

Outline for lecture 2

ECON 1a, Spring 2008, Warren Gibson

- Normative and positive statements
 - Positive: statements about what is or is likely to be
 - Normative: statements about what ought to be
 - Example:
 - * “Minimum wage laws cause unemployment.” – positive
 - * “Minimum wage laws should be repealed.” – normative
 - Economics is about positive statements though most economists readily switch hats and express normative political arguments.
- Mankiw’s ten principle of economics:
 1. Tradeoffs: to get something scarce you must give up something else.
 2. Opportunity cost of something is whatever you had to give up to get it. Examples:
 - You decided to come to class: the cost might be an hour playing video games.
 - You spend a dollar for a bottle of water: The next best use of that dollar might have been paying down your student loan.
 - You use frequent flier miles for a trip to Hawaii: the next best use might have been a trip to New York.
 3. Rational people think at the margin. One more cup of coffee?
 4. Incentives are important. Reward or punishment that encourages action.
 5. Trade can generate gains for all.
 6. Markets are usually a good way to organize society.
 7. Governments can sometimes improve market outcomes (I disagree).
 8. Standards of living depend on ability to produce
 - Ability to produce depends on level of capital investment

- Level of capital investment depends on degree of respect for property rights.
- 9. Money inflation leads to price inflation.
- 10. There is a short-run tradeoff between unemployment and inflation.
 - Maybe.
- There are costs associated with nearly all transactions. **Transaction costs** are the costs of
 1. Finding a trading partner
 2. Negotiating a deal
 3. Monitoring the terms of the deal (if necessary)
- **Saving** is the key to increased future consumption.
 - You are saving when you do not consume all of your current income
 - Nearly all savings are directed to investment
 - Investment is the acquisition of capital goods to be used to produce consumer goods or other capital goods.
 - Capital goods consist of buildings, machines, materials, etc.
- Investment can be direct or indirect.
 - Direct investment
 - * Plant a garden
 - * Start a business
 - Indirect investment
 - * Buy shares of stock.
 - * Open a bank savings account
- Free markets serve as an information network that allows buyers and sellers to find each other
 - What's needed to provide the coffee I buy at Starbucks?
 - * Coffee beans from South America

- * Water
 - * Brewing machine
 - * Cup, lid, jacket
 - * Person to sell the coffee
 - * Accountant to track sales and expenses
 - * etc., etc., etc.
- No one directs all these people. All are guided by profit opportunities.
 - This is an example of **spontaneous order**.
- Adam Smith’s “invisible hand” metaphor (quote from p. 10)