

CHAPTER 1: Limits, Alternatives, Choices

Features of the Economic Perspective

1. Scarcity and Choice → scarcity restricts options and demands choices
 - a. Opportunity costs (sacrifices): to obtain more of one thing, society forgoes the opportunity of getting the next best thing, the cost of choice
2. Purposeful Behavior → individuals look for and pursue opportunities to increase their utility
 - a. Rational self interest
3. Marginal Analysis → comparisons of marginal benefits and marginal costs for decision making
 - a. Diamond example

Scientific Method

1. Observing real-world behavior and outcomes
2. Formulation of a hypothesis based on observations
3. Testing the explanation by comparing outcomes of specific events to outcome predicted by hypothesis
4. Accepting, rejecting, and modifying the hypothesis
5. More testing of hypothesis
 - a. A very well tested and widely accepted theory → **Economic Principle**: statement about economic behavior that enables prediction of the probable effects of certain actions

Economic Principles

1. Generalizations
 - a. Principles express tendencies
2. Other-things-equal assumption
 - a. Assumption that factors other than those being considered do not change
3. Graphical Expression
 - a. Economic models are expressed graphically

Microeconomics

- Part of economics concerned with decision making by individual customers, workers, households, and business firms

Macroeconomics

- Examines economy as a whole, or basic subdivisions, or aggregates
- Aggregates: government, household, business sectors
 - o Collection of specific economic units treated as if they were one unit
 - o Ex. Millions of consumers in the US → one unit called "consumers"

Positive Economics

- Focuses on facts and cause-and-effect relationships
- Description, theory development, and theory testing
- Avoids value judgments
- "what is"

Normative Economics

Microeconomics Midterm Study Guide

- Incorporates value judgments about what the economy should be like or what particular policy actions should be recommended to achieve a desirable goal
- Focus on desirability of certain aspects of the economy
- "what ought to be"
- Individuals Economizing Problem
 1. Limited Income
 2. Unlimited Wants

Budget Line

- Schedule or curve that shows various combinations of two products a consumer can purchase with a specific money income
- Attainable and unattainable combinations
 - o All combinations beyond the budget line are unattainable
- Trade-Offs and opportunity costs
- Choice
- Income changes
 - o Increase in money income shifts budget line to the right
 - o Decrease in money shifts line to the left

Production Possibilities Model

- Assumptions → full employment, fixed resources, fixed technology, two goods (consumer & capital)

Production Possibilities Curve

- Points lying on curve → economy is using all of its available resources
- Points lying inside curve → reflect less total output

Law of Increasing Opportunity Costs

- As the production of a particular good increases, the opportunity cost of producing an additional unit rises

Optimal Allocation

- Optimal amount of activity when marginal benefit equals marginal cost

Sample Problems

CHAPTER 2: The Market System and the Circular Flow

Command System

- Socialism or communism
- Government owns most property resources
- Economic decision making occurs through a central economic plan

Market System

- Private property → individuals own firms not government
- Freedom of enterprise and choice → ensures that entrepreneurs and private businesses are free to obtain and use
- Freedom of choice → enables owners to employ or dispose of their property and money as they see fit
- Self Interest → motivating force behind units
- Competition → basis is found in the freedom of choice

Use of Money → medium of exchange

Five Fundamental Questions

- What goods and services will be produced?
- How will the goods and services be produced?
- Who will get the goods and services How will the system accommodated change?
- How will the system promote progress?