

Chapter 1 – The Economic Approach

What is economics about?

Economics is about scarcity and the choices we have to make because our desire for goods and services is far greater than their availability from nature

Four major types of resources

Resources are the ingredients/inputs that people use to produce goods and services

The four major types are:

Resource (Input)	Type	Return (Output)
Land	Natural	Rent
Labor	Mental/Physical	Wage
Capital	Physical/Financial	Interests
Entrepreneurship		Profit

Scarcity vs. Poverty

Scarcity

Positive Economics

Testable

Objective

True/False

Poverty

Normative Economics

Opinion

Subjective

Opinion Based

Scarcity

Asks the question: if the price were to be \$0 would there be enough?

Indicates there is less of a good freely available from nature than people would like

Positive economics – testable – concrete yes/no

Poverty

The number set to define poverty is based off of some statistics but primarily based off of opinion

Has to do with choice

I.e. In 2010 \$21,000 (total income) for a family of 4 was the cut off for poverty

Imagine that same family living in Haiti with \$21,000/year

Economic Way of Thinking – Principles of Economic Thinking

1. There is always a trade-off

We call this “trade-off” our *opportunity cost*

Opportunity cost is what you give up when you do something else

When you use resources, you’re always giving up the opportunity to use them in a different way

It is the most highly valued alternative you could be doing when you are doing something

If we subsidize losses (bailouts) the government is supporting the misuse of resources

I.e. seatbelts – cost \$50 billion/year and save ~400 lives/year. Could that \$50 billion/year be used for something like cancer research that could potentially save ~500 lives/year?

Everything has a cost

2. Individuals choose purposefully and therefore, economically

“Trying to get the most for least”

When things cost the same what gives you the most satisfaction in the end or *utility*

Utility – the subjective benefit or satisfaction a person expects from a choice or course of action

People behave rationally

I.e. if three things give you the same utility you choose the one that costs the least

This cost is a total cost; it includes *transaction cost*, *opportunity cost*, etc.

Transaction cost – total cost that it takes to make the transaction

3. Incentives Matter

You can get anything you want with the right incentives

Positive vs. negative incentives

Positive incentives – i.e. I will pay you \$50 if you do this

Negative incentives – i.e. you will pay me \$50 if you do this (handicapped parking spots)

People respond to incentives in a predictable way

Intended consequences vs. actual consequences

4. Economic Thinking is Marginal Thinking

People make decisions at the *margin*

What it costs to do one additional thing

Describes the effects of a change in the current situation

I.e. what the extra cost is for the producer to produce one additional unit

Change from the status quo

5. Information is a Costly Good

Implies *rational ignorance*

Rational ignorance – after the cost/benefit analysis if it costs more to learn something than the benefit of learning it, rationally we shouldn't learn it, so people are sometimes people make decisions without total and perfect information

I.e. When something costs you a lot you gain more information about it than when something costs you a little (pencil vs. car)