

Warmup/Review

- Rank and impact the four economic principles that relate to how people make decisions.
- Rank and impact the three economic principles that relate to how people interact.

Five more economic
issues to be aware of...

Micro vs. Macro

Micro vs. Macro

- MICROeconomics- Study of small economic units such as individuals, firms, and industries (competitive markets, labor markets, personal decision making, etc.)
- MACROeconomics- Study of the large economy as a whole or in its basic subdivisions (National Economic Growth, Government Spending, Inflation, Unemployment, etc.)

Microeconomics examines

- Individual markets
- the behavior of firms (companies) and consumers
- the allocation of land, labor and capital resources
- Supply and demand
- The efficiency of markets
- Product markets
- Supply and Demand
- Profit maximization
- Utility maximization
- Competition
- Resource markets
- Market failure

Macroeconomics examines

- National markets
- Total output and income of nations
- Total supply and demand of the nation
- Taxes and government spending
- Interest rates and central banks
- Unemployment and inflation
- Income distribution
- Economics growth and development
- International trade

Positive vs. Normative

Positive vs. Normative economics

- **Positive Statements**- Based on facts. Avoids value judgements (what is).
- **Normative Statements**- Includes value judgements (what ought to be).

Positive or Normative?

- Unemployment rose by 0.8 percent last quarter as 250,000 Americans lost their jobs in both the public and private sectors.
- Unemployment rates are higher among less educated workers, therefore government should include education and job training programs as a component of benefits for the nation's unemployed.
- Rising pork prices have led to a surge in demand for chicken across China.
- Increased use of public transportation reduces congestion on city streets and lowers traffic fatality rates.
- Rising pork prices harm low income households whose incomes go primarily towards food, therefore, to slow the rise in food prices, the Chinese government should enforce a maximum price scheme on the nation's pork industry.
- It is the government's obligation to provide public transportation options to the nation's people to relieve the negative environmental and health effects of traffic congestion.

Factors of Production

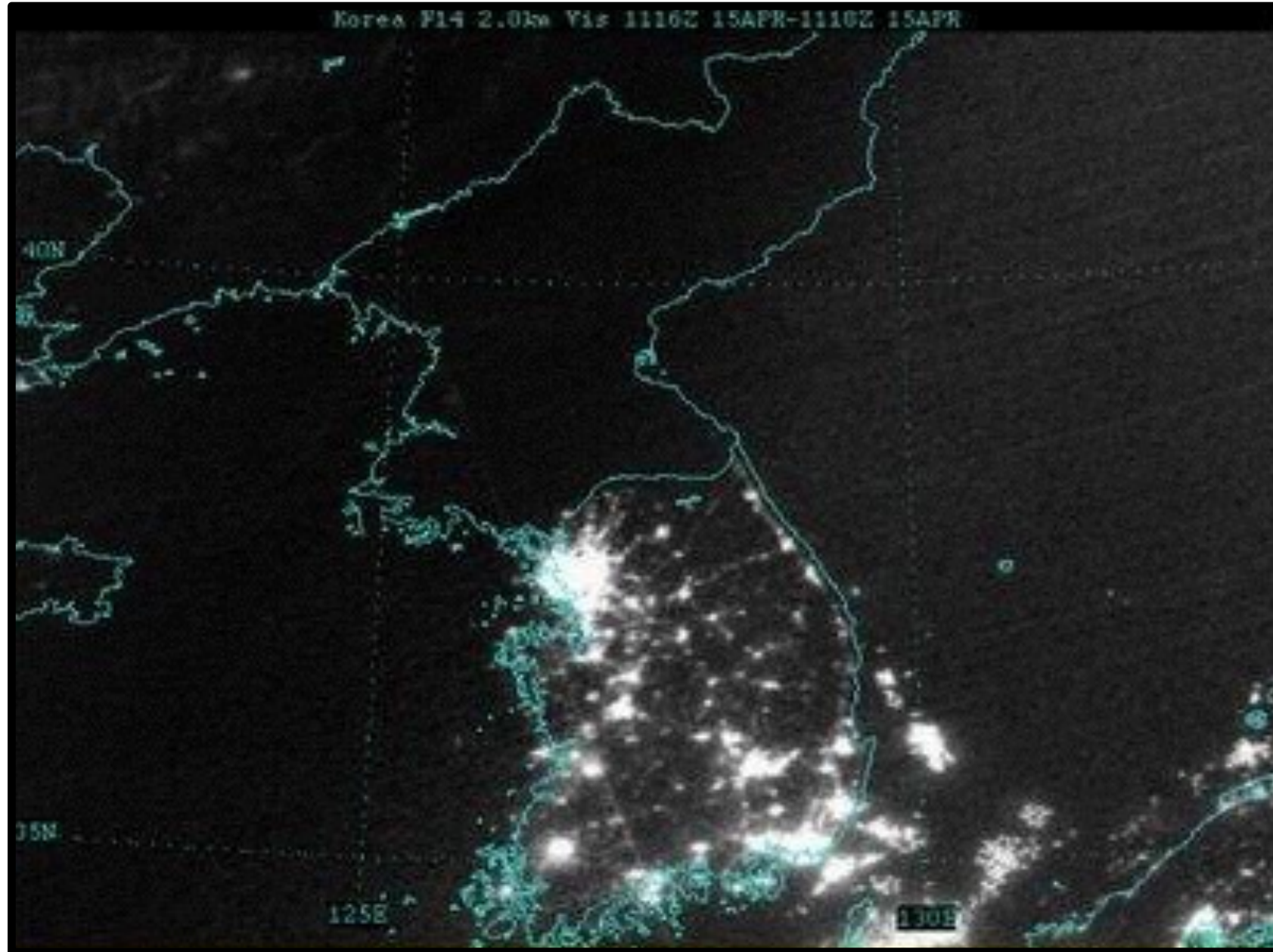
The Factors of Production

The production of all of the good we desire requires scarce resources. It is the allocation of these resources between humans' competing wants that Economics focuses on.

Land	Labor	Capital	Entrepreneurship
Land resources are those things that are "gifts of nature". The soil in which we grow food, wood, minerals such as copper and tin and resources such as oil, coal, gas and uranium are scarce	Labor refers to the human resources used in the production of goods and services. Labor is the human work, both physical and intellectual, that contributes to the production of goods and services	Capital refers to the <i>tools and technology</i> that are used to produce the goods and services we desire. Since more and better tools enhance the production of all types of goods and services, from cars to computers to education to haircuts, yet the amount of capital in the world is limited, <i>capital</i> is a scarce resource.	This refers to the innovation and creativity applied in the production of goods and services. The physical scarcity of land, labor and capital does not apply to human ingenuity, which itself is a resource that goes into the production of out economic output.

Types of Economy

The Difference Between a Market Economy and Command Economy



North Korea and South Korea at Night

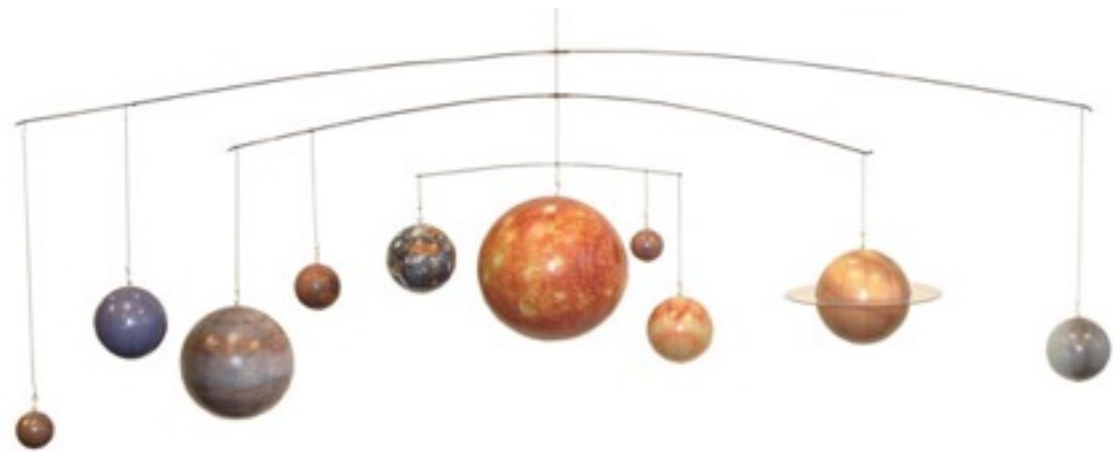
North Korea's GDP is \$40 Billion

South Korea's GDP is \$1.3 Trillion (32 times greater).

Use of Models

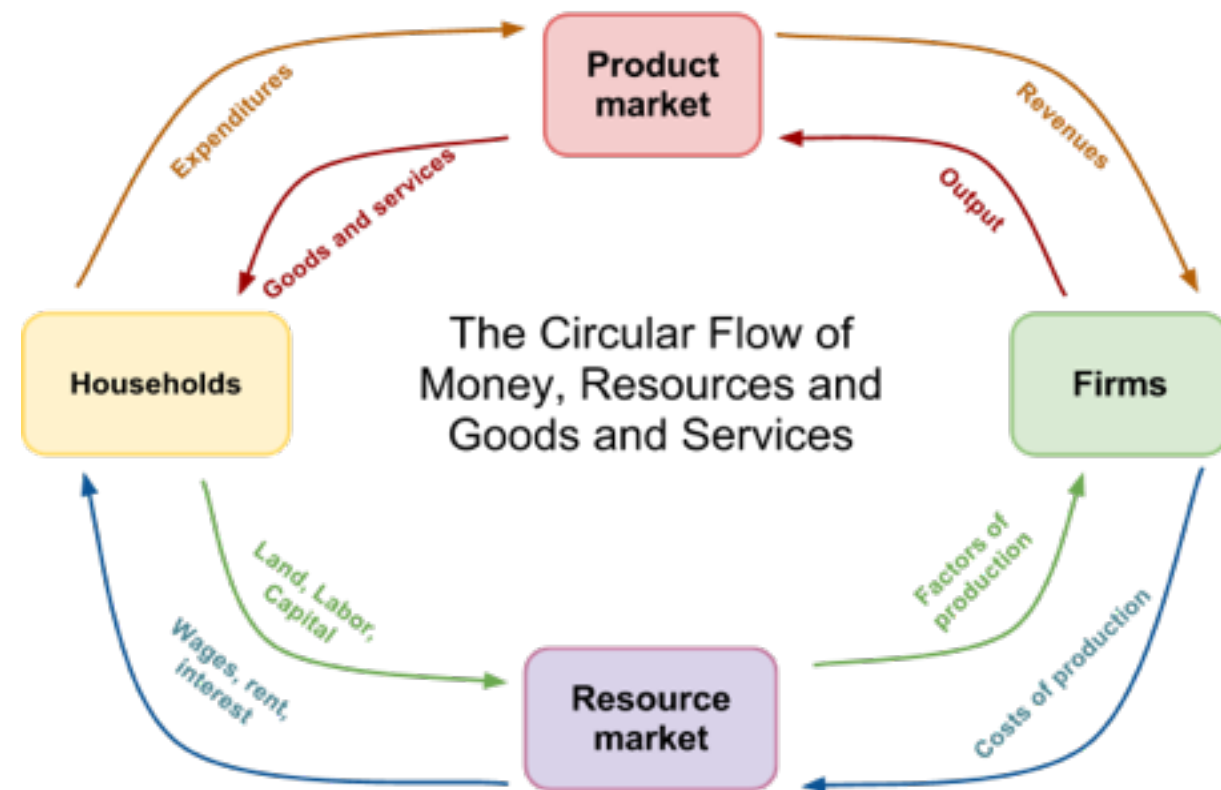
Model Building in Economics

A popular tool in the Economist's kit is the *economic model*. Just like scientists in other fields, economists use models to represent something from the real world.



A model of the solar system: Allows astronomers to illustrate in a simplified model the relationships between solar bodies.

A Circular Flow Model: Allows economists to illustrate in a simplified model the relationships between households and firms in a market economy.



Get with David
Ricardo Partner

DEMAND

Resource Market

SUPPLY



\$\$\$ Costs \$\$\$

Resources

\$\$\$ Income \$\$\$

Resources
(Factors of
Production)



Businesses



Households

**Circular Flow
Diagram**

Goods and
Services

\$\$\$ Revenue \$\$\$



Product Market

Goods and
Services

\$\$\$ Spending \$\$\$

SUPPLY

DEMAND

Check for understanding: Where on the circular flow diagram?

- Mary buys a car from General Motors for \$20,000.
- General Motors pays Joe \$5000/month for work on the assembly line.
- Joe gets a \$15.00 haircut.
- Joe's barber uses the \$15 to take his girlfriend to the movies. (He's very frugal and brought his own homemade popcorn. You can leave the popcorn out of this equation.)

In Resource Markets:

- Households supply productive resources (**land, labor, capital**)
- Firms buy productive resources from households. In exchange for their productive resource, firms pay households:
 - **Wages:** payment for labor
 - **Rent:** payment for land
 - **Interest:** payment for capital
 - **Profit:** payment for entrepreneurship
- Firms seek to minimize their costs in the resource market
- Firms employ productive resources to make products, which they sell back to households in the product market

In Product Markets:

- Consumers buy **goods and services** from firms
- Households use their money incomes earned in the resource market to buy goods and services
- **Expenditures** by households become **revenues** for firms
- Firms seek to **maximize their profits**
- Households seek to **maximize their utility** (happiness)

Notice the circular flow of money payments from one market to the other

Product and Resource Markets

In the market system, there exists an interdependence between all individuals.

- Households (that's us) depend on the goods and services produced by business firms, and the incomes they provide us, for our survival
- Business firms depend on households for the workers, the capital, the land resources they need to produce the goods they hope to sell us and make profits on.

These exchanges all take place in one of two categories of market present in all market economies

Product Markets	Resource Markets
<p>Where households buy the goods and services we desire from firms. Examples:</p> <ul style="list-style-type: none">• The market for private schools• The market for dental services• The market for airline travel• The market for football merchandise	<p>Where business firms buy the productive resources they need to make their products:</p> <ul style="list-style-type: none">• The market for teachers• The market for dentists• The market for pilots• The market for football players