Chapter 1: Introduction

Outline and Conceptual Inquiries

What is Economics? Limits and Tradeoffs
Would you be sorry if all your wants were satisfied?
Why study economics?

Economics Dissected
Microeconomics versus Macroeconomics
Why will a team full of outstanding players not necessarily win?

Positive versus Normative Economics
Why can two people agree on the price of a movie but possibly not agree on whether to go see the movie?

Value of Applied Economics
Why are most economists artists?
Application: Business Schools Spawning from Applied Economics

Building Models
Making Assumptions
How do humans differ from other animals?

Doing Analysis
How did the Babylonian and Greek scientists differ?

Using Tools
How is Adam Smith’s invisible hand made visible?
Application: Economists as Engineers
Models Provide Scientific Explanation, Prediction, and Control

Origins of Microeconomics
Application: An Alternative to the Marshallian Cross?

Partial-Equilibrium versus General-Equilibrium Models
Why are apertures changed on economic lenses?
**Summary**

1. Economics is the study of how society allocates its scarce resources among its unlimited wants.

2. Microeconomics is the study of individual agent interactions and the efficient allocation of resources. Macroeconomics is the study of the economy as a whole.

3. Positive economics is concerned with what is, was, or will be, and normative economics is concerned with what ought to be.

4. Applied economics is the application of economic theory to the solution of practical problems facing an economy. The art of economics is applied economics, which takes goals from normative economics and determines how to achieve them using positive economics.

5. Based on the scientific method, models are simplified representations of reality with a set of underlying assumptions.

6. Methods employed for developing models are prose, geometry, mathematics, and computer programming.

7. Models are constructed for explanation, prediction, and control. Explanation determines the relationship among variables. If the conclusions from a model are not yet observed, then the model will predict them. Control involves altering one or more of a model’s exogenous variables to predict a particular outcome.

8. The Marshallian cross represents the crossing of the supply and demand curves. At the intersection, the equilibrium price and quantity are determined. In equilibrium, there is no tendency for the price and quantity to change.

9. Partial-equilibrium analysis results from considering the equilibrium in only one market with limited effects from other markets. General-equilibrium analysis considers the equilibrium among a number of markets or the whole economy.
Key Concepts

- agent
- art of economics
- analytical solution
- assumptions
- applied economics
- control
- data
- econometrics
- economics
- economy
- endogenous variables
- exogenous variables
- explanation
- fallacy of composition
- fallacy of division
- general-equilibrium model
- global bliss
- hypotheses
- inflation
- local bliss
- macroeconomics
- market equilibrium
- markets
- microeconomics
- models
- normative economics
- numerical solution
- paradigm
- partial-equilibrium model
- positive economics
- prediction
- price theory
- properties
- scientific method
- social science
- social welfare
- society
- system
- variables

Key Equations

Quantity Supplied = Quantity Demanded

Market equilibrium is where quantity supplied equals quantity demanded. There is no incentive for consumers or firms to change their market behavior.
TESTING YOURSELF

Multiple Choice

1. Scarcity is defined as
   a. A lack of resources to satisfy every want
   b. A problem in developing countries with limited resources
   c. Demand exceeding supply
   d. Applying to natural resources such as land and oil, but not to other resources such as labor and capital.

2. The difference between local bliss and global bliss is
   a. Local bliss is a microeconomic concept, whereas global bliss is a macroeconomic concept
   b. Local bliss maximizes individual welfare, whereas global bliss maximizes social welfare
   c. Local bliss maximizes a local economy’s social welfare, whereas global bliss maximizes the global economy
   d. Local bliss maximizes social welfare subject to resource constraints, whereas global bliss has no resource constraints.

3. Which of the following is an economic agent?
   a. Household
   b. Firm
   c. Government policymaker
   d. All of the above.

4. Which of the following would not be a topic covered in a microeconomics course?
   a. The number of hours an individual chooses to work each week
   b. The level of unemployment in an economy
   c. How a firm sets its price and output
   d. The causes of pollution.

5. A basketball team composed of the best players in the nation may not win the national championship because of the
   a. Fallacy of composition
   b. Fallacy of division
   c. Fallacy of economics
   d. Fallacy of partial equilibrium.

6. Positive economics
   a. Investigates possible impacts of various policies
   b. Is what ought to be
   c. Determines the desirability of an issue
   d. Involves what should occur.
7. Which of the following is a normative statement?
   a. If the minimum wage is increased, the unemployment rate will rise
   b. A rise in the interest rate will lower automobile sales
   c. There is an inverse relationship between price and quantity demanded
   d. The federal government should increase taxes on upper income earners.

8. In economics, models are used to
   a. Confirm hypotheses
   b. Increase our understanding of the real world
   c. Develop facts concerning market phenomenon
   d. Prove economic theories.

9. In the model of consumer demand, if price is the exogenous variable, the quantity demanded is a (an) ____________ variable?
   a. Endogenous
   b. Predictive
   c. Positive
   d. All of the above.

10. A hypothesis is
    a. A theory that has not necessary been accepted
    b. Is used for explanation, prediction and controlling economic behavior
    c. A simplified representation of reality
    d. A logical conclusion based on a theoretical model.

11. Market equilibrium occurs where
    a. Price changes to the point of where production equals consumers’ demand
    b. Firms inventories are at their optimal levels and consumers are facing a constant price
    c. Quantity supplied equals quantity demanded
    d. All of the above.

12. Partial equilibrium occurs where
    a. Price and quantity demanded are in equilibrium but not supply
    b. Price and quantity supplied are in equilibrium but not demand
    c. There is market equilibrium in one market
    d. There is equilibrium in microeconomics but not necessary in macroeconomics.
**Short Answer**

1. Is a scarce resource a resource in shortage?
2. Is economics concerned with the way that society chooses to allocate its limited resources.
3. Explain the difference between microeconomics and macroeconomics.
4. Explain the difference between a positive statement and a normative statement.
5. What did Keynes mean by the art of economics?
6. Are simple economic models often too unrealistic to be useful?
7. What are the differences between an exogenous and endogenous variable.
8. Describe the steps in the scientific method.
9. Illustrate graphically the Marshallian cross and indicate the market equilibrium price and quantity.
10. Why is the Marshallian cross considered to be only a partial-equilibrium model?