


The Economic Approach

Full Length Text — Part: 1 Chapter: 1
Micro Only Text — Part: 1 Chapter: 1
Macro Only Text — Part: 1 Chapter: 1

To Accompany "Economics: Private and Public Choice 11th ed."
James Gwartney, Richard Stroup, Russell Sobel, & David Macpherson
Slides authored and animated by:
James Gwartney, David Macpherson, & Charles Skipton

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What is Economics About?

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Scarcity and Choice

- **Scarcity** and choice are the two essential ingredients of an economic topic.
- Goods are **scarce** because desire for them far outstrips their availability from nature.
- Scarcity forces us to choose among available alternatives.

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Scarcity and Choice

Scarce Goods	Limited Resources
Food (bread, milk, meat, eggs, vegetables, coffee, etc.)	Land (various degrees of fertility)
Clothing (shirts, pants, blouses, shoes, socks, coats, sweaters, etc.)	Natural Resources (rivers, trees, minerals, oceans, etc.)
Household goods (tables, chairs, rugs, beds, dressers, television sets, etc.)	Machines and other human-made physical resources
Space exploration	Non-human animal resources
Education	Technology (physical and scientific "recipes" of history)
National defense	Human resources (the knowledge, skill, and talent of individuals)
Recreation	
Leisure time	
Entertainment	
Clean air	
Pleasant environment (trees, lakes, rivers, open spaces, etc.)	
Pleasant working conditions	

- History is a record of our struggle to transform available, but **limited resources** ...into **scarce goods** – things that we would like to have.

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Scarcity and Poverty


- Scarcity** and **poverty** are not the same thing.
 - Absence of poverty implies some basic level of need has been met.
 - An absence of scarcity would imply that all of our desires for goods are fully satisfied.
- We may someday eliminate poverty, but scarcity will always be with us.

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Scarcity Necessitates Rationing

- Every society must have a means to ration scarce resources among competing uses.
- Resources and goods can be rationed in various ways (e.g. first-come, first served).
 - In a market setting, price is used to ration goods and resources.
 - When price is used, the good or resource is allocated to those willing to give up "other things" in order to obtain ownership rights.
 - When price is used to ration goods, people have a strong incentive to earn income so they will be able to pay the required price.

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Competition Results from Scarcity

- Competition is a natural outgrowth of the need to ration scarce goods.
- Changing the rationing method used will change the form of competition, but it will not eliminate competitive tactics.

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Questions for Thought:

1. How are grades rationed in your economics class? How does this rationing method influence student behavior? Suppose the highest grades were rationed to those who the teacher liked best. How would this method of rationing influence student behavior?

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The Economic Way of Thinking

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Guideposts to Economic Thinking

- The use of scarce resources to produce a good is always costly.
 - Someone must give up something if we are to have more of a scarce good.
 - The highest valued alternative that must be sacrificed is the **opportunity cost** of the choice.
- Individuals choose purposefully; therefore they will economize.
 - **Economizing:** gaining a specific benefit at the least possible cost.

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Guideposts to Economic Thinking

- Incentives matter
 - As personal benefits (costs) from choosing an option increase, other things constant, a person will be more (less) likely to choose that option.
- Economic reasoning focuses on the impact of **marginal** changes.
 - Decisions will be based on **marginal costs** and **marginal benefits** (utility).
- Since information is scarce, **uncertainty** is a fact of life.

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Guideposts to Economic Thinking

- In addition to their initial impact, economic events often generate **secondary effects** that may be felt only with the passage of time.
- The value of a good is **subjective** and varies with individual preferences.
- The test of an economic theory is its ability to predict and explain events in the real world.

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Questions for Thought:


1. In an effort to promote energy conservation, Congress mandates a minimum average gas mileage that auto manufacturers must achieve for the cars that they sell. Can you think of any secondary effects of these mandates that will conflict with energy conservation? With auto safety?
2. "The government should provide goods such as health care, education, and highways because it can provide them free."
-- Is this true or false?
3. Would sound policy attempt to reduce pollution emissions to zero? Why or why not.

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Positive and Normative Economics


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Positive Economics

- **Positive Economics:**
The scientific study of "what is" among economic relationships.
- Positive economic statements **can** be proved either true or false.
 - **Example:**
The inflation rate rises when the money supply is increased.


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Normative Economics


- **Normative Economics:** Judgments about "what ought to be" in economic matters.
- Normative statements reflect subjective values. They **cannot** be proved true or false.
 - **Example:** The inflation rate should be lower.

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Pitfalls to Avoid in Economic Thinking


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Four Pitfalls

- Violation of the *ceteris paribus* condition.
- *Ceteris paribus* is a Latin term meaning "other things constant."
- When describing the effect of a change, the outcome may be influenced by changes in other things.
- Good intentions do not guarantee desirable outcomes.
 - An unsound proposal will lead to undesirable outcomes even if it is supported by proponents with good intentions.
 - Politicians may be able to gain by focusing attention on a problem even if their policy response is ineffective or even harmful.


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Four Pitfalls

- Fallacy of composition
 - The **fallacy of composition** is the erroneous view that what is true for the individual (*or the part*) is also true for the group (*or the whole*).
 - **Microeconomics** focuses on narrowly defined units, while **macroeconomics** is focused on highly aggregated units.
 - One must beware of the fallacy of composition when shifting from micro- to macro-units.
- Association is not causation.
 - Statistical association alone cannot establish causation.


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Questions for Thought:

1. Which of the following are positive economic statements and which are normative?
 - (a) The speed limit should be lowered to 55 miles per hour on interstate highways to reduce the number of deaths and accidents.
 - (b) Higher gasoline prices cause the quantity of gasoline that consumers buy to increase.
 - (c) A comparison of costs and benefits should not be used to assess environmental regulations.
 - (d) Taxes on alcohol result in less drinking and driving.


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Questions for Thought:

2. "Economist, n. – A scoundrel whose faulty vision sees things as they really are, not as they ought to be." (*See chapter-opening quote.*)
What is the underlying message of this definition from Ambrose Bierce? Does it indicate that economists think with their heads or their hearts? Is this good or bad?


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Questions for Thought:

3. Suppose you were spending your own money to buy a new entertainment center (TV, DVD player, etc) for your apartment. Would you have an incentive to economize? Suppose your parents had given you permission to buy which ever entertainment center you wanted with their money. Would that influence what you would buy? Why or why not?

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**End
Chapter 1**

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