

Lecture 1: What Is Economics?

I. The Economic Problem: There are scarce resources but unlimited potential uses of those resources. This scarcity forces tradeoffs between resource use. Who is to decide how to allocate scarce resources? Who decides what is produced and who gets what?

Alternatives:

Command Economy: A central authority decides what is produced and who gets what.

Market, or Price Economy: Relies on individual self-interest to decide how resources are used.

1. Prices are attached to alternative uses, communicating their value, and these prices guide resource allocation in a totally uncoordinated, decentralized way; the "invisible hand". Prices are a "signal".
2. Incentives are key. If a business can make a profit selling something, they'll do it. And, if they can make more profit, they'll want to do more.
3. Conversely, the higher the price of something, the more costly it is for buyers, so buyers will want to use less and conserve.

Example 1: Food, housing, and cars are needed to live and function in today's society. But the government (central authority) doesn't control the production of these vital products. Instead, farmers produce food, builders construct houses, and auto companies make cars because they earn profits by doing so. And the more profit they make, the more they'll want to produce.

Example 2: What if a hurricane wipes out many of the orange trees in Florida. Less orange juice is available. How is it decided who gets it? In a command economy, some central authority would. In the market economy, orange juice becomes more valuable, so its price rises. This causes buyers to collectively use less.

Example 3: Where to live? Apartments and houses that are closer to NCSU cost more per square foot because faculty and students save commuting time and money if they're close to the campus. Conversely, apartments and houses farther away from campus cost less per square foot because they don't save commuting time and money. So, for a central amount of money budgeted

for housing, faculty and students must decide which they value most, closeness to campus or more space to live in.

II. We Will Talk About the Market, or Price, System in this Course.

The two fundamental concepts in this system are:

Demand: shows how much buyers purchase of something (product or service) as its price (per unit) varies: result: buy more at lower price; buy less at higher price

Supply: shows how much producers make and sell of something (product or service) as its price (per unit) varies; result: make and sell more at higher price; make and sell less at lower price

The "coming together" of demand and supply determines how much is produced and bought and at what price.

For individuals and businesses, economics is really about benefits and costs. Compare the benefit from buying a new shirt to the cost of not using that money in another way. Or, the owner of a pizza restaurant compares the benefit on profits of hiring more delivery persons vs. adding more tables and chairs in the store. The cost of anything is the value of what you can't buy with those same resources - economists call this *opportunity cost*.

It should be clear that economics applies to individuals (or households) and businesses. It also applies to government decisions. But there are three problems for the government application:

1. politicians aren't using their own money - they may look at benefits and costs differently than taxpayers
2. politicians can divide benefits and costs - have one group pay the costs while another gets the benefits
3. politicians have short time horizons - often just until the next election or end of their term; so sometimes they try to accelerate the benefits and delay the costs

III. Microeconomics: the economics applied to households and businesses and their interaction in the market (market is simply where buyers and sellers come together)

Macroeconomics: the economics applied to the national economy and government economic policy

IV. Three Common Criticisms of Market Economics

1. Those with more money (resources) can get more: It's true that someone earning \$100,000 a year can buy more than someone earning \$10,000. So is this fair?
One answer is "yes", if the person earning \$100,000 a year did so because society valued what they did more than the person earning \$10,000. Also, most societies do re-distribute some amount of income from the rich to poor (in U.S. \$500 billion annually).
2. Money is the only thing that matters in a market economy: Not really. Money is just the convenient and easy way we measure resources. But if something can't be measured with money, it doesn't mean it's worthless.
3. In a market economy, what's to prevent businesses from charging extremely high prices to buyers and making huge profits?
Answer: Competition - more on this later.

V. Other Key Economic Principles

1. Benefits of something rise, or costs fall - get more of it
Benefits of something fall, or costs rise - get less of it
2. The ultimate impact of economic actions may not be seen immediately.
3. Economics is not about money - it's about choice. Money is just a convenient measuring tool.
4. Trade is key - we specialize and trade. Trade is a "positive sum game", only occurs if both sides (buyer and seller) see a net benefit at the time
5. Competition is buyer's best friend - if several firms are competing for the consumers' business, this will keep costs down and quality up
6. The value of a resource depends on when in time it occurs (time value of money)
7. The economic future is hard to predict.