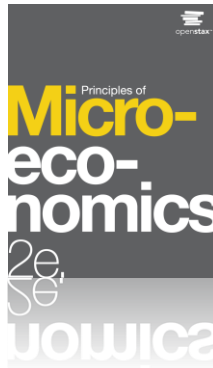


# PRINCIPLES OF ECONOMICS 2e

## Chapter 1 Welcome to Economics! PowerPoint Slideshow



## CH.1 OUTLINE



- 1.1: What is Economics, and Why Is It Important?
- 1.2: Microeconomics and Macroeconomics
- 1.3: How Economists Use Theories and Models  
to Understand Economic Issues
- 1.4: How To Organize Economies: An Overview  
of Economic Systems

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## 1.1 What is Economics, and Why Is It Important?



- **Economics** is the study of how humans make decisions in the face of scarcity. These can be individual decisions, family decisions, business decisions or societal decisions.
- **Scarcity** means that human wants for goods, services and resources exceed what is available.
- The **FRED** website (<https://openstax.org//FRED/>) includes data on nearly 400,000 domestic and international economic and social variables over time, which will be used often in this course.

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## Economics in the social media age



Economics is greatly impacted by how well information travels through society. Today, social media giants Twitter, Facebook, and Instagram are major forces on the information superhighway. (Credit: modification of work by Johan Larsson/Flickr Creative Commons)

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## Scarcity

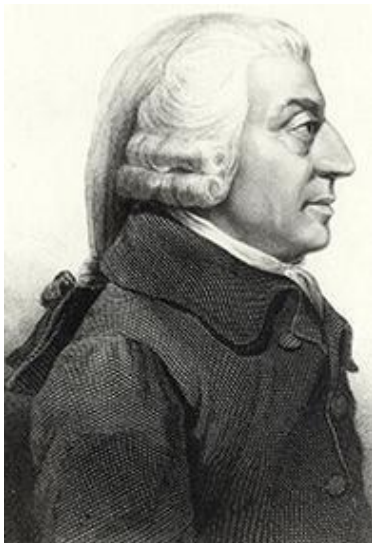


Homeless people are a stark reminder that scarcity of resources is real. (Credit: "daveynin"/Flickr Creative Commons)

### Discussion Question: What are examples of critical goods and services?

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## Comprehensive study of economics



Adam Smith introduced the idea of dividing labor into discrete tasks, in his famous 1776 book, titled *The Wealth of Nations*. (Credit: Wikimedia Commons)

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## The Division of and Specialization of Labor



- **Division of labor** - the way in which different workers divide required tasks to produce a good or service.
  - Workers on an assembly line are an example of the divisions of labor. (Credit: Nina Hale/Flickr Creative Commons)

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## Why the Division of Labor Increases Production



- Dividing and subdividing the tasks involved with producing a good or service, produces a greater quantity of output.
- **Specialization** - when workers or firms focus on particular tasks for which they are well-suited within the overall production process.
  - Specialization allows businesses to take advantage of **economies of scale**, which means that for many goods, as the level of production increases, the average cost of producing each individual unit declines.

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## 1.2 Microeconomics and Macroeconomics



- Economics is concerned with the well-being of all people, including those with jobs and those without jobs, as well as those with high incomes and those with low incomes.
- **Microeconomics** focuses on the actions of individual agents within the economy, like households, workers, and businesses.
- **Macroeconomics** is the branch of economics that focuses on broad issues such as growth, unemployment, inflation, and trade balance.

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## Other Economic Terms



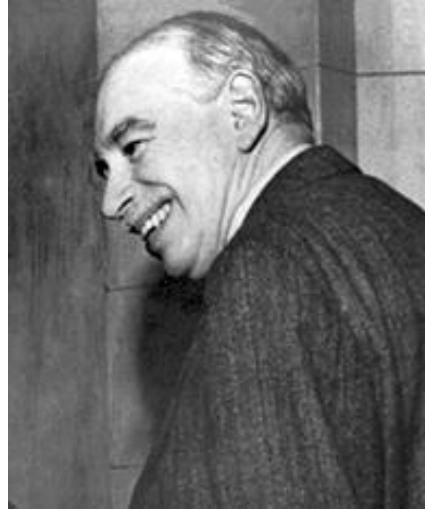
- **Monetary policy** - policy that involves altering the level of interest rates, the availability of credit in the economy, and the extent of borrowing.
  - Determined by a nation's central bank
- **Fiscal policy** - economic policies that involve government spending and taxes.
  - Determined by a nation's legislative body

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## 1.3 How Economists Use Theories and Models to Understand Economic Issues



- One of the most influential economists in modern times was John Maynard Keynes. (Credit: Wikimedia Commons)
- Keynes thought that economics teaches you how to think, not what to think.



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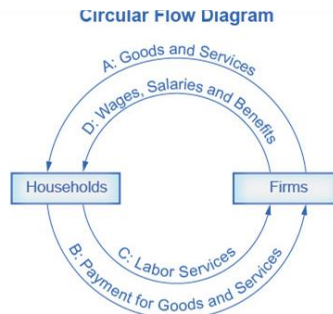
## Economic Theories and Models



- A **theory** is a simplified representation of how two or more variables interact with each other.
  - A good theory is simple enough to understand, while complex enough to capture the key features of the object or situation you are studying.
- Economists use **models** to test theories, but for this course we will use the terms model and theory interchangeably.

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## Circular Flow Diagram



- The **circular flow diagram** shows how households and firms interact in the goods and services market, and in the labor market.
  - The direction of the arrows shows that in the **goods and services market**, households receive goods and services and pay firms for them.
  - In the **labor market**, households provide labor and receive payment from firms through wages, salaries, and benefits.

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## 1.4 How To Organize Economies: An Overview of Economic Systems



There are at least three ways that societies organize an economy:

- **1) Traditional economy** - typically an agricultural economy where things are done the same as they have always been done.
  - Oldest economic system
  - Used in parts of Asia, Africa, and South America
  - Occupations tend to stay in the family
  - What you produce is what you consume
  - Little economic progress or development

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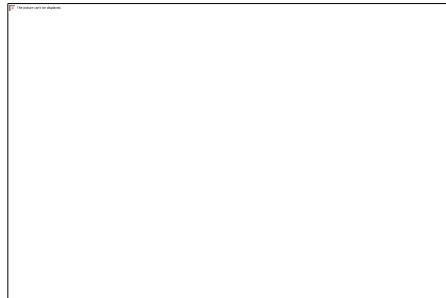
## An Overview of Economic Systems



- **2) Command economy** - an economy where economic decisions are passed down from government authority and where the government owns the resources.
  - Government decides what goods and services will be produced and what prices it will charge for them.
  - The government decides what methods of production to use and sets wages for workers.
  - The government provides many necessities like healthcare and education for free.

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## An Overview of Economic Systems



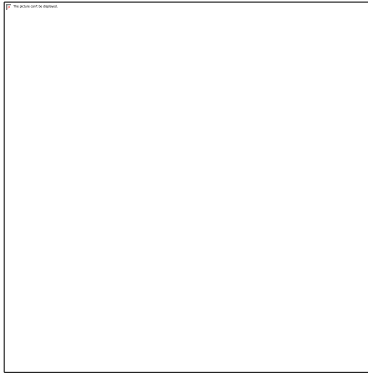
(Credit: Jay Bergesen/Flickr Creative Commons)

- Examples of command economy:
  - Ancient Egypt
  - Medieval manor life
  - Communism
  - Currently, Cuba and North Korea

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## An Overview of Economic Systems



- **3) Market economy** - an economy where economic decisions are decentralized, private individuals own resources, and businesses supply goods and services based on demand.
- **Market** - interaction between potential buyers and sellers; a combination of demand and supply.

- **Private enterprise** - system where private individuals or groups of private individuals own and operate the means of production (resources and businesses).

Nothing says “market” more than The New York Stock Exchange.

(Credit: Erik Drost/Flickr Creative Commons)

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## Real World Economies



Most economies in the real world are mixed. They combine elements of command, traditional, and market systems.

- The U.S. economy is positioned toward the market-oriented end of the spectrum.
- Many countries in Europe and Latin America, while primarily market-oriented, have a greater degree of government involvement in economic decisions than the U.S. economy.
- China and Russia, while they have moved more in the direction of having a market-oriented system, remain closer to the command economy end of the spectrum.

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## Regulations: The Rules of the Game



- There is no such thing as an absolutely free market.
- Regulations always define the “rules of the game” in the economy.
- Economies that are primarily market-oriented have fewer regulations—ideally just enough to maintain an even playing field for participants.
- Heavily regulated economies often have **underground economies** (or black markets), which are markets where the buyers and sellers make transactions without the government’s approval.

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## The Rise of Globalization



- **Globalization** - the trend in which buying and selling in markets have increasingly crossed national borders.
- **Exports** - the goods and services that a nation produces domestically and sells abroad.
- **Imports** - the goods and services that are produced abroad and then sold domestically.
- **Gross domestic product (GDP)**- measures the size of total production in an economy.

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## The Global Economy



Cargo ships are one mode of transportation for shipping goods in the global economy. (Credit: Raul Valdez/Flickr Creative Commons)

**Discussion question: What are examples of products and services in the modern economy? How has this contributed to globalization?**

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