

Chapter 1

Scarcity, Opportunity Cost,
& Marginal thinking

Laughter Curve

- Q. Why did God create economists?
- A. In order to make weather forecasters look good.

What Economics Is

- *Economics* is the study of how human beings coordinate their wants and desires, given the decision-making mechanisms, social customs, and political realities of the society.

What Economics Is

- One of the key words in the definition is "*coordination*."

What Economics Is

- Any economic system must solve three central coordination problems:
 - What, and how much, to produce.
 - How to produce it.
 - For whom to produce it.

What Economics Is

- *Scarcity* exists because individuals want more than can be produced.
 - *Scarcity* – the goods available are too few to satisfy individuals' desires.

What Economics Is

- The degree of scarcity is constantly changing.
- The quantity of goods, services, and usable resources depends on technology and human action.

What Economics Is

- *Economics* is the study of how to get people to do things they're not wild about doing and not to do things they are wild about doing.

What Economics Is

- To understand the economy, you need to learn:
 - Economic reasoning.
 - Economic terminology.
 - Economic insights economists have about issues, and theories that lead to those insights.

What Economics Is

- To understand the economy, you need to learn:
 - Information about economic institutions.
 - Information about the economic policy options facing society today.

A Guide to Economic Reasoning

- Economic reasoning is making decisions by comparing costs and benefits.

Marginal Costs and Marginal Benefits

- The relevant costs and benefits that matter are the expected *incremental*, or additional, costs incurred and the expected *incremental* benefits of a decision.

Marginal Costs and Marginal Benefits

- Economist use the term *marginal* when referring to additional or incremental.

Marginal Costs and Marginal Benefits

- *Marginal cost* – the additional cost to you over and above the costs you have already incurred.
 - This means not counting *sunk costs* – costs that have already been incurred and cannot be recovered.

Marginal Costs and Marginal Benefits

- *Marginal benefit* – the additional benefit above and beyond what you've already accrued.

Marginal Costs and Marginal Benefits

- According to the *economics decision rule*:
 - If the relevant benefits of doing something exceed the relevant costs, do it.
 - If the relevant costs of doing something exceed the relevant benefits, don't do it.

Economics and Passion

- Economic reasoning is based on the premise that everything has a cost.
- It leads to a better society for the majority of people.

Opportunity Cost

- *Opportunity cost* is the basis of cost/benefit economic reasoning
- It is the benefit foregone, or cost, of the next-best alternative to the activity you have chosen.

Opportunity Cost

- In economic reasoning, opportunity cost must be less than the benefit of what you have chosen.

Opportunity Cost

- Opportunity costs are not limited to individual decisions but to government decisions as well.

Economics and Market Forces

- The opportunity cost concept applies to all aspects of life.
- It is fundamental to understanding how society reacts to scarcity.

Economics and Market Forces

- When goods are scarce, they must be rationed.
 - That means a mechanism must be chosen to determine who gets what.

Objective Policy Analysis

- To make clear the distinction between objective and subjective analysis, economics is divided into three categories:
 - Positive economics
 - Normative economics
 - Art of economics

Objective Policy Analysis

- *Positive economics* – the study of what is, and how the economy works.
- *Normative economics* – the study of what the goals of the economy should be.

Objective Policy Analysis

- *Art of economics* – the application of the knowledge learned in positive economics to achieve the goals determined in normative economics.

Objective Policy Analysis

- Maintaining objectivity is easier in positive economics – harder in normative economics.
