

Chapter 1

The Nature of Economics

- At a physiological level, human existence requires food and shelter
- Other goods and services give pleasure or utility and meaning to individual's lives
- In Neoclassical economics wants are considered as “unlimited”
- We live in a finite world where resources, time and technology are limited

Economics as a Study of Allocation

- As a decision science, economics is the study of how individuals and societies choose alternatives that best achieve an objective.
- Must know objective, all feasible alternatives and have a criteria to evaluate alternatives with respect to (wrt) objective
- Tools used are opportunity cost, Marginal cost (MC), Marginal Benefit (MB), supply, demand, costs, . . .

Five Basic Questions of Allocation

- What goods and services should be produced? (requires ranking, valuation or prioritization)
- How many of each good (and service) should be produced?
- How should those goods be produced?
- When should those goods be produced?
- Who should get the goods that are produced?
- These 5 questions are interrelated.

Economics as a Study of Provisioning

- Society must have a system of institutions, allocative mechanisms, beliefs, knowledge and social infrastructure to perform the allocation processes; it is the “rules of the game”
- Institutions are habitual patterns of behavior
- Social institutions include such things as: property rights, law, markets, religion, marriage, . . .
- The infrastructure may evolve overtime or be “engineered”

Role of Individual in Society

- In social sciences there is an ongoing debate about the appropriate role of the individual to the society or community
- “ How can the freedom or liberty of the individual be maintained and at the same time provide for the commonweal?”
- Social mechanisms for coordinating behavior of individuals; Cooperation, Conscriptio and Competition

Cooperation, Conscription and Competition

- There are two “tools” that individuals have to dealing with the problem of scarcity; the use of technology and social interaction
- Cooperation and Conscription are opposite ends of a continuum
- Competition can be structural or rivalry
- Modern economy is a mixture of cooperation, conscription and competition

Important Terms

- **Agents** – an individual who has the ability and authority to make a decision and act on it
- An agent may act for a “**principal**”
- **Contract** – an agreement between two or more agents
- **Institutions** – are habitual patterns of behavior that are embedded in society
- **Technology** is the knowledge about individuals’ relationships to the natural and built environment

Definitions of Economics

- Current – *“the social science concerned with the efficient use of limited resources or scarce resources to achieve maximum satisfaction of human material wants”* (McConnell, p3, 2004)
- Marshall, 1920 – *“...economics is the study of mankind in the ordinary business of life; it examines that part of individual and social action which is most closely connected with the attainment and with the use of the material requisites of wellbeing.”*
- Heilbroner – *“...the process by which society marshals and coordinates the activities required for its provisioning.”*
- Samuels – *“... economy is a process of valuation... That to behave and to choose is to engage in valuation and thereby to participate in the social, socioeconomic, valuation process.”*

Microeconomics

- The study of the behavior and interactions among various individuals, organizations and society within an economic system
- What forces shape the behavior of agents?
- What is the nature of the interactions among agents?
- Neoclassical economics focuses on;
 - Individual behavior (reductionism)
 - Mechanical methodology of “cause and effect”
 - Market orientation

Economic Decisions

- Rules – implicit, explicit
- Intuition
- Reason and rational behavior
 - Objective, alternatives, “best alternative wrt objective
- Information and market behavior
- Incentives