<u>LIMITS, ALTERNATIVES, AND CHOICES</u>

I. Definition of Economics: The social science concerned with how individuals, institutions and society make choices under conditions of scarcity.

II. The Economic Perspective: economic way of thinking
   a. Scarcity and choice:
      i. Scarce economic resources mean limited goods and services
      ii. TINSTAAFL
      iii. Opportunity Cost: the most desirable alternative given up in an economic decision
   b. Purposeful Behavior
      i. Utility: opportunity to derive pleasure, satisfaction or happiness
      ii. Rational self-interest:
         1. Purposeful behavior: people make decisions with some desired outcome in mind.
         2. Self-interested behavior is designed to increase personal satisfaction
   c. Marginalism: Benefits and Costs
      i. Marginal Analysis: comparisons of marginal costs and benefits
         1. Marginal means "extra" or one additional unit.
            a. An extra hour of study? Another year of school?
            b. Always means forgoing something else for your marginal benefit

III. Theories, Principles, and Models

a. Scientific Method: testing hypotheses
b. Economic theories and principles are statements about economic behavior or the economy that enable prediction of probable effects of certain actions
    i. Highly useful in understanding how the economy works
c. Generalizations: typical consumer or for consumers as a group
d. Other-things-equal assumption: Ceteris Paribus
e. Graphical Expression: See chapter 1 appendix; pgs. 26-32

IV. Microeconomics and Macroeconomics
a. Microeconomics: concerned with individual units such as person, household, firm or industry
    i. Individual decision-making
    ii. The economy under a microscope
b. Macroeconomics: Economy as a whole or its basic subdivisions or aggregates
    i. Government, household or business sectors
    ii. Aggregate: collection of specific economic units treated as one unit
        1. Obtain an overview, or general outline, of the structure of the economy and the relationships of its major aggregates.
    iii. Total output, total employment, total income, aggregate expenditures, general price levels

V. Individual's Economic Problem: need to make choices because wants are unlimited, but means (income, time, resources) for satisfying wants in limited.

a. Limited Income: wages, interest, rents, profits;
    i. Even Bill Gates has limited income
b. Unlimited Wants
    i. Necessities: food, clothing, shelter
    ii. Luxuries: perfume, yachts, sports cars
    iii. Economic wants change over time
        1. Ipods
    iv. Services, as well as goods, satisfy our wants.
        1. Car repair, medical services, accounting services, banking
    v. Desires for goods and services cannot be fully satisfied.
    vi. It is in our self-interest to economize, or pick and choose the goods and services we desire (maximize our satisfaction).
c. A Budget Line: budget constraint
    i. Schedule or curve that shows various combinations of two products a consumer can purchase with a specific money income
    ii. Review the example on page 11.
    iii. All combinations of products on or inside the budget line are attainable.
    iv. All combinations of products beyond the budget line are unattainable.
    v. The budget line depicts trade-offs between two products arising from limited income.
        1. The straight line budget constraint in the example on page 11 indicates constant opportunity cost.

a. The opportunity cost remains the same as more products of the alternative are bought.

vi. Choice: limited income forces people to choose what to buy and what to forgo to fulfill wants.

1. Evaluate your marginal benefits and marginal costs.

vii. Change in Income: location of budget line will move to the right with an increase in income; and move to the left with a decrease in income.

VI. Society's Economic Problem: also under condition of scarcity

a. Scarce Resources: Economic resources for society are all natural, human, and manufactured resources that go into the production of goods and services.

b. Resource Categories: Factors of Production or Inputs

i. Land: all natural resources (gifts of nature)

ii. Labor: physical and mental talents of individuals used in producing goods and services

iii. Capital: capital goods: manufactured aids used in producing consumer goods and services;

1. Also known as "investment."
2. Capital goods differ from consumer goods in that consumer goods satisfy wants and needs directly, whereas capital goods do so indirectly.

3. Money produces nothing; only a means to acquire real capital.

iv. Entrepreneurial Ability

1. Entrepreneur takes initiative in combining other three resources to produce a good or service.
2. Makes strategic business decisions.
3. Innovator
4. Risk bearer

VII. Production Possibilities Model

a. Assumptions: Full employment, fixed resources, fixed technology, two goods

i. Food products are consumer goods

ii. Manufacturing equipment are capital goods

b. Production Possibilities Table: review figure 1.2 on page 15

i. There is a cost: more food products mean less manufacturing equipment.

ii. By moving from point A to point E, society chooses more now at the expense of more later.

iii. Generalization: at any point in time, fully employed economy must sacrifice some good to obtain more of the other good.

c. Production Possibilities Curve: represents maximum output of two products

d. Law of Increasing Costs: reflected in the bowed shape of the curve

i. The opportunity of one additional unit of product A is greater than the opportunity cost of the preceding unit.

ii. Law states that the more of a product society produces, the greater is the opportunity cost of obtaining that extra unit.

iii. Economic rationale: economic resources are not completely adaptable to alternative uses.
   1. Many resources are better at producing one type of good or service than at producing others.

e. Optimal Allocation: how to maximize satisfaction
   i. Marginal benefit = marginal cost
   ii. Review figure 1.3 on page 17
   iii. Resources are being efficiently allocated to any product when marginal benefit = marginal cost

VIII. Unemployment, Growth and the Future in the Production Possibilities Model
   a. Graphically, unemployment, or underutilization of resources are represented by points inside the production possibilities curve: figure 1.4 on page 19
   b. A Growing Economy:
      i. Increase in Resource Supplies: changes over time.
         1. A shift outward in the production possibilities curve represents Economic Growth or a total larger output.
      ii. Advances in Technology: more production
         1. Economic growth is a result of:
            a. Increases in supplies of resources
            b. Improvements in resource quality

c. Technological advances

c. Present Choices and Future Possibilities:

   i. Goods for the present are consumer goods such as food, clothing and entertainment

   ii. Goods for the future are capital goods and are the ingredients for economic growth

   iii. Good for the future will move the curve further outward then goods for the present: see figure 1.6 on page 22