Lecture 2.
Economic Thinking (cont’d)
What is Economics?

Session ID: DDEE

Clicker Question
Announcements

- Please read announcements on the course website every Monday, Wednesday and Friday.
  http://sites.bu.edu/manove-ec101/

- Check your assignments on MyEconLab frequently.

- Discussion sections start this week.

- Purchase your clickers or ResponseWare apps when you are sure you will stay in the course.

Thinking Like an Economist (Continued)
Principles of Economic Thinking

- So far, we’ve covered two useful principles of economic thinking.
  1. Think about the goods (not the money).
  2. Everything has a cost.

- Now we will add four more principles.

3. When deciding “how many,” think at the margin.

- The marginal unit is a unit you might add to units that you already have.

  - **Example:** If I already have four apples, how much is the fifth apple worth to me? The fifth apple is the marginal unit.

  - **Example:** If I already have one copy of my chemistry textbook, how much is another copy worth to me? The second copy is the marginal unit.
Marginal benefit is the benefit provided by the marginal unit.

Marginal cost is the opportunity cost of the marginal unit.

When deciding how many units to buy, sell or use, marginal benefits and marginal costs should be compared.

The marginal benefit of the last unit that you buy should be at least as large as the marginal cost…

…but they do NOT have to be equal.

Example: How Many Pizza Slices should I buy?

You are eating pizza slices.

Each slice costs $1

Should you eat 4 slices?

Your analysis of the problem:

- 4 slices costs me $4
- I get $5 worth of pleasure from 4 slices.
- So I’ll eat 4 slices.  ???
Economic Thinker’s Analysis

The 4\textsuperscript{th} slice is “the marginal unit.”

- The 4\textsuperscript{th} pizza slice would cost me $1 \textit{(the marginal cost)}.
- But if I’ve already eaten 3 slices, I won’t be very hungry.
- So my pleasure from the 4\textsuperscript{th} slice \textit{(the marginal benefit)} …
- I _____ buy it.

Here, we are thinking “at the margin.”
4. People respond to incentives—sometimes in unexpected ways.

**Example:** Protecting the Elderly

- A law prohibits eviction of the elderly for nonpayment of rent.
- How would the law affect housing for the elderly?

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**Example:** Protecting trees.

- Suppose the U.S. Congress passes a tough law that limits the use of paper.
- What would happen to the number of trees?
Suppose Congress made it illegal to eat chicken or eggs. What would happen to the number of chickens?
Trees and Chickens

Are trees used for paper similar to chickens used for food?

If people stopped using paper, would there be...?

5. Prices that reflect ALL opportunity costs provide the best incentives.

Should drivers have to pay tolls for using highways?

Should universities be free?

We will discuss the cost of attending university later in the course.
Clicker Question

**Example:** Highway Tolls

- Are highway tolls necessary for good highway management? Why?
6. Statistical findings are often misleading.

**Example:** What should you conclude from the following statement?

“In my experience, sex makes students unhappy.” —Psychiatrist, Harvard Student Health Service

**Clicker Question**
What is Economics?

My Own Definition of Economics

Economics is the **scientific study** of **human behavior** associated with the **production and distribution** of the **“necessities and conveniences of life.”**

I’ll explain each of the *italicized* terms in reverse order in the next few slides.
“necessities and conveniences of life.”

- refers to the goods and services that people need or want (for example: bread, clothes, music).

- The phrase was contained in the first sentence of Adam Smith’s 1776 book, *An Inquiry into the Nature and Causes of the Wealth of Nations*

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**Production**

- What is production?

- It is the *transformation* of some goods and services (inputs) to other goods and services (outputs).

- **Example:** Pizza Production
**Distribution**

- In primitive economies, people produce for themselves and consume most of their own production.

- In more complex economies, efficient **specialist producers** use *large quantities of inputs* to produce *large quantities of outputs*.

- Outputs must be distributed to consumers.

- Inputs must be distributed to producers.

**Human Behavior**

- Economics is *not* about production technology— that’s engineering.

- It’s *not* a study of the things people buy.

- It *is* about how people organize themselves for the production and distribution of goods and services.

- It *is* about what people do in order to create necessities and conveniences.

- It *is* about an aspect of human behavior.
**Scientific Study**

- Economics is *not* about how to run a business—that’s Management.
- It’s *not* about how to make money.
- It *is* an observational science like astronomy and meteorology (the science of weather).
- Experiments are less common in economics than in biology, physics and chemistry.
- But like other sciences, economics uses **models** as a basic tool.

**Scientific Models:**
- Models are similar to real-world objects in details that are important to the intended analysis…
- but simpler in details unimportant to the analysis.
  - model airplanes vs. real airplanes
  - mice vs. human beings

- *Economists prefer mathematical models:*
  \[ Q = f(p) \] , etc.
Wealth

- Wealth refers to the capacity to create valued goods and services.

- Wealth takes many forms:
  - **Physical capital**: buildings, roads, machines, ships, cars, stores and warehouses filled with goods;
  - **Human capital**: education and training, which makes people more productive;
  - Good governmental institutions; and
  - **Social capital**: productive social and economic organizations, private and public.

- Economists want to understand why some societies have far more wealth than others.
Economic Agents

- The word “agent” is economic jargon for a person or group that plays an active role in the economy.

- We describe three important types of agents.

- Households
  - individuals living alone, or
  - small groups living together (often related) and making joint economic decisions.

- Firms
  - individuals producing alone, or
  - groups of people producing together.
Governments

- Governments are groups of people who jointly regulate households and firms.
- Governments may be viewed as specialized firms with regulatory functions.
- Governments also provide public goods, [to be discussed later].

Households, firms, and governments are

- composed of many of the same people,…
- playing different roles.

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