

Introduction

The increasing obesity rate among U.S. citizens is a health concern which can be addressed if individuals make different choices about diet and exercise. The medical community is increasingly looking to economists for ideas about how choices and behavior might be modified in response to various incentives.

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Learning Objectives

- Discuss the difference between microeconomics and macroeconomics
- Evaluate the role that rational self-interest plays in economic analysis

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Learning Objectives

- Explain why the study of economics is a science
- Distinguish between positive and normative economics

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Chapter Outline

- The Power of Economic Analysis
- Defining Economics
- Microeconomics versus Macroeconomics

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Chapter Outline

- The Economic Person: Rational Self-Interest
- Economics as a Science
- Positive versus Normative Economics

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Did You Know That ...

- More than half of all Italians in their 20's live with their parents?
- This is the result of labor market regulation that discourages firms from hiring permanent employees?
- There are countless examples like this in which economic incentives can account for social patterns?

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The Power of Economic Analysis

- The economic way of thinking is a framework to analyze solutions to economic problems, such as:
 - Staying in school
 - Choosing which classes to take
 - Sending U.S. troops abroad

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The Power of Economic Analysis

- Economics is a way of thinking about all decisions, such as:
 - Voting and public policy
 - Choosing a career
 - Buying a home
 - Immigration policy

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Defining Economics

- **Economics**
 - The study of how people allocate their limited *resources* to satisfy their unlimited *wants*
 - The study of how people make choices

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Defining Economics

- **Resources**
 - Things used to produce other things to satisfy people's wants
- **Wants**
 - What people would buy if their incomes were unlimited

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Defining Economics

- With limited income (resources), people must make choices to satisfy their wants.
- Economics studies how these choices are made.

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Microeconomics versus Macroeconomics

■ Microeconomics

- The study of decision making undertaken by individuals (or households) and by firms
 - Pollution
 - Crime
 - Health Care
 - Education

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Microeconomics versus Macroeconomics

■ Macroeconomics

- The study of the behavior of the economy as a whole
 - Inflation
 - Taxes
 - Unemployment
 - Economic growth
 - International trade

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The Economic Person: Rational Self-Interest

“It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from the regard to their own interest.”

—Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, 1776

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The Economic Person: Rational Self-Interest

- Economists assume that people make choices in their own self-interest and in a rational manner.

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Example: Attacking the Rationality Assumption with Coffee Mugs

- Experimental economists simulate real-world situations in a laboratory setting to observe human behavior.
- In some of these experiments, participants choose not to make trades that would appear to benefit them.
- Does this disprove the rationality assumption?

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The Economic Person: Rational Self-Interest

- **Rationality Assumption**
 - The assumption that people do not intentionally make decisions that would leave them worse off

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The Economic Person: Rational Self-Interest

- **Questions**
 - Does the fact that some people make apparently irrational choices invalidate the rationality assumption in economics?
 - Can economic models be applied to situations in which behavior is at odds with what we expect from rational people?

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The Economic Person: Rational Self-Interest

- **Rationality and the use of incentives**
 - Positive incentives
 - Negative incentives
- **Making choices**
 - Balancing cost and benefits

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The Economic Person: Rational Self-Interest

- Some examples of incentives
 - Choices faced by dialysis patients
 - Choices between life and death

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The Economic Person: Rational Self-Interest

- Defining self-interest
 - The pursuit of one's goals
 - Humanitarian
 - Prestige
 - Wealth
 - Power
 - Friendship

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Example: The Perceived Value of Gifts

- The perceived value of gifts
 - Should we substitute gift certificates for physical gifts?
 - Often, the recipient of the gift places a value on it far less than the market value.

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Economics as a Science

- **Models or Theories**
 - Simplified representations of the real world used as the basis for predictions or explanations
 - A map and getting directions are examples of models

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Economics as a Science

- **Assumptions**
 - The set of circumstances in which a model is applicable
- The **Ceteris Paribus Assumption** (KAY-ter-us PEAR-uh-bus)
 - Nothing changes except the factor or factors being studied

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Example: Getting Directions

- A map is a simplifying model of reality.
- The degree of simplification varies across maps; some contain more detail than others.
- Economic models attempt to focus on what is relevant to the problem at hand and omit what is not.

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Economics as a Science

- Economics is an **empirical** science.
 - Real-world data is used to evaluate the usefulness of a model.
 - Models are useful if they predict economic phenomena.
- Economic models predict how people react, not how they think.

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Positive versus Normative Economics

- **Positive Economics**
 - Purely descriptive statements or scientific predictions—a statement of *what is*
- **Normative Economics**
 - Analysis involving value judgments—a statement of *what ought to be*

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Issues and Applications: Applying Economics to the Problem of Childhood Obesity

- Children of full-time working mothers are twice as likely to be obese as are children of stay-at-home moms.
- To the extent that working mothers have less time to devote to outings that would provide exercise for their children, this helps explain the pattern.
- Also, working mothers are less able to supervise their children's choice of food for meals and snacks.

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Issues and Applications: Applying Economics to the Problem of Childhood Obesity

- When both parents work full-time, more of the child's daily routine is supervised by other caregivers.
- The parents' choices about allocation of time and the schools' choices about the availability of healthy food items are all economic decisions.

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Summary Discussion of Learning Objectives

- Microeconomics versus Macroeconomics
 - Economics is the study of how individuals make choices to satisfy wants.
 - Microeconomics is the study of individual decision making by household firms.
 - Macroeconomics is the study of nationwide phenomena, such as inflation and unemployment.

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Summary Discussion of Learning Objectives

- Self-interest in economic analysis
 - Rational self-interest is the assumption that individuals behave in a reasonable (rational) way in making choices to further their interests.

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Summary Discussion of Learning Objectives

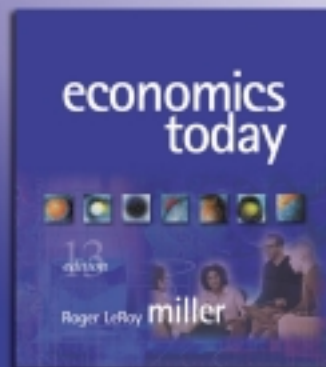
- Economics as a science
 - Economists use models, or theories, that are simplified representations of the real world to analyze and make predictions about the real world.

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Summary Discussion of Learning Objectives

- The difference between positive and normative economics
 - Positive economics deals with *what is*, whereas normative economics deals with *what ought to be*.

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End of
Chapter 1
**The Nature
of Economics**

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