

Chapter 1

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Limits, Alternatives, and Choices

Chapter Objectives
Economic Perspective
Theories
Principles and Models
Macro and Microeconomics
Individual's Economizing Problem
Society's Economizing Problem
Production Possibilities Model
Unemployment, Growth, and the Future
Last Word

Key Terms



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- **Economics Defined** - the social science concerned with the efficient use of scarce resources to achieve the maximum satisfaction of economic wants.
- **Scarce Resources** - since all resources are limited we are forced to make economic choices – how to use our resources to accomplish “maximum satisfaction”.
 - **The Economizing Problem**
 - **Opportunity Cost**



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The Economic Perspective

- **Purposeful Behavior** - Economics assumes that people act in “rational self-interest” when making economic choices.
 - **Utility** - usefulness, pleasure, or satisfaction from a resource or product.
- **Marginal Analysis** - the comparison of the extra or additional costs or benefits resulting from an economic choice.
 - We will continue to add additional units until the cost exceeds the benefit ($MC=MB$)
 - Marginal Benefits
 - Marginal Costs



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Theories, Principles, and Models

- The Scientific Method – economists use it!
 - Observation of facts
 - Formulation of hypothesis
 - Testing of hypothesis
 - Accept, reject, or change hypothesis
 - Theory ➤ Law or Principle ➤ Model
- Economic Theory
 - Generalizations – what most people *tend* to do not what everyone *will* do.
 - Other-Things-Equal Assumption (*ceteris paribus*) – assume that all other variables are constant in a given analysis.



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Macro and Microeconomics

- **Macroeconomics**– examines the decisions of large sectors, government, or the economy as a whole (*aggregate*).
- **Microeconomics**– deals with economic decision making of individuals, smalls firms, or small units.
- **Positive Economics**– cause and effect, scientific, fact based analysis.
- **Normative Economics**– uses value judgments, what *should* happen, for analysis.

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Individual's Economizing Problem

- Limited Income
- Unlimited Wants
- A Budget Line
- Attainable and Unattainable Combinations
- Tradeoffs & Opportunity Costs
- Choice

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Individual's Economizing Problem



GLOBAL PERSPECTIVE

Average Income, Selected Nations

<u>Country</u>	<u>Per Capita Income 2004</u>
Switzerland	\$48,230
United States	41,400
Japan	37,180
France	30,090
South Korea	13,980
Mexico	6,770
Brazil	3,090
China	1,290
Pakistan	600
Nigeria	390
Rwanda	220
Liberia	110

Source: World Bank

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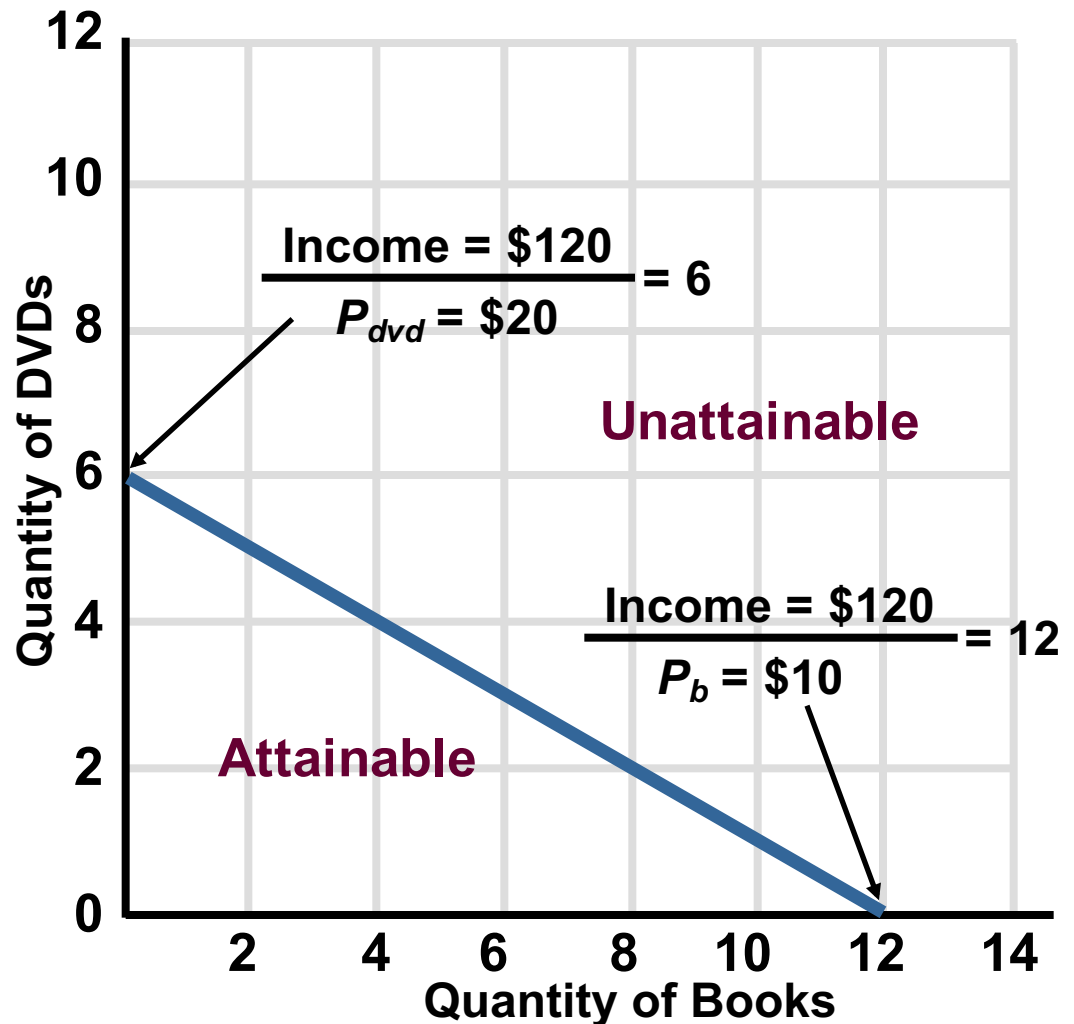
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Individual's Economizing Problem

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\$120 Budget

DVDs \$20	Books \$10
6	0
5	2
4	4
3	6
2	8
1	10
0	12



Key Terms

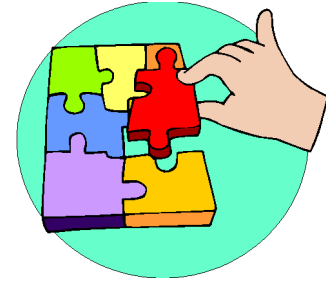


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Society's Economizing Problem



- Factors of Production
(Scarce Resources)

- Land - natural resources of “gifts of nature”
- Labor - physical and mental talents of workers
- Capital - tools, machinery, manufactured goods used to produce consumer goods
 - Investment
- Entrepreneurial Ability - the idea or “sparkplug”, innovation, risk

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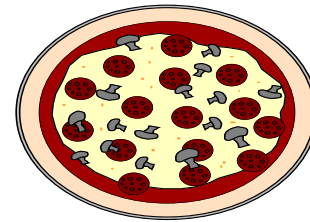
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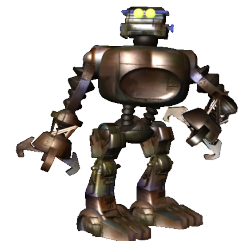
Production Possibilities Model

- The Production Possibilities Curve (ppc) shows the maximum combination of goods and services that can be produced from a given amount of resources.



- **Assumptions**

- Full Employment
- Fixed Resources
- Fixed Technology
- Two Goods
 - Consumer Goods (Pizzas)
 - Capital Goods (Industrial Robots)



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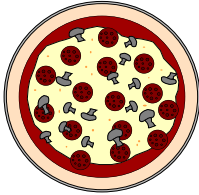
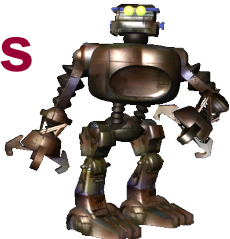


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Production Possibilities Model

Production Possibilities Table

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Type of Product	Production Alternatives				
	A	B	C	D	E
Pizzas (in hundred thousands) 	0	1	2	3	4
Industrial Robots (in thousands) 	10	9	7	4	0

Plot Points to Create Graph...

Key Terms



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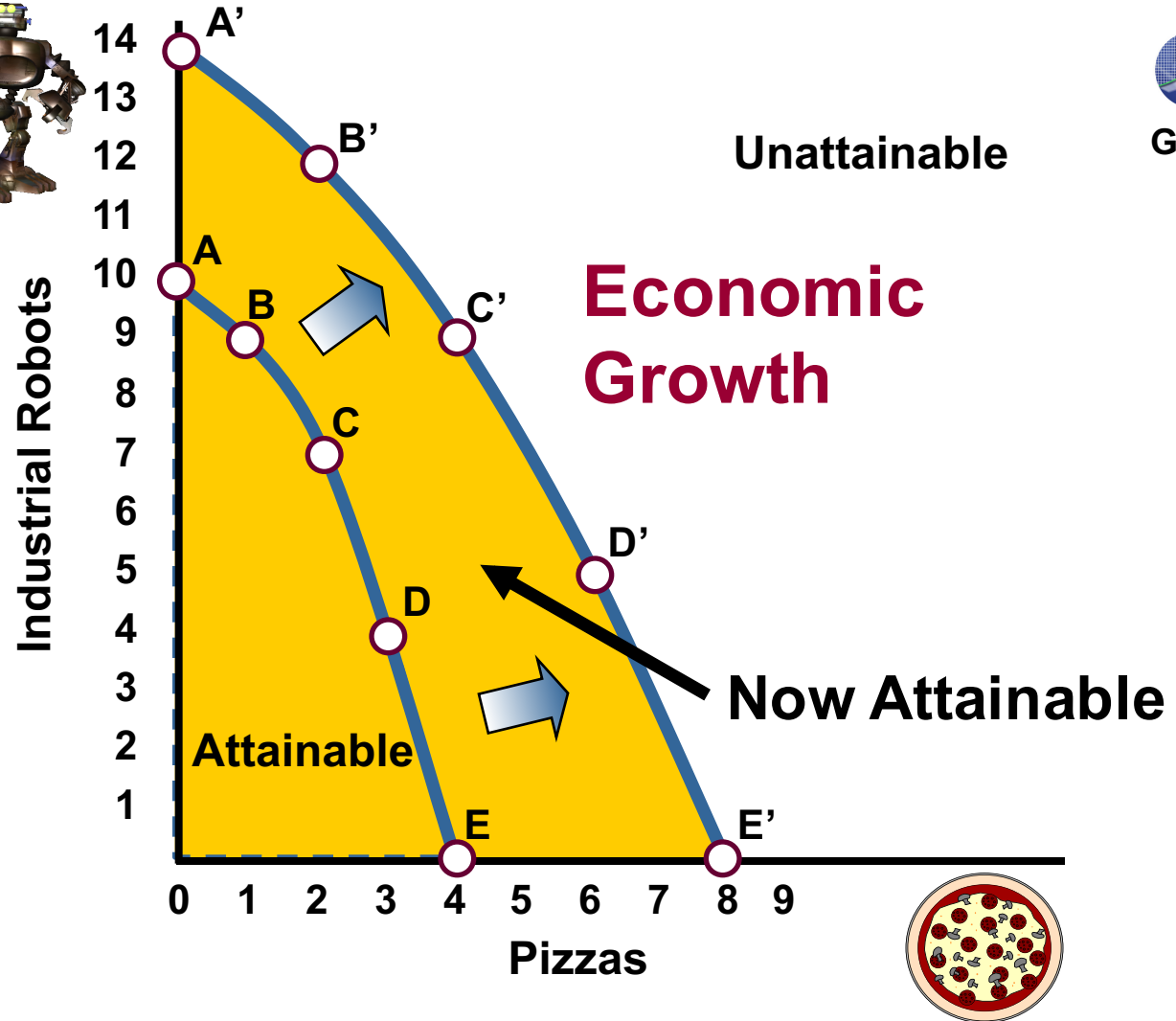
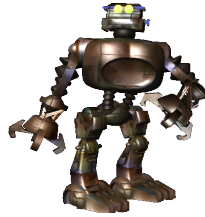


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Production Possibilities Model Production Possibilities Curve



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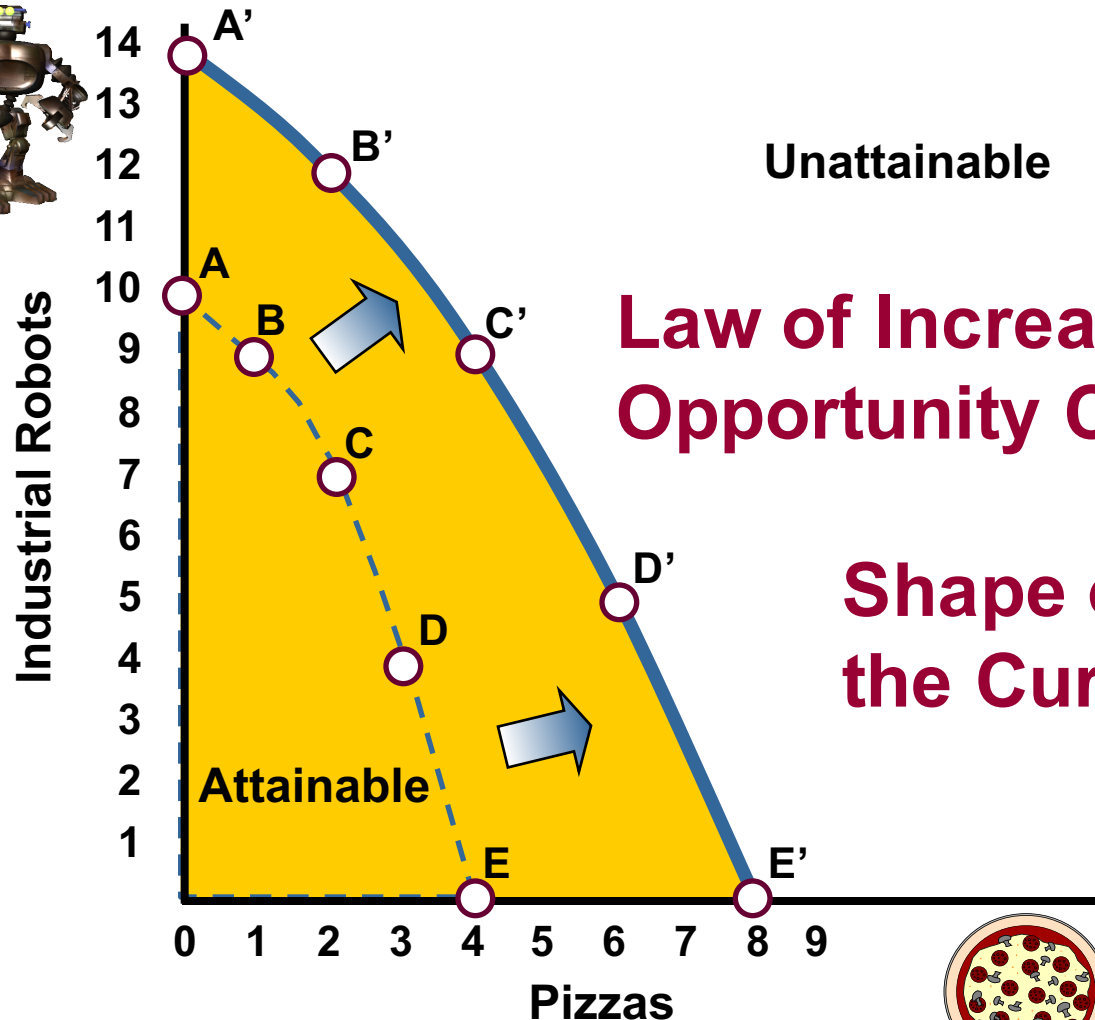
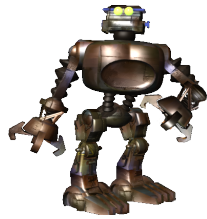


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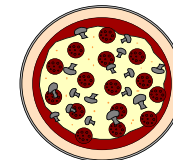


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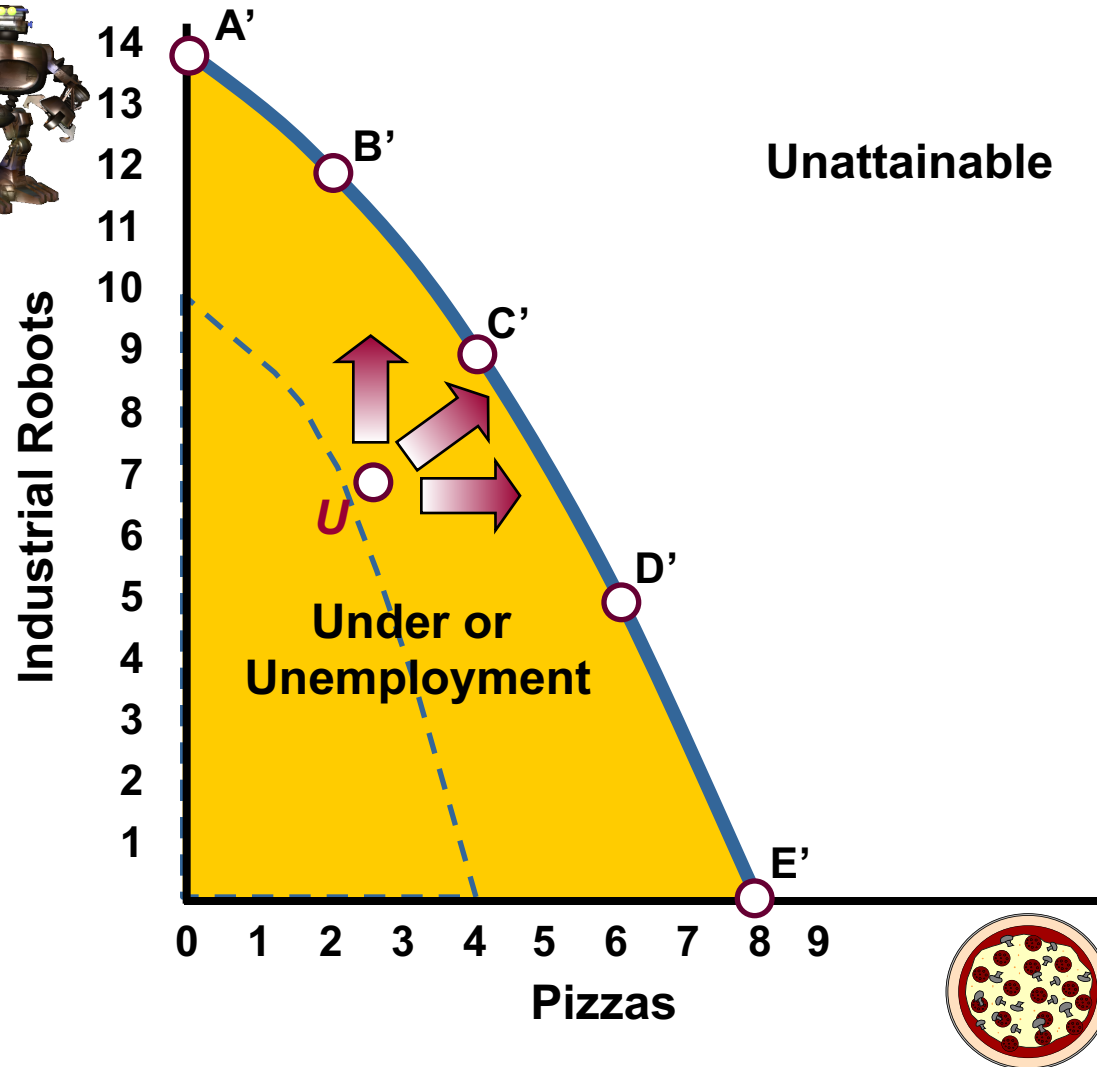
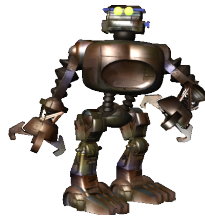
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Production Possibilities Model

Production Possibilities Curve



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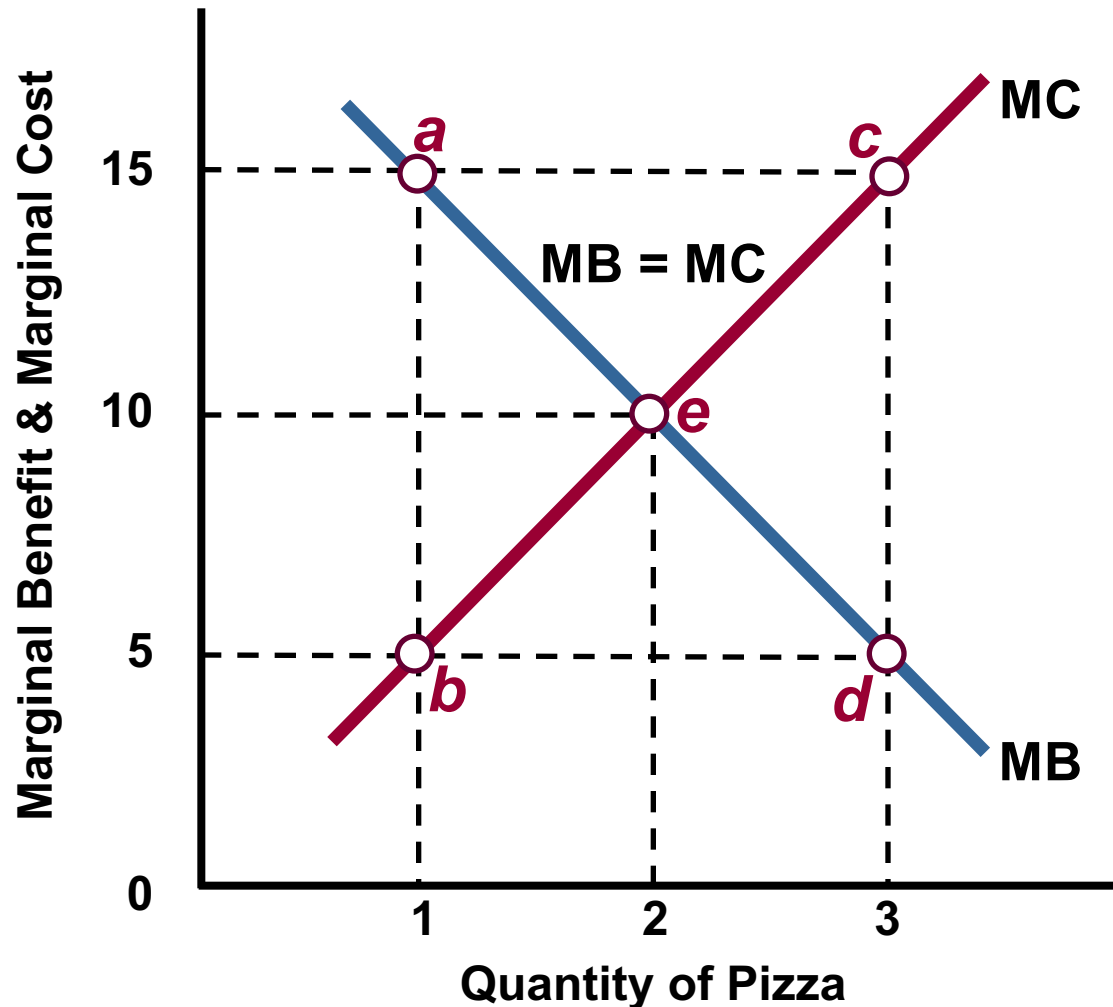


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Production Possibilities Model Optimal Allocation of Resources



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Unemployment Growth and the Future

- **A Growing Economy**
- **Economic Growth**
 - Increasing Resource Supplies
 - Increasing Resource Quality
 - Technological Advances

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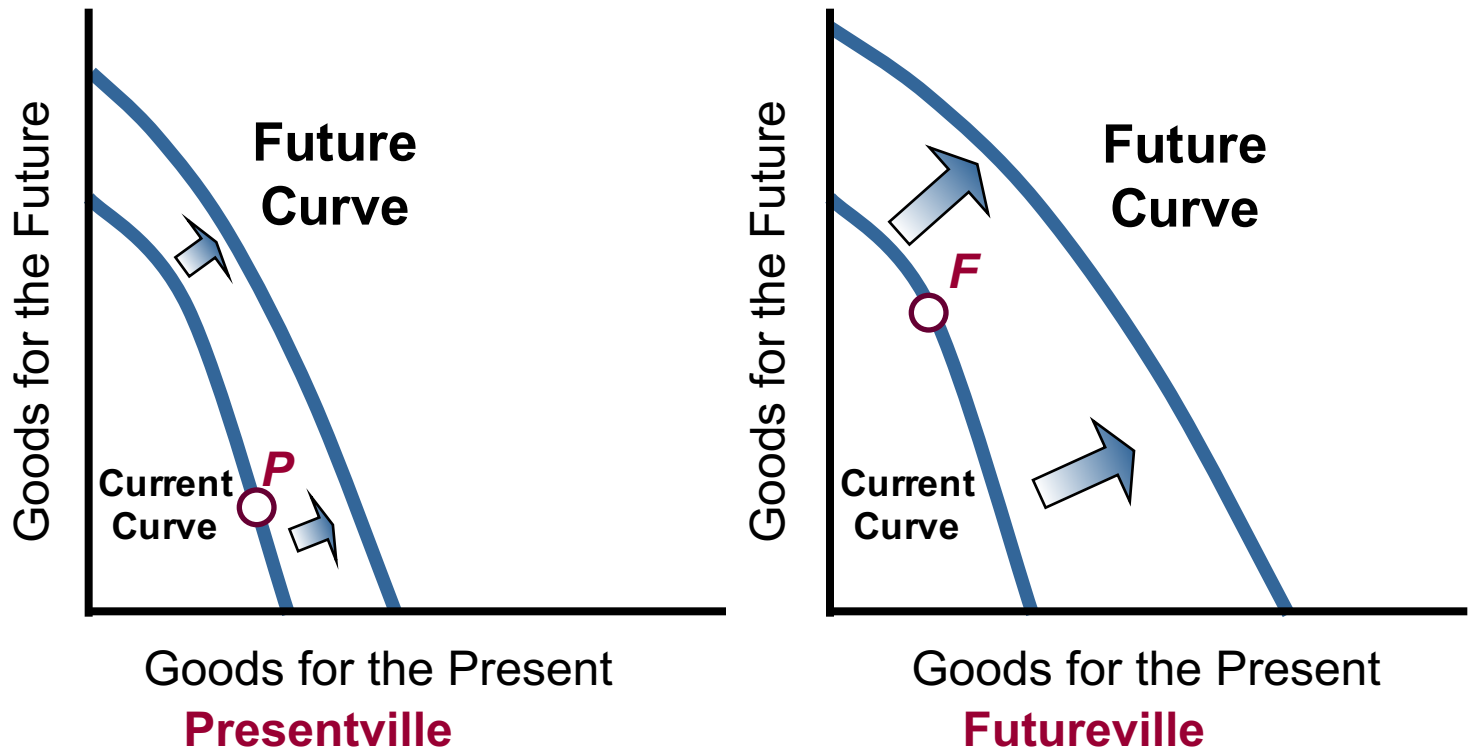


Present Choices & Future Possibilities



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Compare Two Hypothetical Economies



Implications of International Trade

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Pitfalls to Sound Economic Reasoning



- **Biases**
- **Loaded Terminology**
- **Fallacy of Composition**
- **Post Hoc Fallacy**
- **Correlation but not Causation**

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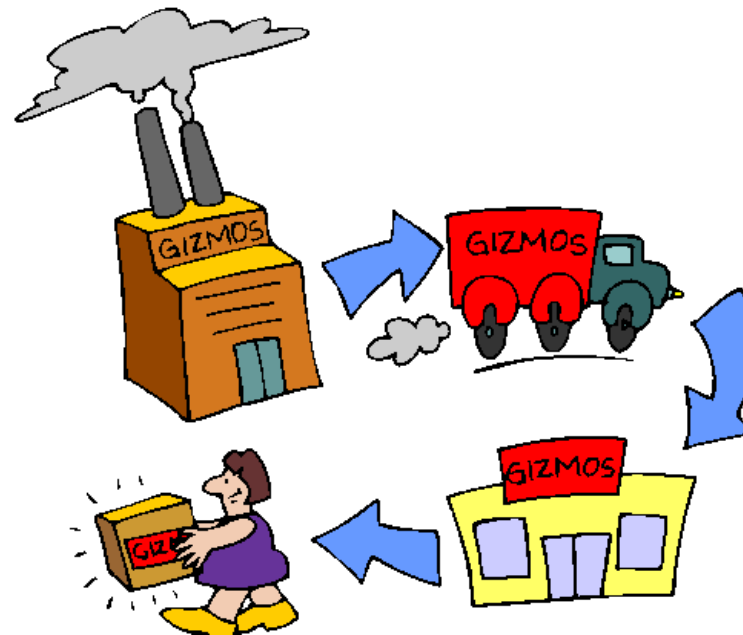
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- economics
- economic perspective
- opportunity cost
- utility
- marginal analysis
- scientific method
- economic principle
- other-things-equal assumption
- macroeconomics
- aggregate
- microeconomics
- positive economics
- normative economics
- economizing problem
- budget line
- economic resources
- land
- labor
- capital
- investment
- entrepreneurial ability
- factors of production
- consumer goods
- capital goods
- production possibilities curve
- law of increasing opportunity costs
- economic growth

Next Chapter Preview...

The Market System and the Circular Flow



Chapter 2 Next!

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