

# LECTURE #1: MICROECONOMICS

## CHAPTER 1

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Ten Principles

Economics as Science

# Economics & Scarcity

- Society allocates people, land, buildings, and machines to various productive tasks. It also allocates the output of goods and services produced.
- Society decides who will eat caviar and who will eat potatoes. It must decide who will drive a Ferrari and who will take the bus.
- Allocation is necessary because goods and services are *scarce* relative to the demand for those same goods and services.

# Economics & Scarcity

- **Scarcity** means that society has limited resources and therefore cannot produce all the goods and services people wish to have. Just as each member of a household cannot get everything he or she wants, each individual in a society cannot attain the highest standard of living to which he or she might aspire.
- **Economics** is the study of how society manages its scarce resources. How are resources allocated and who makes the allocation decisions is the subject of economics.

# Ten Principles of Economics

## How People Make Decisions

- 1. Decision makers face trade-offs.
  - "Guns vs. Butter" argument
  - Clean environment vs. high levels of income argument
  - Efficiency vs. Equality: dividing the pie – the role of gov't
- 2. All things incur opportunity costs
  - What must you give up in order to get something else?
- 3. People are economically rational
  - Decision making at the *margins*
  - The concept of *marginal costs vs marginal benefits*
- 4. Incentives Matter
  - What induces a person to act?
  - Government Policy and Social Objectives

# Ten Principles of Economics

## How People Interact

- 5. Trade makes every one better off
  - Comparative advantage and opportunity costs
- 6. Free markets are the most efficient way to organize economic activity
  - Moving the allocation and production decisions to the individual
  - Price are an important allocation criterion
- 7. Governments can sometimes improve market outcomes
  - The key word is '*sometimes*'
  - The property rights issue
  - Market power: ability to influence outcomes
  - Market failure: inefficient allocation of resources

# Ten Principles of Economics

## How The Economy As A Whole Works

- 8. The *Standard of Living* reflects the ability to produce goods and services
  - What causes differences in the standard of living across countries?
  - Why is productivity important?
  - Why are property rights and stable democratic governments necessary?
- 9. Governments can upset the economic cart
  - Financing public services by printing money >>> inflation
- 10. Is there a short-term trade-off between **Inflation** and **Unemployment**
  - What causes inflation: too much money or too much demand or both?
  - Does the economy need some level of inflation to work?
  - The role of governmental policy

# Circular Flow of Money and Goods

## Factor Inputs and Outputs

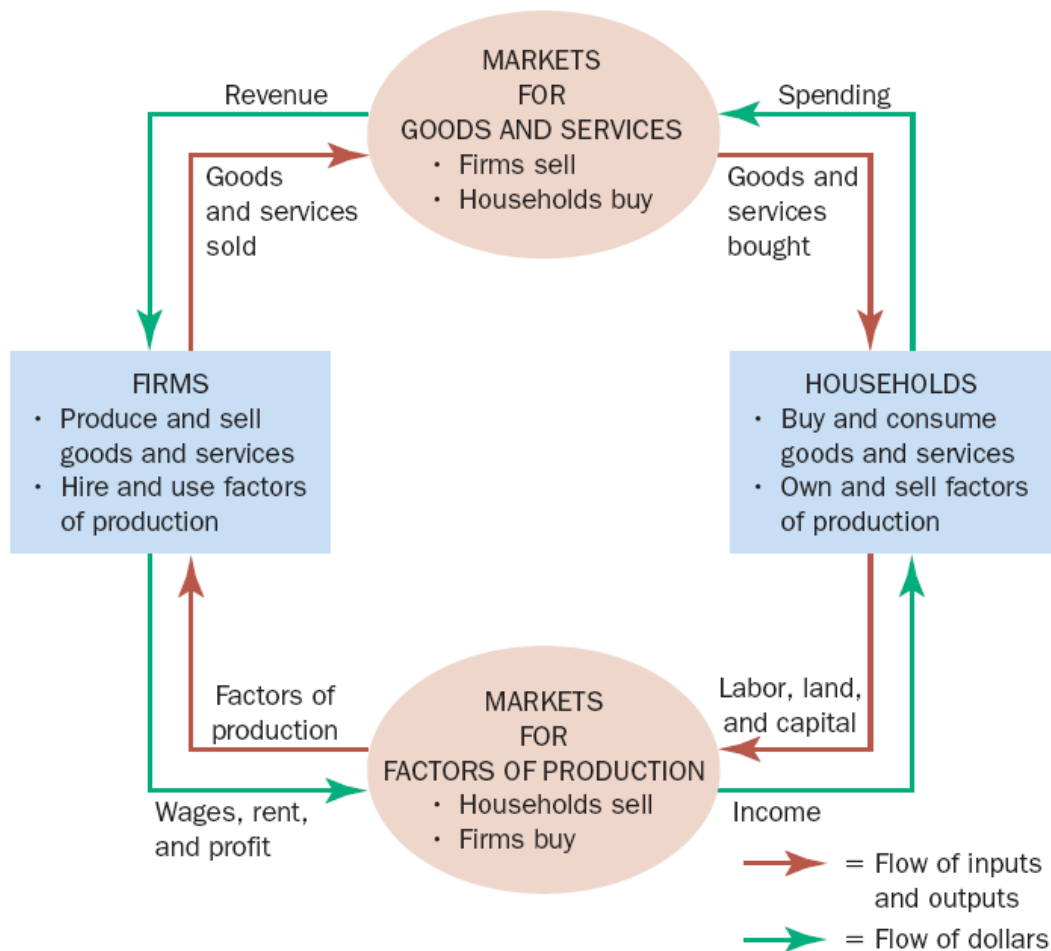


Diagram is a schematic representation of the organization of the economy. Decisions are made by households and firms. Households and firms interact in the markets for goods and services and in the markets for the factors of production. The outer set of arrows shows the flow of dollars, and the inner set of arrows shows the corresponding flow of inputs and outputs.