

Chapter

1

Microeconomics

Unit 1: Basic Economic Concepts

***Lesson 1: The Economic
Way of Thinking***



**WHY ARE WE A NATION OF
COUCH POTATOES?**

Why are we a nation of Couch Potatoes?

- Surf the television channels, glance at any news stand, or open a clothing catalog, and it becomes clear: Americans admire people who look slender and physically fit.





Why are we a nation of Couch Potatoes?

- Yet, according to the Center for Disease Control and Prevention, only about 25% of Americans are getting enough exercise and about 35% of American adults are overweight.
- The percentage of children who are overweight has doubled since the early 1970s.
- ***Why do an increasing number of Americans, the same people who admire the trim, slender look so often featured in the media, exercise too little and eat too much?***

True/False Clues

- Few Americans know that exercising more and eating less can help many people become healthier. True or False?
- Exercise and a healthful diet are free. True or False?
- In jobs that involve physical work, exercise is like a fringe benefit. True or False?
- The price of food has been increasing. True or False?
- Passive modes of entertainment – like television and video games – are popular with many Americans. True or False?
- Common jobs in the past – in mining, farming, and manufacturing, for example – were much safer than today's jobs in technology, law, and finance. True or False?

The Solution to the Couch Potato Mystery

The Mystery

Why do an increasing number of Americans, the same ones who admire the trim, slender look so often featured in the media, exercise too little and eat too much?

The Solution

- Americans are not gaining extra weight because they are lazy or because of a sudden increase in the desire to eat fatty foods.
- Instead, they are choosing new jobs created in a changing market system – new jobs that have resulted in less exercise.
- Americans have in effect *traded* thinness for other values & work-related benefits enabling them to live longer and healthier lives.
- Some Americans enjoy new forms of passive entertainment; for them, the *opportunity cost* of physical activity would include giving up time they now spend watching TV or playing video games.

Adam Smith and the Birth of Economics as a Modern Social Science



- Adam Smith made economics a social science.
- Born in 1723 in Scotland, Smith's masterpiece was *An Inquiry into the Nature and Causes of The Wealth of Nations*, published in 1776.
- Why, Adam Smith asked, are some nations wealthy while others are poor?
- His answer: the division of labor and free markets.

Adam Smith and the Birth of Economics as a Modern Social Science



- Using hand tools, one person might make 20 pins a day.
- By breaking the process into a number of individually small operations in which people specialize—by the **division of labor**—ten people could make a staggering 48,000 pins a day.
- But a firm must sell 15 million pins a year to stay in business!
- So **free markets** are needed too.

The Economic Way of Thinking

- Everything has a cost.
 - *Opportunity Cost*
 - People incur costs when making decisions, even when people appear to pay nothing.

The Economic Way of Thinking

- Everything has a cost.
- People choose for good reasons.
 - **Normative** versus **positive economics**
 - Normative economics : Judgments about “what ought to be” in economic matters . Normative economic views cannot be proven false because they are based on value judgments.
 - Positive economics: The scientific study of “what is” among economic relationships.

The Economic Way of Thinking

- Everything has a cost.
- People choose for good reasons.
- Incentives matter.
 - Supply and demand analysis
 - Theory of the firm
 - Factor markets
 - Government decision making
 - *When incentives change, people's behavior changes in predictable ways.*

The Economic Way of Thinking

- Everything has a cost.
- People choose for good reasons.
- Incentives matter.
- People create economic systems to influence choices and incentives.
 - Cooperation among people is governed by written and unwritten rules.
 - As rules change, incentives and behavior change.
 - The success of market systems and the failure of communism are rooted in incentives.

The Economic Way of Thinking

- Everything has a cost.
- People choose for good reasons.
- Incentives matter.
- People create economic systems to influence choices and incentives.
- People gain from voluntary trade.
 - People trade when they believe the trade makes them better off.
 - If they expect no benefits, they don't trade.
 - People, not countries, trade.
 - A market system is about trade.
 - Economics is about trade.

The Economic Way of Thinking

- Everything has a cost.
- People choose for good reasons.
- Incentives matter.
- People create economic systems to influence choices and incentives.
- People gain from voluntary trade.
- Economic thinking is marginal thinking.
 - ***Marginal choices*** involve the effects of additions and subtractions from current conditions

The Economic Way of Thinking

- Everything has a cost.
- People choose for good reasons.
- Incentives matter.
- People create economic systems to influence choices and incentives.
- People gain from voluntary trade.
- Economic thinking is marginal thinking.
- The value of a good or service is affected by people's choices.
 - Goods and services do not have intrinsic value
 - Their value is determined by the preferences of buyers and sellers

The Economic Way of Thinking

- Everything has a cost.
- People choose for good reasons.
- Incentives matter.
- People create economic systems to influence choices and incentives.
- People gain from voluntary trade.
- Economic thinking is marginal thinking.
- The value of a good or service is affected by people's choices.
- Economic actions create secondary effects.
 - Ex. Rent controls

The Economic Way of Thinking

- Everything has a cost.
- People choose for good reasons.
- Incentives matter.
- People create economic systems to influence choices and incentives.
- People gain from voluntary trade.
- Economic thinking is marginal thinking.
- The value of a good or service is affected by people's choices.
- Economic actions create secondary effects.
- The test of a theory is its ability to predict correctly.