMPLOYMENT, FULL PRODUCTION ECONOMY WHERE THE AVAILABLE SUPPLIES OF RESOURCES AND TECHNOLOGY ARE FIXED.

**OPPORTUNITY COST**---THE AMOUNT OF OTHER PRODUCTS THAT MUST BE SACRIFICED TO PRODUCE A UNIT OF A PRODUCT.

EX: THE NUMBER OF ROBOTS THAT MUST BE GIVEN UP TO GET ANOTHER UNIT OF PIZZA.

**LAW OF INCREASING OPPORTUNITY COSTS**---THE PRINCIPLE THAT AS THE PRODUCTION OF A GOOD INCREASES, THE OPPORTUNITY COST OF PRODUCING AN ADDITIONAL UNIT RISES.

**ECONOMIC GROWTH**

1. INCREASE IN THE QUANTITY OF RESOURCES
2. INCREASE IN THE QUALITY OF RESOURCES
3. ADVANCES IN TECHNOLOGY

**INTERNATIONAL TRADE**

**INTERNATIONAL SPECIALIZATION**---DIRECTING DOMESTIC RESOURCES TO OUTPUT THAT A NATION IS HIGHLY EFFICIENT AT PRODUCING.

**INTERNATIONAL TRADE**---INVOLVES THE EXCHANGE OF GOODS FOR GOODS PRODUCED ABROAD.

-SPECIALIZATION AND TRADE ENABLE A NATION TO GET MORE OF A DESIRED GOOD AT LESS SACRIFICE OF SOME OTHER GOOD.