

CHAPTER 1

ECONOMICS AND LIFE

Chapter Overview

Economists approach problems differently from many other people. Underlying economics is the basic principle of rational behavior—that people make choices to achieve their goals in the most effective way possible. In this chapter we have introduced the basic concepts economists use, as well as four questions they ask to break down problems. Throughout this book, students will see these concepts and questions over and over again:

1. Scarcity: What are the wants and constraints of those involved?
2. Opportunity cost: What are the trade-offs?
3. Incentives: How will others respond?
4. Efficiency: Why isn't everyone already doing it?

In later chapters, as we progress to more complicated problems, students should use these four questions to break down problems into manageable pieces, ones they can understand using the fundamental concepts presented in this chapter.

Learning Objectives

- LO 1.1:** Explain the historical thought behind macroeconomics.
- LO 1.2:** Explain the economic concept of scarcity.
- LO 1.3:** Explain the economic concepts of opportunity cost and marginal decision making.
- LO 1.4:** Explain the economic concept of incentives.
- LO 1.5:** Explain the economic concept of efficiency.
- LO 1.6:** Distinguish between correlation and causation.
- LO 1.7:** List the characteristics of a good economic model.
- LO 1.8:** Distinguish between positive and normative analysis.

Chapter Outline

OPENING STORY: MAKING AN IMPACT WITH SMALL LOANS

The Basic Insights of Economics

Scarcity (**LO 1.2**)

Performance and decision making (**LO 1.3**)

BOX FEATURE: WHAT DO YOU THINK? – THE OPPORTUNITY COST OF A LIFE

Incentives (**LO 1.4**)

Efficiency (**LO 1.5**)

An Economist's Problem-Solving Toolbox

Correlation and Causation **(LO 1.6)**

Correlation without Causation **(LO 1.6)**

Omitted variables **(LO 1.6)**

BOX FEATURE: FROM ANOTHER ANGLE – DOES ICE CREAM CAUSE POLIO?

Reverse causation **(LO 1.6)**

Models **(LO 1.7)**

BOX FEATURE: REAL LIFE – TESTING MODELS AGAINST HISTORY

Positive and Normative Analysis **(LO 1.8)**

BOX FEATURE: WHAT DO YOU THINK? – THE COST OF UNIVERSITY EDUCATION

Conclusion

Beyond the Lecture

Class Discussion: Scarcity (LO 1.2)

Have students review [this recent TED talk by Peter Diamandis](#). Peter highlights the impact of human ingenuity on scarcity and argues that we should be optimistic about the use of technology to address problems in the future. This is a great springboard for discussion.

1. Do students think that technology will continue to improve living standards and mitigate the problems associated with scarcity?

Writing Assignment: Opportunity Cost and Marginal Decision Making (LO 1.3)

Have students review [this article by Russell Roberts](#) on opportunity cost. It highlights some basic examples that are familiar to students. Require students to write a brief essay on the opportunity costs associated with decisions in their lives, decisions that firm's make, or government decisions. This can be used as a catalyst for class discussion as well.

Class Discussion: Opportunity Cost and Marginal Decision Making (LO 1.4)

Consider playing the song "Should I Stay or Should I Go" by The Clash to start an early class. It is a great way to start a conversation about marginal decision making, a topic that can be difficult for students to understand. This example is found at the website "From Abba to Zeppelin, Led: Using Music to Teach Economics," located [here](#).

1. How should someone make a decision based on additional benefits and costs?
2. What information does the decision maker need?

Class Discussion: Incentives (LO 1.5)

In order to highlight the importance of incentives, consider discussing [Chapter 3 of *Freakonomics*](#) by Steven Levitt and Stephen Dubner with your students. The chapter provides insight into the career of an individual who is involved in the illegal drug market. You could also ask students to review [this Los Angeles Times commentary](#) on the chapter, also written by Levitt and Dubner.

1. Ask students to consider why an individual would be willing to endure the risks associated with the illegal drug market given the relatively low pay and poor working conditions that many workers endure. Students really enjoy this interesting discussion.
2. How does this market compare to other markets? There are surprising similarities and differences between legal markets and the black market.

Solutions to End-of-Chapter Questions and Problems

Review Questions

1. Suppose you are shopping for new clothes to wear to job interviews, but you're on a tight budget. In this situation, what are your wants and constraints? What does it mean to behave rationally in the face of scarcity? [LO 1.2]

Answer: If you are deciding what to buy for a job interview, your want is to buy clothing that looks clean and professional, so you can present the best possible impression to potential employers. Your constraint is the amount of money you can spend on this clothing. A person behaving rationally would buy the nicest clothes they could afford.

2. You are a student with a demanding schedule of classes. You also work part-time and your supervisor allows you to determine your schedule. In this situation, what is your scarce resource? How do you decide how many hours to work? [LO 1.2]

Answer: Your scarce resource is time. You need both time to study and time to work. Presumably, you want to do well in school and also make money. You will try to balance your schedule so that you work as much as possible while still having enough time to study and do well in school.

3. Think about the definition of scarcity that you learned in this chapter. Name three ways that you confront scarcity in your own life. [LO 1.2]

Answer: We face scarcity in many aspects of our lives. I love to travel and explore new places. I face scarcity in both time and money that keeps me from traveling as often as I would like. In my professional life, I also face scarcity. There are lots of worthy projects I would like my department to take on, but I am limited in my available resources of employees, time, and budget. Collectively, as a society, we want more camping sites in the summer months. But there are limited number of sites available.

4. When shopping for your interview clothes, what are some trade-offs you face? What is the opportunity cost of buying new clothes? What are the benefits? How do you balance the two? [LO 1.3]

Answer: The money you spend on clothes for a job interview could be spent on other things instead, so it is one opportunity cost. Another opportunity cost is the time you spend shopping, which could be spent preparing for your interview or playing Frisbee. The benefits include looking put-together during the interview, which provides a boost to your job