Chapter 1
The Art and Science of Economic Analysis

These slides supplement the textbook, but should not replace reading the textbook.
What is the economic problem?
Because we live in a world of scarce resources, but people have unlimited wants and needs, how do we meet their needs in this world of scarcity?
What assumption do we make?

People behave in accordance to their own self interest
What is rationale self interest?

People select the alternatives they expect will yield the most satisfaction and happiness.
What is macroeconomics?

The study of the economic behavior of entire economies
What is microeconomics?
The study of the economic behavior in particular markets, such as the market for computers
What is a good?
A tangible item that is used to satisfy wants
What is a service?

An intangible activity that is used to satisfy wants
What is a free good or service?

There is enough of a good or service to go around to everyone who wants it for free
What is a Scarce Good or Service?
There is not enough of a good or service to go around to everyone who wants it for free
When is a good or service scarce?

When the amount people desire exceeds the amount available to them at a zero price
What is the allocation problem?

The allocation problem is who gets and who does not get when something is scarce.
How do we decide who gets?

The price mechanism
What is the price mechanism?

Those persons who get are those persons who want the scarce good the most and have the money to purchase it
What is the economic problem?
Because we live in a world of scarce resources, but people have unlimited wants and needs, how do we meet their needs in this world of scarcity?
What is a resource?

Something that is used to produce goods and services
What is a market?
A set of arrangements through which buyers and sellers carry out exchange at mutually agreeable terms
What is special about the market?

Unless there is a market transaction we are not concerned about it in economics.
What are some examples of resources?

- Land
- Labor
- Capital
- Entrepreneurship
What is land?

Plots of ground and other natural resources used to produce goods and services
What is labor?
The physical and mental efforts of humans used to produce goods and services
What is capital?
Buildings, equipment, and human skills used to produce goods and services
What is human capital?

The skills used to work with capital
What is entrepreneurial ability?

Managerial and organizational skills combined with the willingness to take risks
What is income called from resources?

- Land is rent
- Labor is wages
- Capital is interest
- Entrepreneurship is profit
What is rent?
The payment resource owners receive for the use of their land
What are wages?
The payment resource owners receive for their labor
What is interest?
The payment resource owners receive for the use of their capital
What is profit?
The return resource owners receive for their entrepreneurial ability
How is profit calculated?

Total revenue from sales minus the total cost of resources employed by the entrepreneur
What is a product market?

A market in which goods and services are exchanged.
What is a resource market?

A market in which resources are exchanged.
What does the term marginal mean?

A term used to describe the result of a change in an economic variable
What is an economic model or theory?

A simplified description of reality to understand and predict an economic event.
What is a variable?

A measure, such as price or quantity, that can take on different possible values
What is the other-things-constant assumption?

The assumption, when focusing on key economic variables, remains unchanged.
What is the behavioral assumption?

An assumption that describes the expected behavior of economic actors.
What is an hypothesis?

A statement about relationships among key variables
What is a positive economic statement?

A statement that can be proved or disproved by reference to facts
What is a normative economic statement?

A statement that represents an opinion, which cannot be proved or disproved.
What are some pitfalls of economic analysis?

- Association-is-causation fallacy
- Fallacy of composition
- Secondary effects
What is the association-is-causation fallacy?

The incorrect idea that if two variables are associated in time, one must necessarily cause the other.
What is fallacy of composition?

The incorrect belief that what is true for the individual, or part, must necessarily be true for the group, or whole.
What are secondary effects?

Unintended consequences of economic actions that develop slowly over time as people react to events.
END