Econ 201: Introduction to Economics Analysis

September 2 Lecture: What Is Economics?

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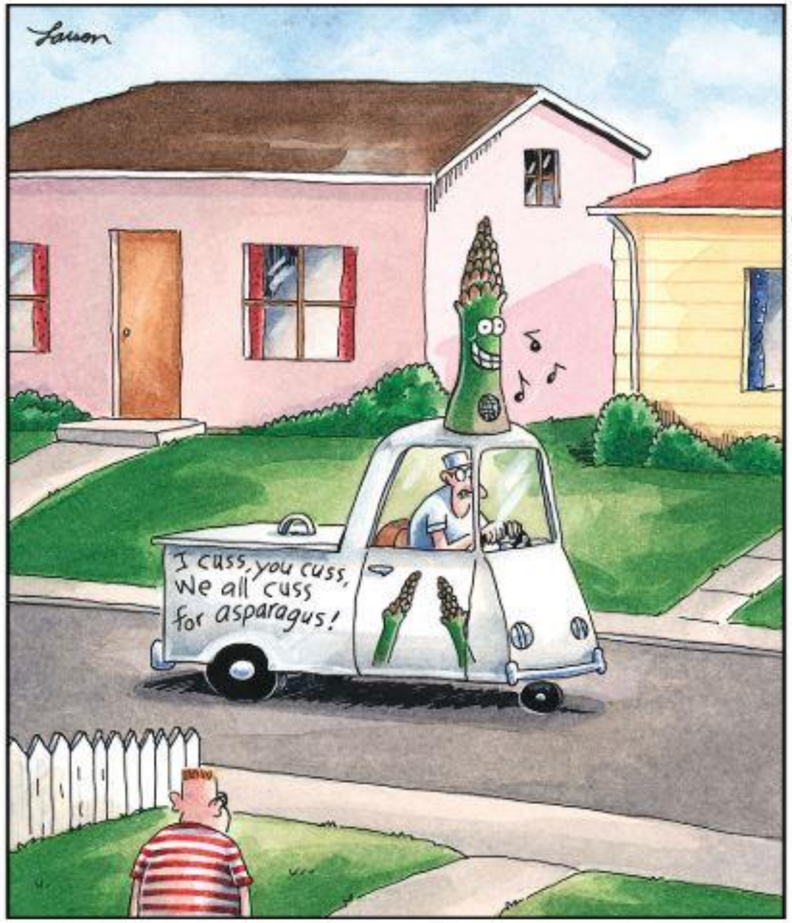
Daily dose of The Far Side



Failed marketing ploys

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Preview of this class session

- We summarize the questions that economics attempts to answer and how it goes about analyzing them
- Our summary is based on Partha Dasgupta's *Very Short Introduction to Economics*
  - You should read this book before or alongside viewing this session
- Conference discussion will focus around the book and the related case of the day

Basic Economics Concepts

Resources are scarce

- Labor
- Capital
  - Physical
  - Human
  - Technological
- Land
- Entrepreneurship

- Time?

Wants are unlimited

- Wants vs. needs
  - We don’t always distinguish these concepts
- (Economists assume) we all want more of *something*
  - Might not be physical good
  - Could be recreational, aesthetic, experiential, etc.
  - Could be an aspect of a good or service
    - Faster Internet service
    - Safer air travel

Economics = resource allocation

- **The Economic Problem**: How to allocate scarce resources among competing wants
- Resource allocation = social and individual choices
- Economics studies how these choices:
  - are made
  - are affected by public policies
  - are affected by social, political, and economic institutions
  - interact together to determine individual and social outcomes
- Positive vs. normative economics

Example for discussion in conference

Suppose that the Reed Bookstore divided up all textbooks and put them into students mailboxes randomly

- Why would this not be optimal (and what criteria are you using for optimality)?
- What would have to happen to improve the situation?
- How might this improvement come about?
- Who would "win" and "lose" from this pattern of resource allocation?

Basic resource-allocation questions

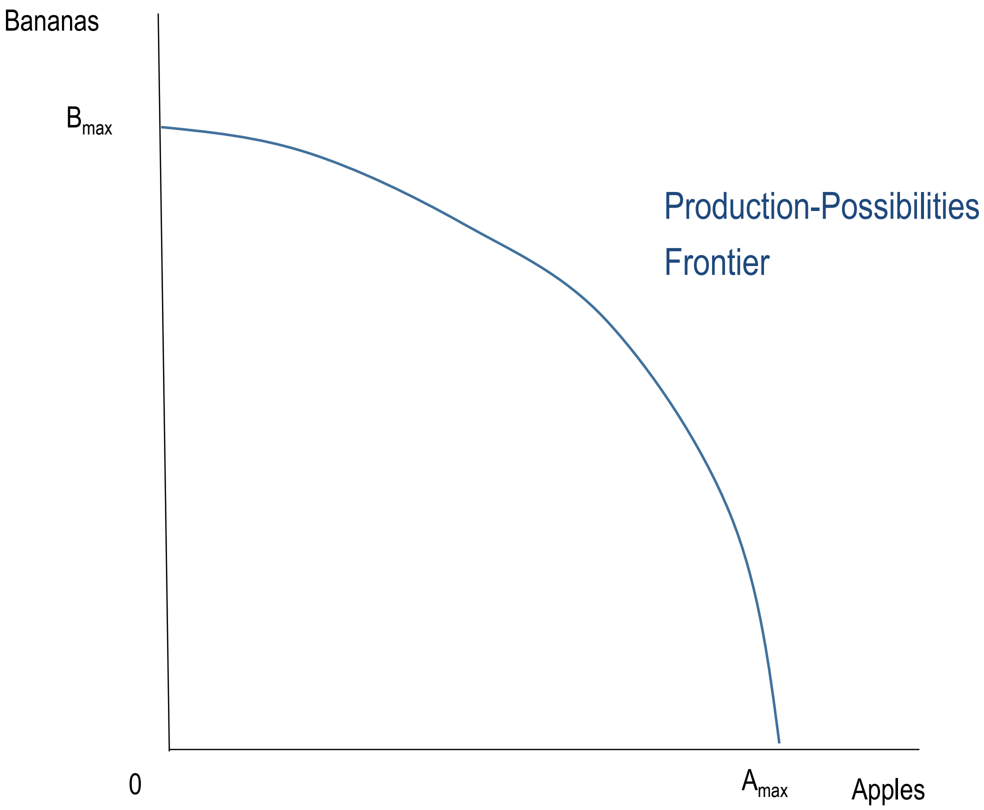
- **What** goods and services are produced (and in what quantities)?
  - By whom is each produced?
- **How** are they produced?
  - With what resources?
  - With what technologies?
- **For whom** are the goods produced?
  - Who gets them?
  - By what rule are they allocated?

Efficiency as goal of resource allocation

- **Economic efficiency** = no waste
  - Don't produce stuff people don't want
  - Don't use more resources than necessary to produce
  - Use the best available technology to combine resources
  - Get products to people who want them most
    - Don't give red car to people who like blue
    - Unexploited "gains from exchange"
- **Pareto efficiency**: No one can be made better off without making someone else worse off

Production-possibilities frontier

- **PPF** shows the alternative combinations that are feasible given the economy's resources
  - Concave to origin if resources are specialized: some land better for bananas and some for applies
- Slope of PPF = opportunity cost of apples: amount of bananas given up to get one more apple
- **Productive efficiency**: economy must be on PPF rather than inside
- Which point on PPF to choose?
  - Marginal benefit = opportunity cost



Markets vs. centralized decision-making

- Institutions of decision-making vary across economies
- **Market**: forum for exchange between buyers and sellers of a good
  - Usually involves voluntary exchange at a determined price
- **Centralized institutions**: governments, businesses, unions, communes, even families
  - Resource-allocation decisions made by leaders of institutions

Traditional Communism

- Government owned large producers
  - Planning bureaucracy decided on producers' outputs, inputs, technologies
- How did the planners know:
  - how much to produce?
  - how much input would be needed?
  - what was the best technology?
  - who should get the product?
- They usually didn't, leading to inefficiency

Market capitalism

- Market prices are signals for private decision-makers
  - Individual agents have property rights over goods and resources
- If people want more of some kind of good → higher price
  - Firms have higher incentive to produce it
  - Consumers have incentive to substitute another good for this one
- Price movements tend to bring markets into balance

Mixed economies

- Nearly all economies have elements of centralized decisions combined with markets
  - Some goods and resources are allocated by governments
  - Most are allocated by consumer and producer decisions guided by markets
  - Ideal boundary is not always clear
- Market failures are situations in which markets' price signals do not provide optimal incentives

What comes next?

- On Friday, we begin the basic analysis of perfectly competitive markets, a rare and idealized situation that leads to optimal resource allocation
- Sections 2.1 through 2.4 of the Goolsbee text cover these topics
- The case of the day asks you to use the basic theory of supply and demand to analyze the dynamics of the current price of oil
- Problem Set #1 is due at the beginning of class on September 9