PART 1.1

ECONOMIC GLASSES:

Man, Market, Economy

UNDERSTANDING ECONOMIC PHENOMENA

UNDERSTANDING SOCIAL PHENOMENA

UNDERSTANDING CULTURAL PHENOMENA

UNDERSTANDING PHENOMENA

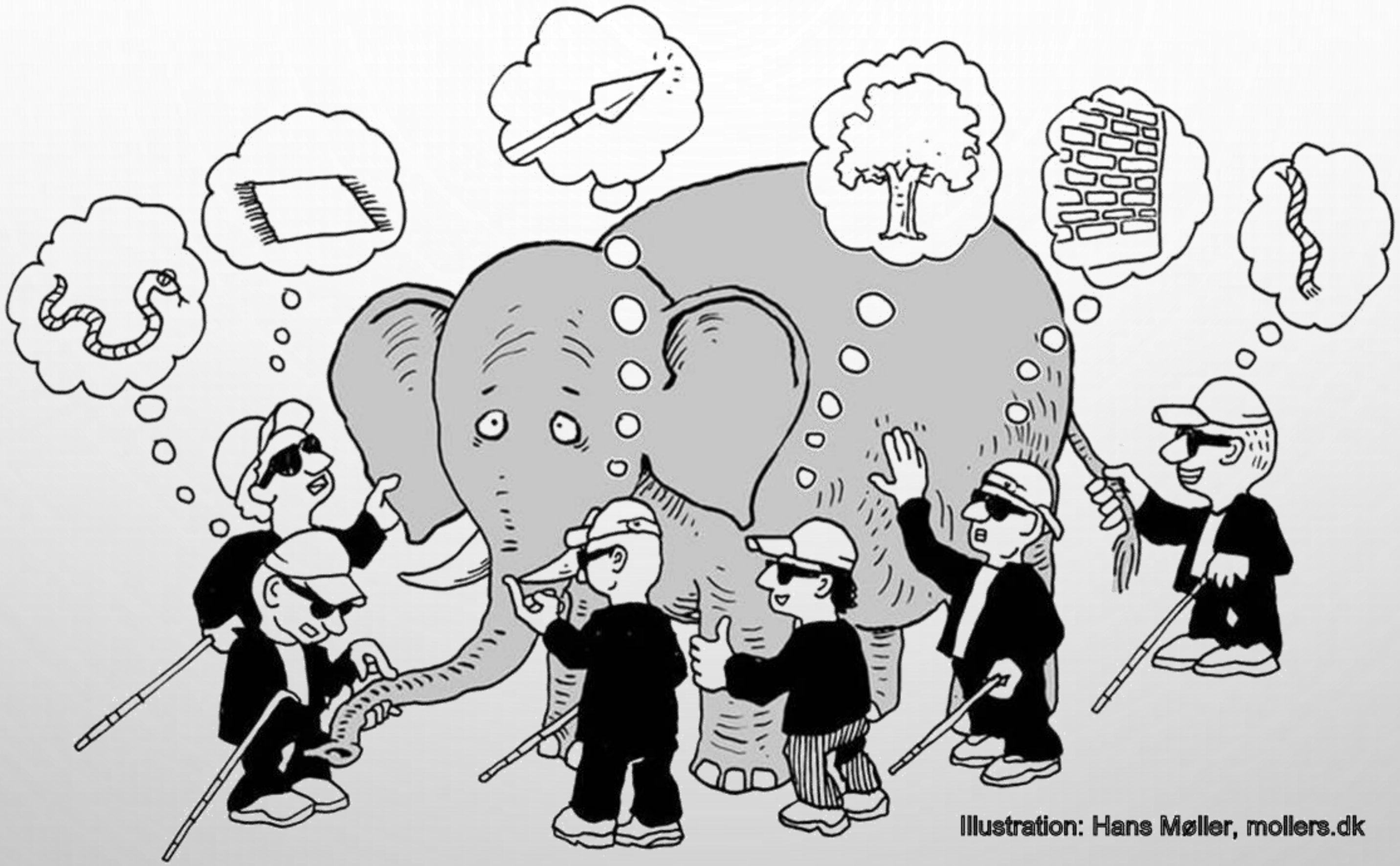
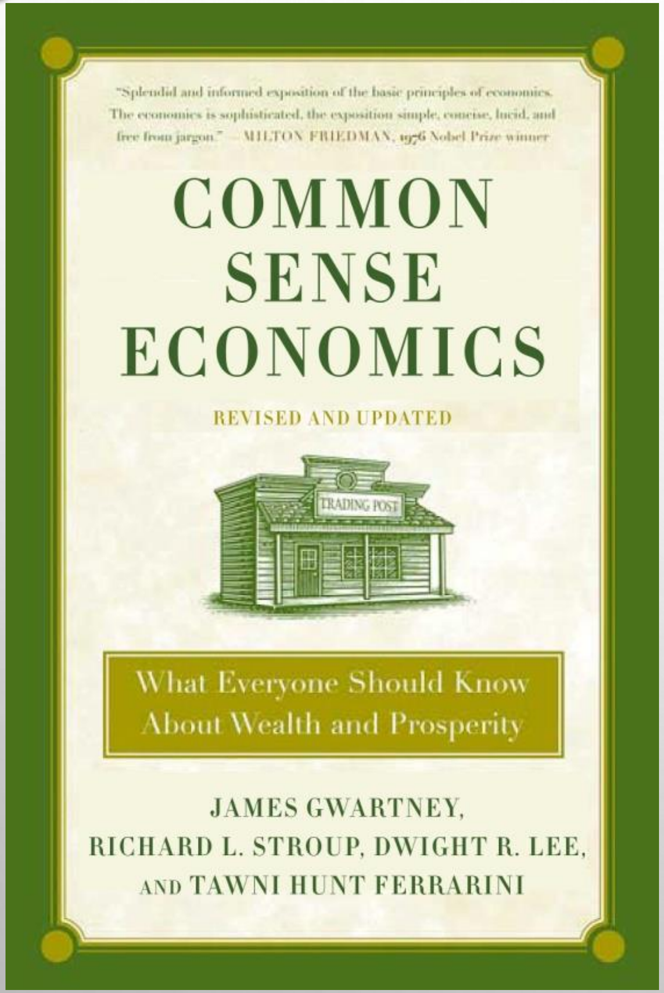


Illustration: Hans Møller, mollers.dk

ECONOMISTS' QUESTIONS

- How do agents make a decision?
- How do agents exchange/interact?
- How does the economy/the world works?



COMMON SENSE ECONOMICS (2010)

WHAT EVERYONE SHOULD KNOW ABOUT WEALTH AND PROSPERITY

By James Gwartney, Richard Stroup, Dwight Lee, And Tawni Ferrarini

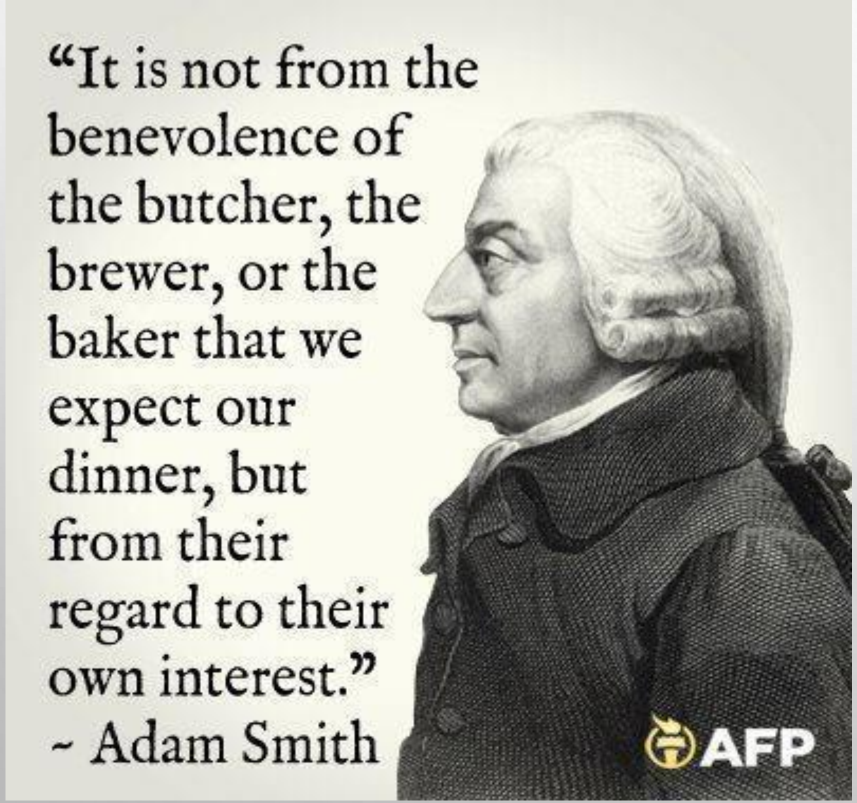
Key objective: Provide important insights with regard to how the world really works, bridging between common sense and basic principles of economics

ELEMENT 1: INCENTIVES MATTER.

- Incentives are the rewards and penalties associated with choices.
- Changes in incentives alter the behavior of people.
- Incentives operate on all levels - personal, familial, industrial and societal levels.

ELEMENT 1: INCENTIVES MATTER.

Is man assumed greedy?

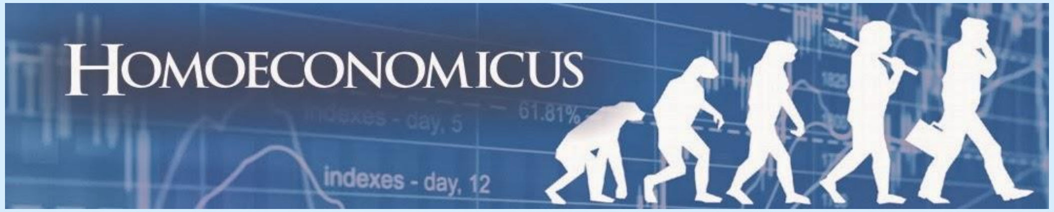


We address ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but of their advantages.."

ELEMENT 1: INCENTIVES MATTER.

Man, a being who inevitably does that by which he may obtain the greatest amount of necessaries, conveniences, and luxuries, with the smallest quantity of labour and physical self-denial with which they can be obtained."

John Stuart Mill



Homo economicus is a term used for ***Homo sapiens*** that acts to obtain the highest possible well-being for him or herself given available information about opportunities and other constraints on his ability to achieve his predetermined goals.

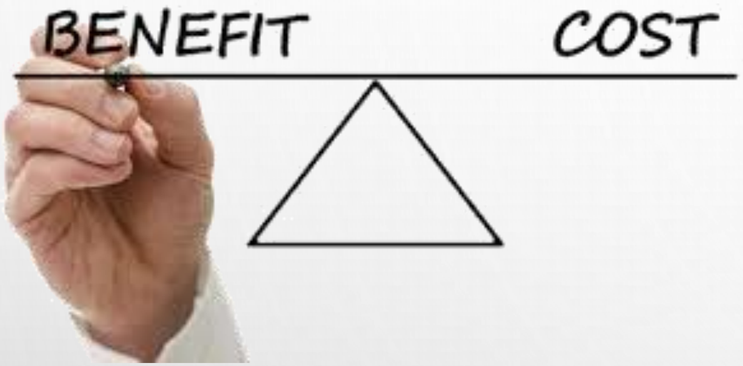
"Mill has only examined the *homo economicus*, or **dollar-hunting animal**."

C. S. Devas in his 1883 work *The Groundwork of Economics*

- *Homo economicus* bases its choices on a consideration of its own personal **"utility function"**.

$$U(x_1, x_2, \ldots, x_n) = \sum_{i=1}^{n} U_i(x_i)$$

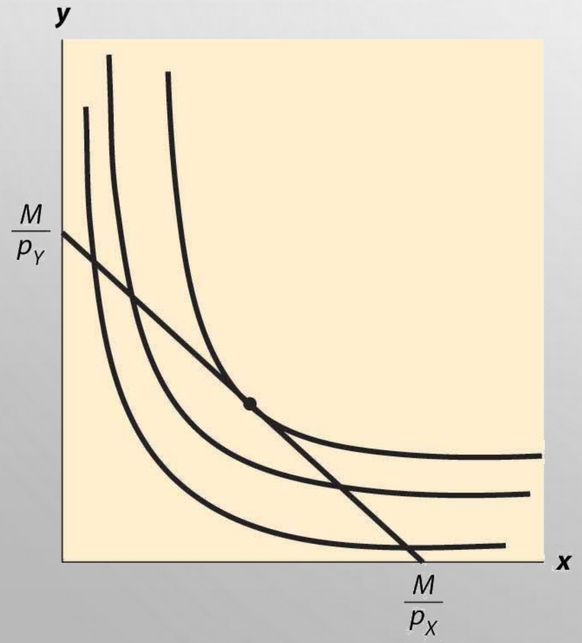
ELEMENT 1: INCENTIVES MATTER.



Rationality

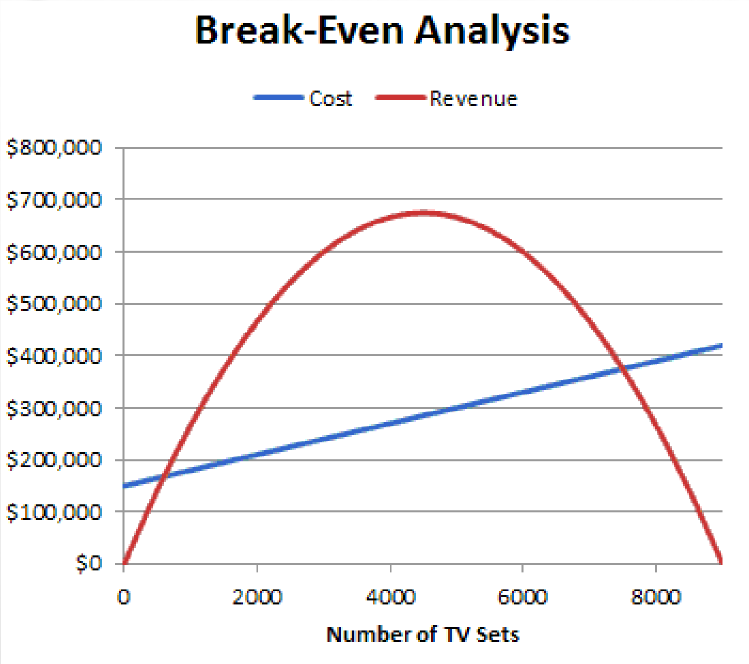
- The idea that **people** and **organizations** are instrumentally rational—that is adopt the best actions to achieve their goals.
- Rationality is a matter of being logically consistent within your preferences and beliefs.
- People have focused on accuracy of beliefs and full use of information—in this view a person who is not rational has beliefs that don't fully use the information they have.

[*Herbert A. Simon*: had argued that a kind of '**bounded rationality'** (the idea that when individuals make decisions, their rationality is limited by the available information) makes more sense for such models]



https://www.youtube.com/watch?v=JaKMimJPxyA
https://www.youtube.com/watch?v=qBCLXZmMQNs
https://www.youtube.com/watch?v=oJbV5R4ZWm4

ELEMENT 1: INCENTIVES MATTER.



Firm: Profit function

- Profit is a reward for transforming resources into something of greater value.
- Losses are just as important! They impose discipline on people, businesses and organizations that are not producing valuable goods and services.
- People of a nation are better off if their resources produce highly valued goods and services.
- Less productive use of resources will be discouraged.

https://www.youtube.com/watch?v=myARteuoDJg
0.00-8.00
42.59-46.00

ELEMENT 1: INCENTIVES MATTER.

Are we all greedy?

- Some people think that incentives matter only when people are greedy and selfish. But people act for a variety of reasons, some selfish and some charitable.
- The choices of both the self-centered and the altruistic will be influenced by changes in personal costs and benefits.

- Will you rescue a sunk child in a) a swimming pool b) Niagara fall?

ELEMENT 1: INCENTIVES MATTER.

Are we all greedy?

- When Mother Teresa’s organization, the Missionaries of Charity, attempted to open a shelter for the homeless in New York City, the city required expensive (but unneeded) alterations to its building. The organization abandoned the project.
- This decision did not reflect any change in Mother Teresa’s commitment to the poor but a change in incentives. Mother Teresa decided that her resources would do more good elsewhere.

ELEMENT 1: INCENTIVES MATTER.

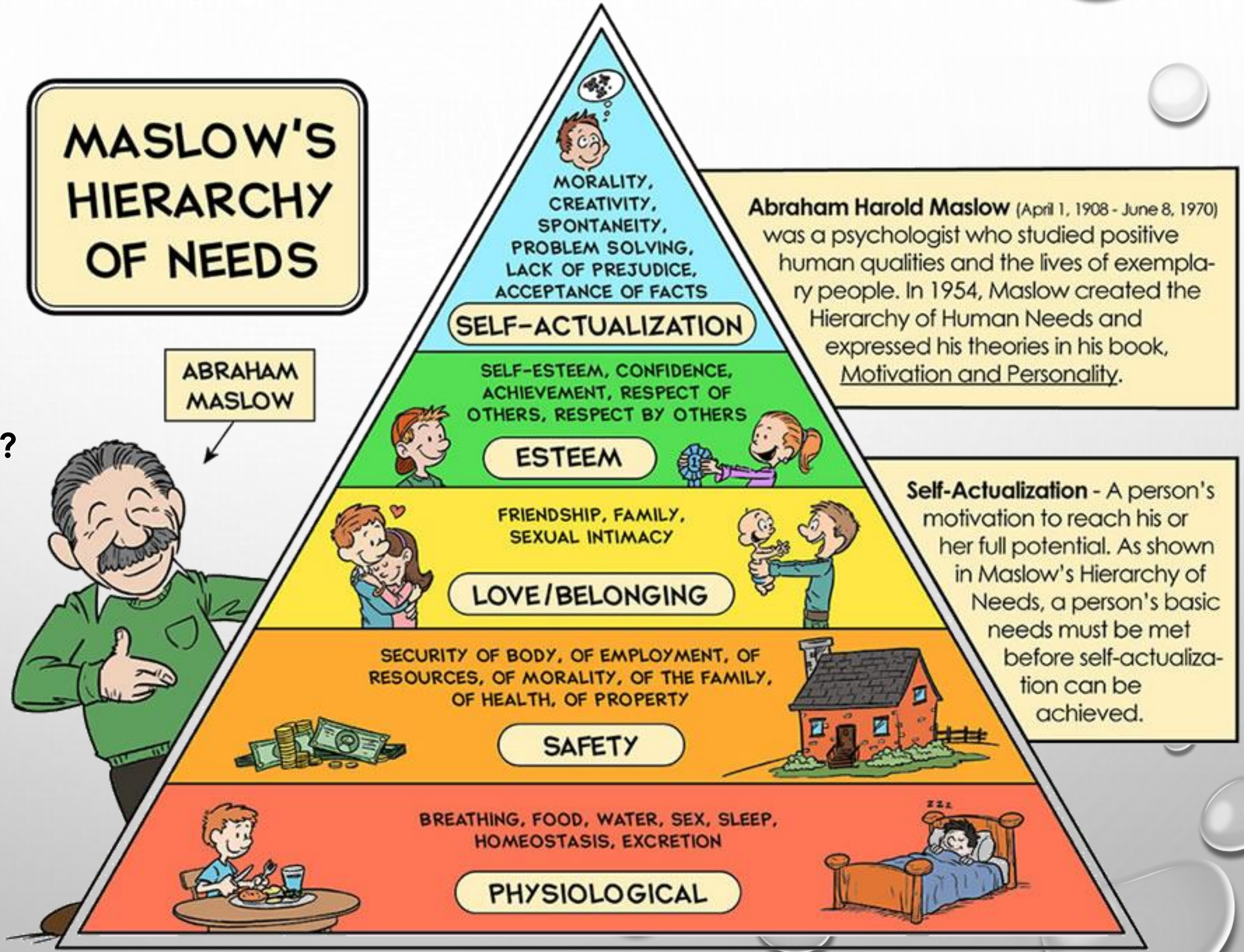
Are we all greedy?

- Amartya Sen has argued Economics should build into its assumptions the notion that people can give credible commitments to a course of conduct.

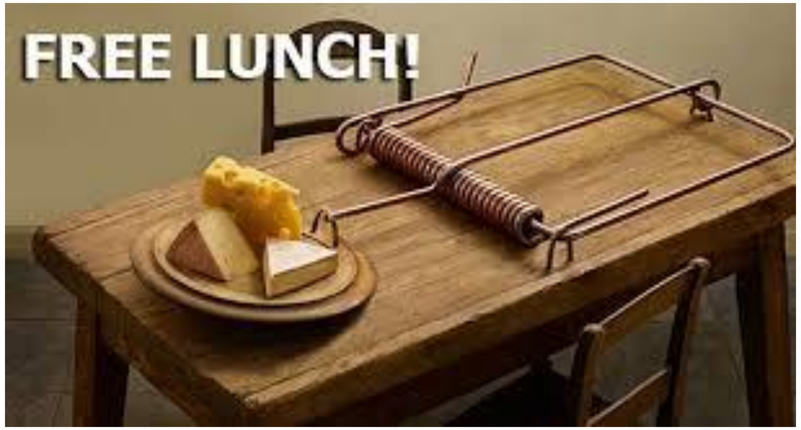
- Otherwise, when two strangers meeting on a street

A: "Where is the railway station?"
B: "There," [pointing at the post office]
A: "and would you please post this letter for me on the way?“
B: "Yes," [determined to open the envelope and check whether it contains something valuable]

Non-economic Incentives?



ELEMENT 2: THERE IS NO SUCH THING AS A FREE LUNCH.



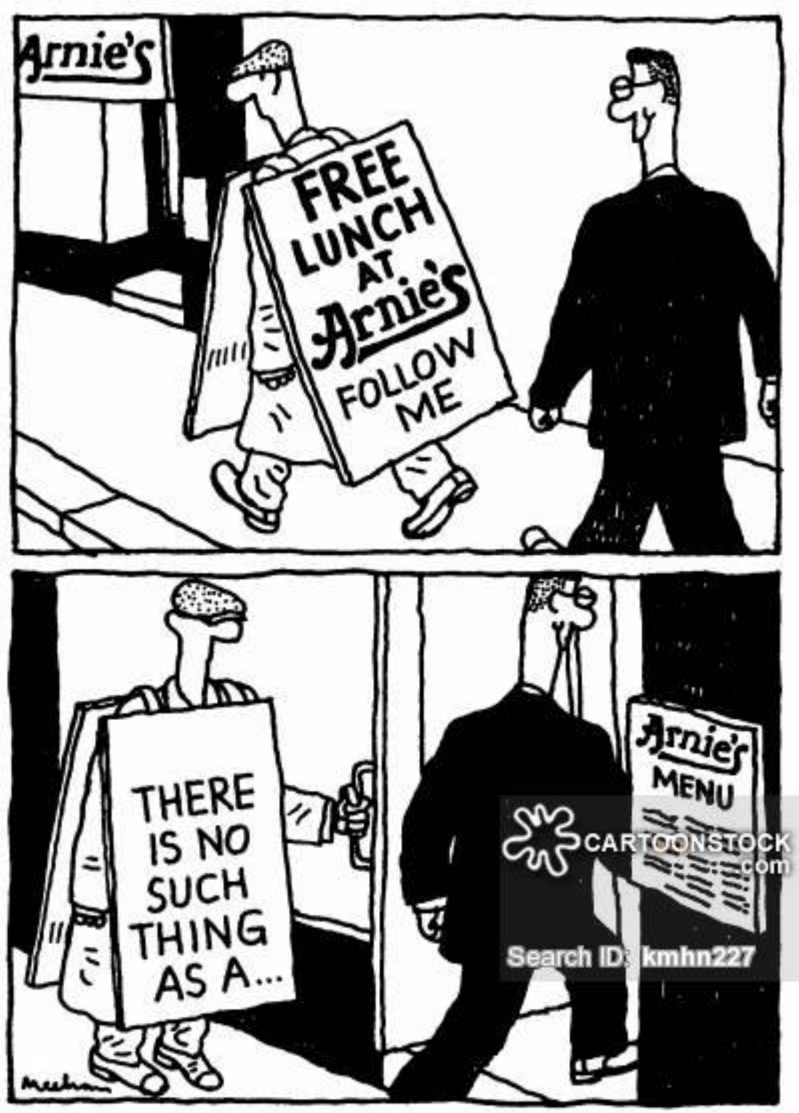
Free lunch?

- A resource is scarce if ***it has alternative uses.***
- Because we are constantly faced with scarcity, we must make **choices**.
- Every time we choose one thing (material or not) we refuse something else.
- We constantly make **trade-offs** in our decisions.
- You always have to pay for any choice chosen.

ELEMENT 2: THERE IS NO SUCH THING AS A FREE LUNCH.

Really?

ELEMENT 2: THERE IS NO SUCH THING AS A FREE LUNCH.



Trade-off

- The sacrifice is the cost we pay for a good or service.
- Both consumers and producers experience costs with everything we do.
- A good can be provided free to an individual or group if others foot the bill. But this merely shifts the costs; it does not reduce them

ELEMENT 3: DECISIONS ARE MADE AT THE MARGIN.

- Few decisions are "all-or-nothing.

ELEMENT 3: DECISIONS ARE MADE AT THE MARGIN.

- Marginal means ‘***additional***’

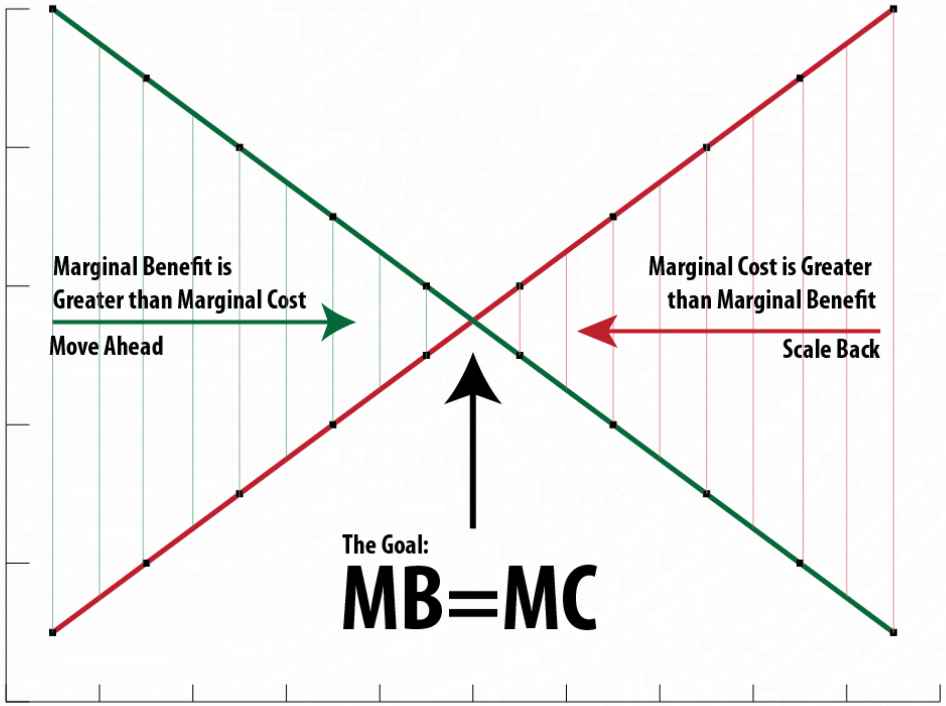
Understanding test: To buy gasoline and have a car washed.
- Cost of gasoline is at $2.50 per gallon, the car wash costs $2,
- But if we buys 10 gallons of gasoline, the car wash is free.

The marginal cost of the tenth gallon of gasoline is..?

a. zero
b. 50 cents
c. $2.00
d. $2.50

ELEMENT 3: DECISIONS ARE MADE AT THE MARGIN.

- To get the most out of our resources, we should ***only take an action when the marginal benefits are greater than the marginal costs***.



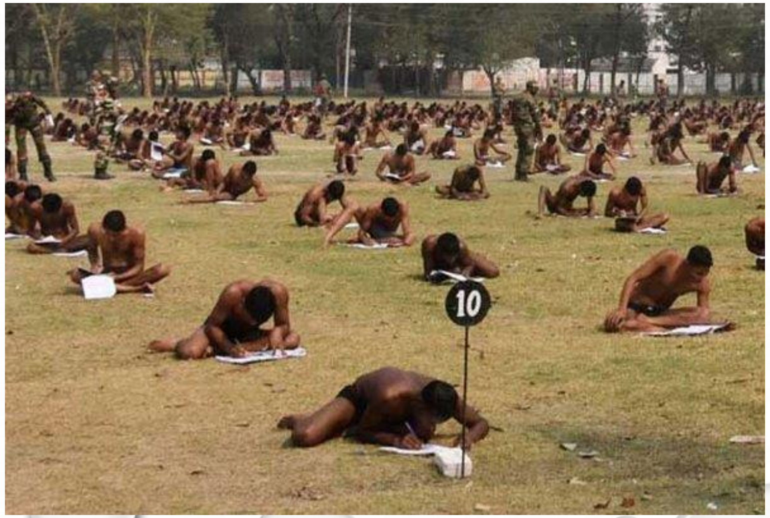
ELEMENT 3: DECISIONS ARE MADE AT THE MARGIN.

- Do you clean your house 100% of the dirt away?
  - How about when company is coming?
  - How about when selling your house?

ELEMENT 3: DECISIONS ARE MADE AT THE MARGIN.

TOWARD ZERO WASTE COMMUNITIES

MOC ZERO CORRUPTION



http://video.postjung.com/95253.html

ELEMENT 3: DECISIONS ARE MADE AT THE MARGIN.

ELEMENT 4: TRADE PROMOTES ECONOMIC PROGRESS.

Trade exists at many levels

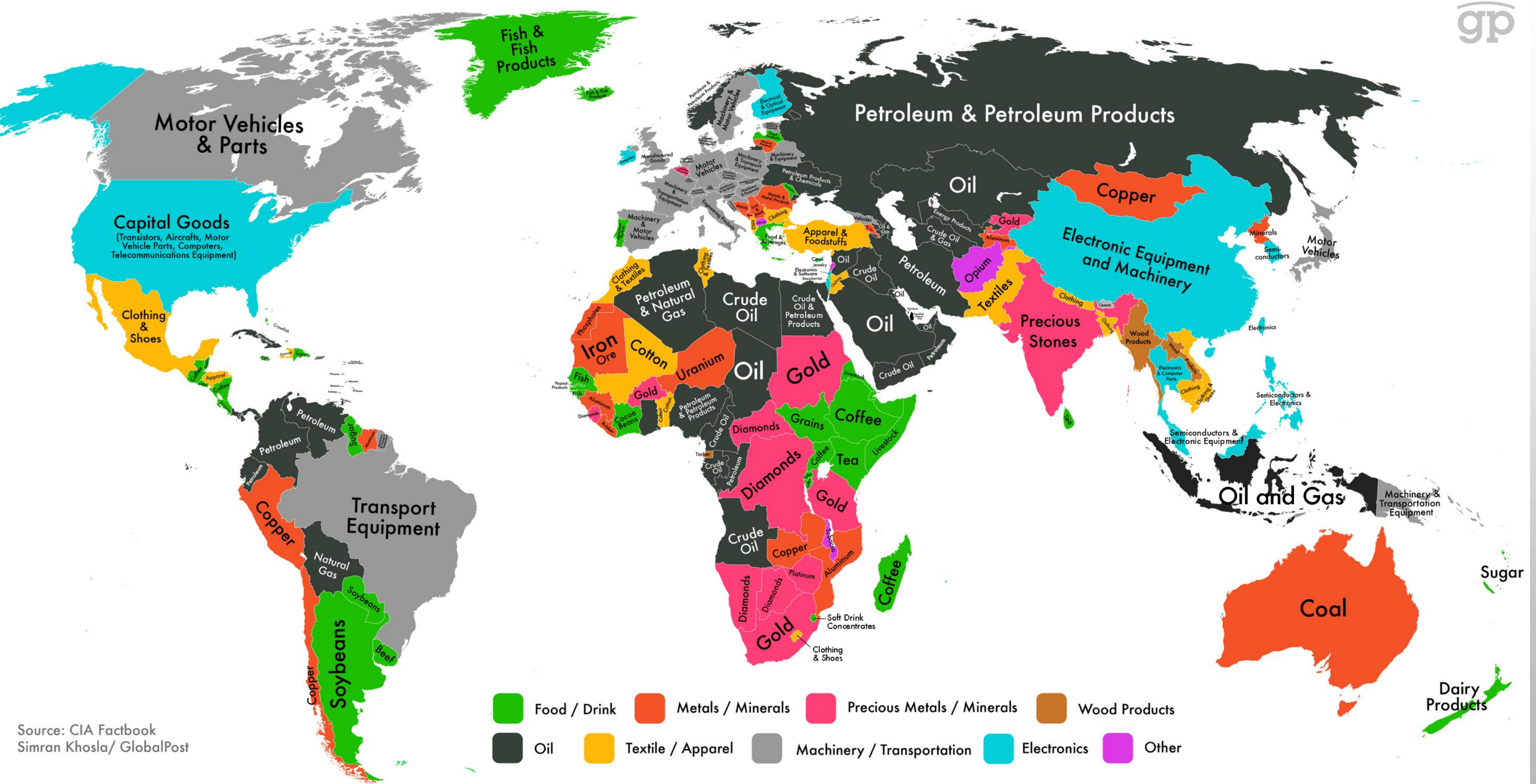
- Enrolling in this class
- Shopping at a grocery store
- Taking a vacation
- Buying imports from China

ELEMENT 4: TRADE PROMOTES ECONOMIC PROGRESS.

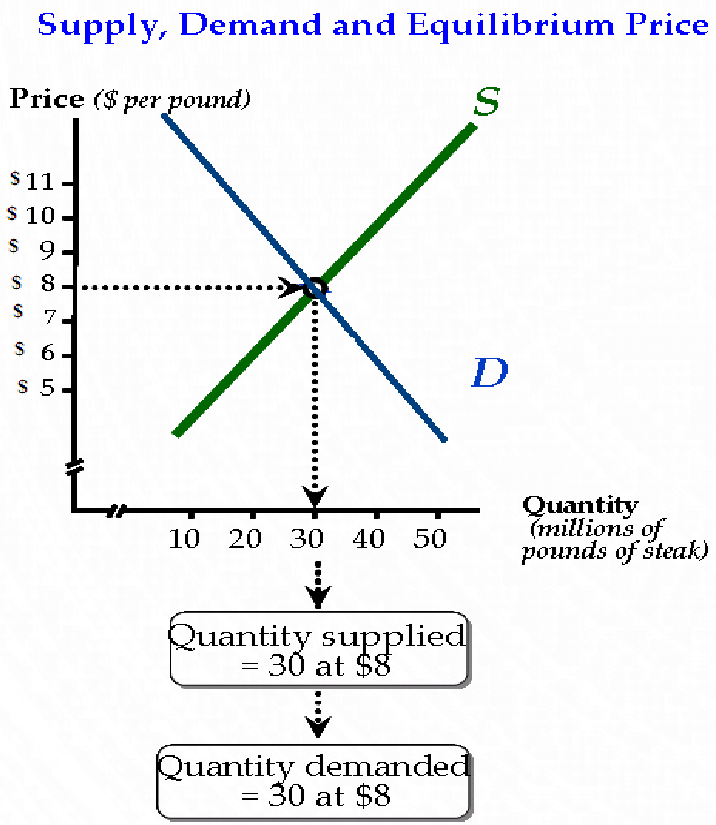
- Why do you buy things from others rather than producing them yourself?
- Would you be better off if you purchased fewer items from others and produced more of what you consume?
- Would the country be better off if we produced more items domestically and purchased fewer from foreigners?

ELEMENT 4: TRADE PROMOTES ECONOMIC PROGRESS.

- Trade moves goods from people who value them less to people who value them more.
- Trade makes larger outputs and higher consumption possible as the result of **specialization**, possibly because it facilitates the use of mass production methods.


Fish & Fish Products
Motor Vehicles & Parts
Capital Goods
(Transistors, Aircrafts, Motor Vehicle Parts, Computers, Telecommunications Equipment)
Clothing & Shoes
Petroleum & Petroleum Products
Oil
Copper
Electronic Equipment and Machinery
Motor Vehicles
Petroleum
Opium
Textiles
Precious Stones
Crude Oil
Petroleum & Natural Gas
Apparel & Foodstuffs
Iron Ore
Cotton
Uranium
Gold
Coffee
Grains
Diamonds
Tea
Copper
Platinum
Aluminum
Soft Drink Concentrates
Clothing & Shoes
Transport Equipment
Natural Gas
Soybeans
Beef
Oil and Gas
Machinery & Transportation Equipment
Coal
Sugar
Dairy Products
Food / Drink
Metals / Minerals
Precious Metals / Minerals
Wood Products
Oil
Textile / Apparel
Machinery / Transportation
Electronics
Other
Source: CIA Factbook
Simran Khosla/ GlobalPost

ELEMENT 4: TRADE PROMOTES ECONOMIC PROGRESS.



- **The "invisible hand"** of market prices directs buyers and sellers toward activities that promote the general welfare.
- Both are made better off as the result of any voluntary market exchange.
- Firms will search for those opportunities where market conditions are such that they are able to generate revenue sufficient to cover their costs.
- Buyers and sellers are motivated to coordinate their actions, cooperate with each other, and work together harmoniously.
- Firms continue to produce a good or service only if consumers value it enough to pay prices sufficient to cover per unit costs.
- Potential gains from trade are maximized.

ELEMENT 4: TRADE PROMOTES ECONOMIC PROGRESS.

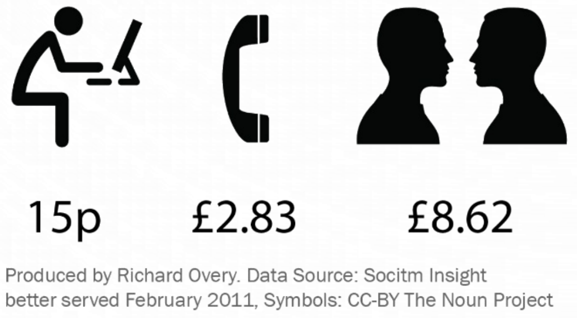
- **Price** is indicative of what consumers are willing and able to pay.
- Price also incorporates the costs of production and the costs of bringing the apples to market in light of other production options.
- When guided by market prices, self-interested individuals will move toward activities that will promote the general welfare.
- This occurs without any central planning.

ELEMENT 4: TRADE PROMOTES ECONOMIC PROGRESS.

- Adam Smith, ***The Wealth of Nations*** (1776) claims the following:

- "It is his own advantage, indeed, and not that of society which he has in his view.
- But the study of his own advantage naturally, or rather necessarily, leads him to prefer that employment which is most advantageous to society…

ELEMENT 4: TRADE PROMOTES ECONOMIC PROGRESS.



- Some other costs to concern in trading: **Transaction Costs**
- The resources spent on
  - Searching out trading partners
  - Searching out product information
  - Negotiating terms of trade
  - Closing sales

ELEMENT 5: PEOPLE EARN INCOME BY HELPING OTHERS.

- People are different in many ways. We have different specialties or comparative advantages…They are our greatest assets!
- Differences in income arise because our differences affect the value of goods and services we help create and supply.
- There is a direct link (ceteris paribus) between helping others in ways that they value and the income we earn.
- If you want a high income job, figure out how to help others in ways they value!!!

https://www.youtube.com/watch?v=cxUuU1jwMgM

ELEMENT 5: PEOPLE EARN INCOME BY HELPING OTHERS.

- The direct link between providing others with things they value and our personal earnings provides each of us with a strong incentive to develop our talents and skills.
  - College students are rewarded for improving their knowledge and skills.
  - Star athletes and entertainers are rewarded for their special skills.
  - Entrepreneurs are rewarded for their strategic risk-taking.

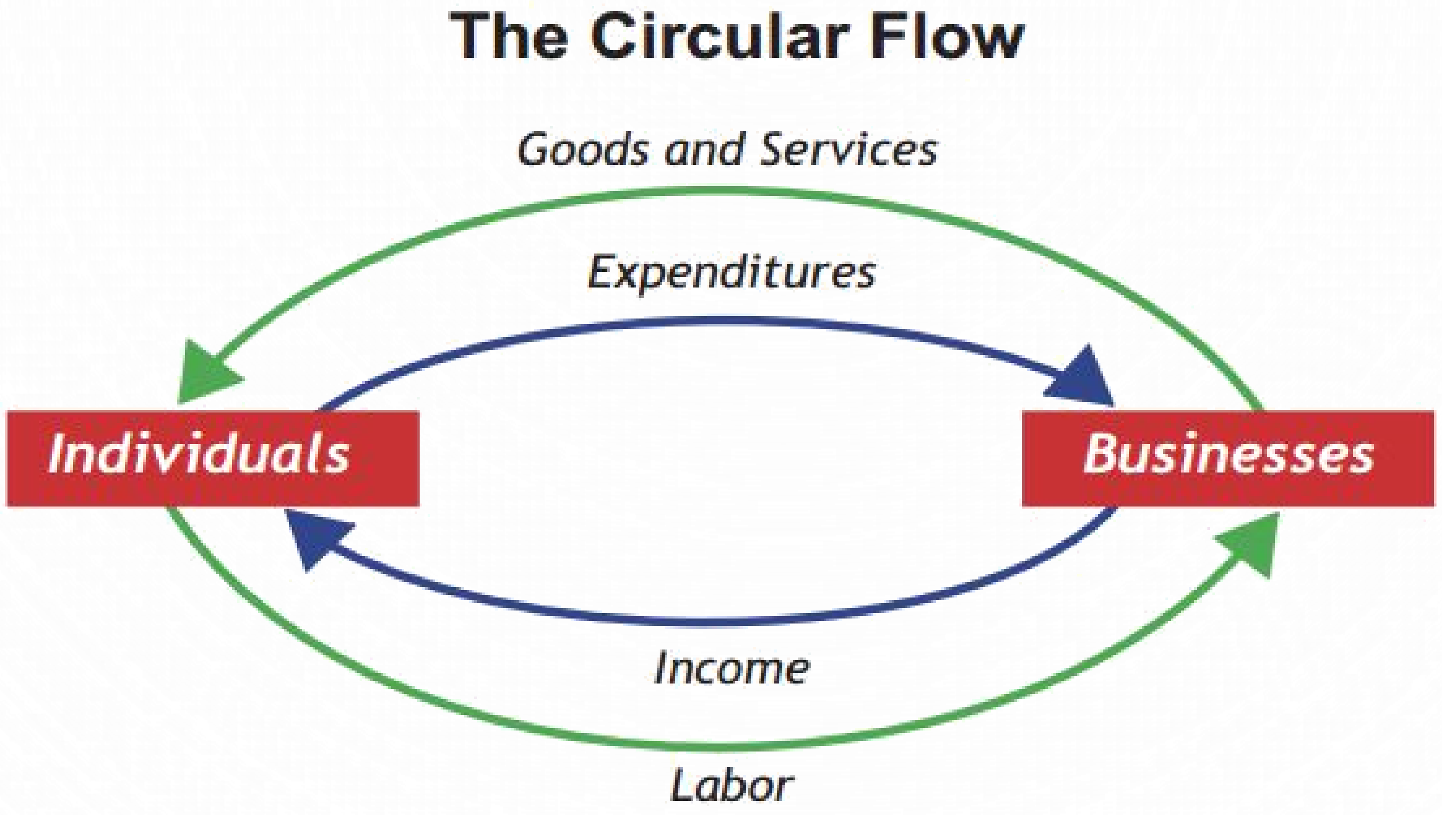
ELEMENT 5: PEOPLE EARN INCOME BY HELPING OTHERS.

ELEMENT 5: PEOPLE EARN INCOME BY HELPING OTHERS.

- It is production of value that really matters, not jobs.
- If jobs were the key to high incomes, we could easily create as many as we wanted.
    - All of us could work one day digging holes and the next day filling them up.
    - We would all be employed, but we would also be exceedingly poor because such jobs would not generate goods and services that people value.
- Can you think of anyone with substantial earnings who is not providing a good or service that others value highly?

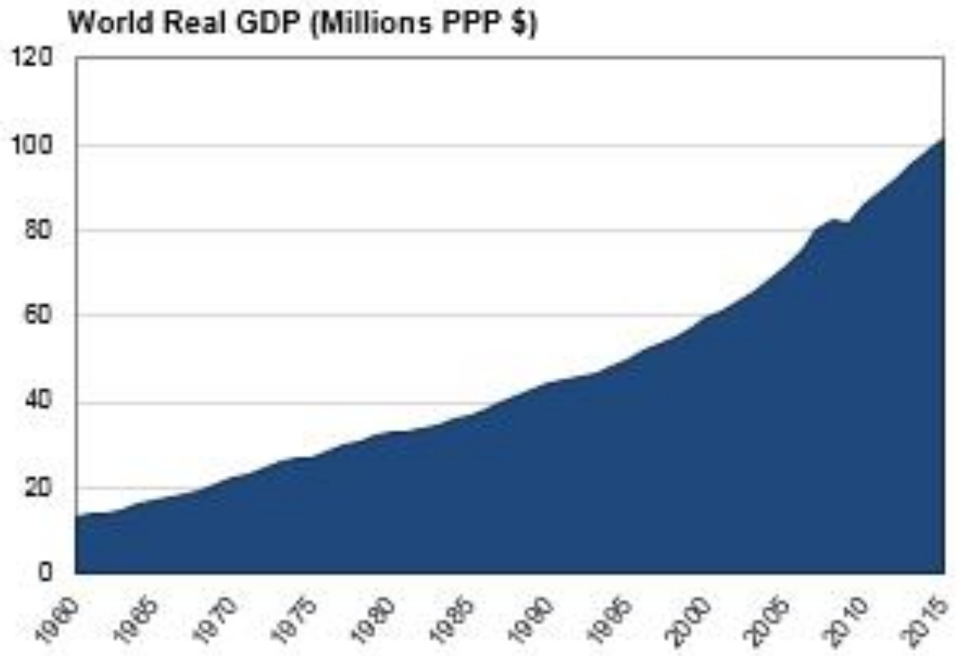
https://www.youtube.com/watch?v=PpWCBPkvGZU

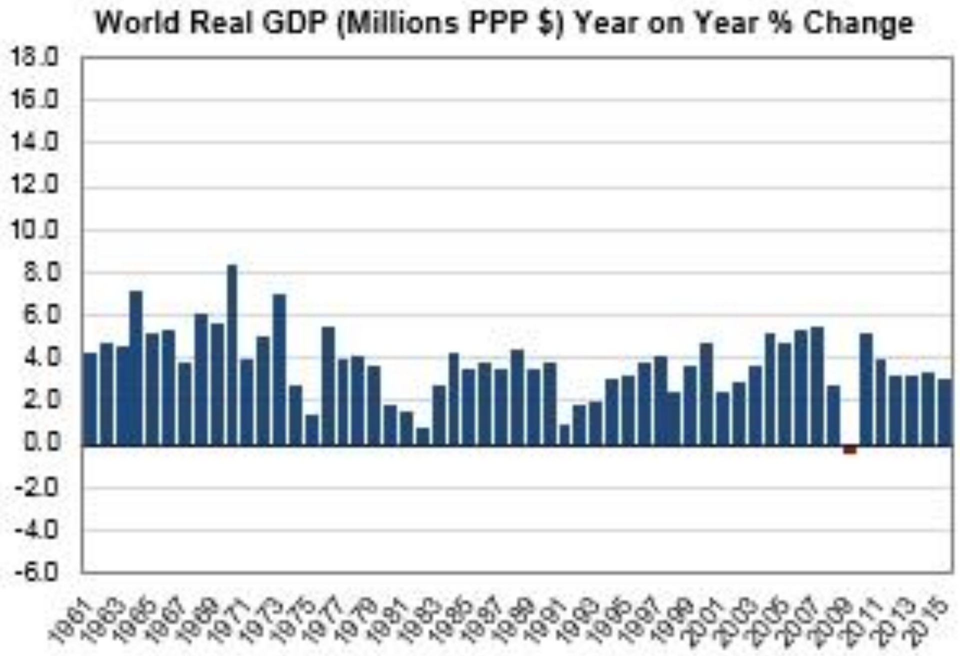
ELEMENT 5: PEOPLE EARN INCOME BY HELPING OTHERS.



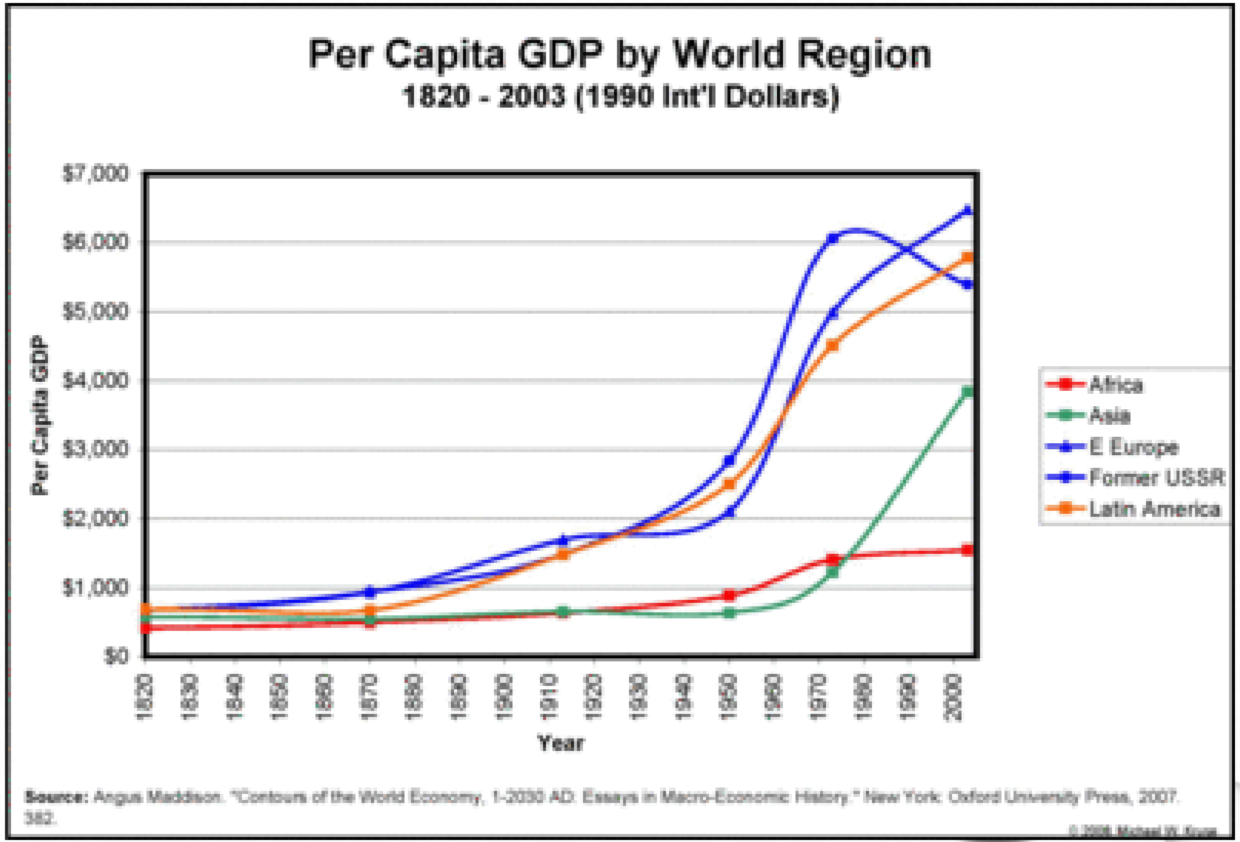
https://www.youtube.com/watch?v=sLuaoirSePg

ELEMENT 6: ECONOMIC PROGRESS COMES PRIMARILY THROUGH TRADE, INVESTMENT, BETTER WAYS OF DOING THINGS, AND SOUND ECONOMIC INSTITUTIONS.

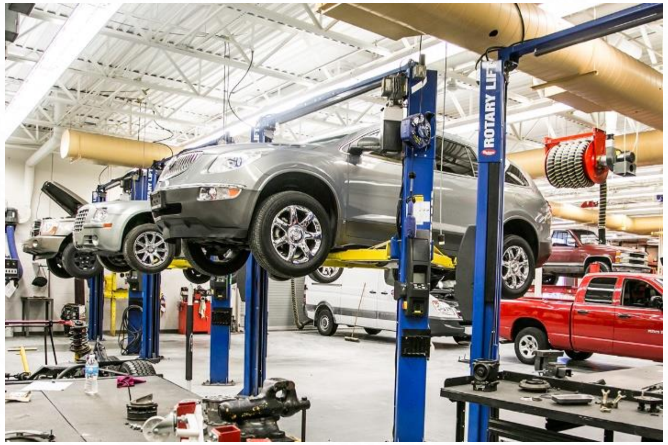




ELEMENT 6: ECONOMIC PROGRESS COMES PRIMARILY THROUGH TRADE, INVESTMENT, BETTER WAYS OF DOING THINGS, AND SOUND ECONOMIC INSTITUTIONS.



ELEMENT 6: ECONOMIC PROGRESS COMES PRIMARILY THROUGH TRADE, INVESTMENT, BETTER WAYS OF DOING THINGS, AND SOUND ECONOMIC INSTITUTIONS.



Sources of Economic Growth

- Investments in productive assets and discovery and development of resources
  - Tools, machines, “human capital”, minerals
- Improvements in technology
  - Internal combustion engine, electricity, computers, by-pass surgeries, etc.
- Improvements in economic organization
  - Legal system, competitive markets, etc.

ASSIGNMENT

- YouTube WATCH: HOW THE ECONOMIC MACHINE WORKS BY RAY DALIO

  https://www.youtube.com/watch?v=rwngkmmv-ag