

EC 205

Fundamentals of Economics

General Description

Economist. noun. A scoundrel whose faulty vision sees things as they really are, not as they ought to be.—after Ambrose Bierce

What Is Economics?

Every day we are forced to make choices because we don't have enough of something. Consider yourself and your activities on any given day: you have twenty-four hours to divide among all the activities you want to perform in that day, whether it's sleeping, studying, working, shopping, talking with friends, playing sports, or watching sports. If you dedicate more time to one activity, you are taking away time from another activity; in other words, you are faced with a decision about how to spend your time and in order to make this decision you have to make some trade-offs. The same principle applies every time you go grocery shopping: you have \$100 to spend on groceries this week and a lot of items to choose from. However, since you only have a limited amount of money, you are forced to make choices. Economics is simply the study of the choices that we are forced to make individually or as a whole due to the scarcity of resources, whether the resource is time or money or any other resource you can imagine.

Economics is divided into two main categories:

- microeconomics, which focuses on the decisions of individual households, firms, and the government, and
- macroeconomics, which looks at the decisions made in highly aggregated markets, and looks at income, employment, and output on a national scale.

Thus, it becomes apparent that economists study individuals acting alone, as well as their behavior when they interact in groups, families, clubs, business firms, and governments. For these reasons, economists primarily focus on our transactions in open

markets. First, market transactions account for much of the total production of goods and services. Second, these transactions produce (generally) observable money prices and quantities. Finally, using market prices and quantities, economists often can make inferences about the benefits and costs of activities that are not undertaken in open markets.

The main objective of this course is for you to learn to practice “the economic way of thinking,” which will prepare you not only for advanced courses in economics, business, law, and government, but also for your role as citizen, householder, and parent!

What is the Course Plan?

The course is divided into thirteen lessons, each with a lesson focus, extensive reading assignments in the text, and, in some lessons, supplemental notes to the text material. You will also have practice questions (not to be submitted), and written assignments to submit for grading that consist of essays and multiple-choice questions. The assignments are to be prepared in sequence and submitted to the Self-paced Courses office.

Many economists believe that a good understanding of microeconomics creates a good foundation and allows for a better understanding of macroeconomics. Therefore, the course begins with an introduction to basic and general economic concepts, moves into microeconomics, then macroeconomics, and ends with economic growth and international trade.

What is the Required Text?

The text required for this course is *Economics: Private & Public Choice* by James D. Gwartney, Richard L. Stroup, Russell S. Sobel, and David A. Macpherson (11th edition, 2006). You may purchase this text from Friday Center Books & Gifts at the Friday Center using the book order form in this manual, or online at <https://s4.its.unc.edu/HigherGrounds/>.

Each lesson draws heavily on the text materials, so, as in most lecture courses, understanding the lesson objectives, supplemental notes, and written assignments in each lesson requires careful reading of the assigned chapters in the text.

**What are Some
Good Study
Habits?**

Make a good friend of the text. Aim for a daily hour with economics, just as you would practice a new piece of music, a language, or a sport. An hour a day will be far more productive than the same total hours in a weekly cram session! When you have an especially busy day, find at least a spare fifteen minutes in which to connect with economics.

As you are reading the material, make sure to have a piece of paper and pen or pencil, and don't be afraid to use them! It helps a great deal to draw the graphs as you are going. Make sure you have a good understanding of what each graph is telling you: What is on each axis, what are the curves telling you, what will happen if the curves shift? It also helps to do the calculations done in the text; follow the calculations step by step and make sure you can replicate—and more importantly understand—them.

**How is Your
Final Grade
Determined?**

Each lesson is comprised of multiple-choice and written essay questions. The final exam will follow the same format, but as it is cumulative or comprehensive, it will consist of more multiple-choice and written essay questions to allow for better testing of the material. Half of your grade for the course will be determined by your scores on the written assignments, and the other half will be determined by your final exam score. The final exam must be taken under supervision, and you must pass the final exam to receive credit for the course.

**How Did It All
Begin?**

The father of economics, Adam Smith, noted that:

“Among men,... the most dissimilar geniuses are of use to one another; the different produces of their respective talents, by the general disposition to truck, barter and exchange, being brought, as it were, into a common stock, where every man may purchase whatever part of the produce of other men's talents he has occasion for.”

In short, specialization in production reduces the costs of goods, and allows producers to exchange their goods for other, more satisfying goods for their consumption, and in so doing, they reap

the gains from trade. The gains arise from the market's affording opportunities both for cost-reducing specialization in production, and for specialization in consumption.

People can select, within their budgets, the mix of goods that best satisfies their unique wants. Considering the range of age, health, tastes, and circumstances among grocery shoppers, the highly varied selections in their carts at the grocery store are no surprise. Finding identical selections in one cart after another would be startling. And anticipate mayhem if you were to replace others' selections in their carts with your own! Regulations and taxes diminish people's choices and are often resisted. (Note that smuggling, which enables people to avoid regulations and taxes, is one of the older professions!)

Over 225 years ago, Adam Smith introduced the *invisible hand principle*. In his famous book, *The Wealth of Nations*, he states:

“Every individual is continually exerting himself to find out the most advantageous employment for whatever [income] he can command. It is his own advantage, indeed, and not that of the society which he has in view. But the study of his own advantage naturally, or rather necessarily, leads him to prefer that employment which is most advantageous to society... He intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was not part of his intention. By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it.”

In this passage, Smith indicates that market forces tend to align the actions of self-interested individuals with the best interests of the society, creating a powerful force that promotes economic progress.

Some new students of economics are squeamish about the assumption that people are motivated by their own gains from trade in the market, in other words, from their self-interested

behavior. It may be helpful, following Adam Smith, to distinguish the self-interested person—the good citizen—from the selfish person who has no fellow feeling. Self-interested people include those who share others’ pain and pleasure somewhat as their own, and so, when making choices, consider their effects on others. Narrowly selfish people are those who are insulated from others’ pain and pleasure in making choices to get gains from trade.

Adam Smith understood that the goods produced by citizens’ taking into account their effects on others—their friendships—were limited, and could be greatly supplemented by the impersonal market. Of every man he wrote:

“In civilized society he stands at all times in need of the cooperation and assistance of great multitudes, while his whole life is scarce sufficient to gain the friendship of a few persons.”

Elsewhere Smith wrote:

“... a spaniel endeavors... to engage the attention of its master who is at dinner, when it wants to be fed by him. Man sometimes uses the same arts with his brethren, and when he has no other means of engaging them to act according to his inclinations, endeavors by every servile and fawning attention to obtain their good will.”

Market exchange, of course, is the “other means of engaging them to act according to his inclinations,” so that few are obliged to live entirely on others’ friendship and gifts. We can do better if we add the gains from impersonal market exchange to the benefits of friendship.

Smith famously described impersonal market exchange as follows:

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

In the market, strangers by reasons of culture, distance, and time engage in mutually beneficial, impersonal market exchange. Note the country-of-origin labels on your clothing, your shoes, your electronic goods, the innards of your computer, and your car. Make a list of these faraway places you’ve never visited and where none of your friends reside. Your credit card enables you to purchase goods and services on your promise that persons unknown to you will be paid. An old man can plant timber in the confidence that rising market value will reward the growth of his stand on its way to being harvested to build houses thirty years hence, for people yet to be born.

We hear little about markets working well (no news is good news), and much about cheating in the market. But does it follow that with less reliance on market exchange there would be less cheating? On the contrary, one might expect less cheating with lower transactions cost and more reliance on market exchange. An unintended consequence of market activity is the dispersal of information without the availability of goods, the “terms of trade,” their prices, qualities, and quantities, and the reputations of traders. This information reduces, but cannot eliminate, the risks of being taken advantage of. Additional information is increasingly costly and eventually exceeds its additional benefits.

For all the benefits of impersonal market exchange and its accommodation of all manner of persons, recall that Adam Smith praised the good citizen, or what I have called the self-interested person. In him or her, self-interest and sympathy are complementary. In *The Theory of Moral Sentiments*, Smith wrote:

“He is certainly not a good citizen who does not wish to promote, by every means in his power, the welfare of the whole society of his fellow citizens. “

He observed:

“How selfish so ever man may be supposed, there are evidently some principles in his nature, which interest him in the fortune of others, and render their happiness necessary to him, though he derives nothing from it, except the pleasure of seeing it.”

Throughout the course you will become familiar with other renowned economists whose visions changed the face of economics over the years. You will read more about the lives and contributions of economists such as David Ricardo, John Maynard Keynes, and Robert Lucas.

Last, But Not Least

Welcome to EC 205!

I am very excited about this course and hope you are as well! I look forward to guiding you in developing “the economic way of thinking.” I’m sure you will see that economics is much more than is typically expected and can be applied to every aspect of our lives. Finally, I hope that you will come to enjoy and appreciate economics as much as I do!

List of Lessons

- Lesson 1: The Economic Way of Thinking
- Lesson 2: Supply and Demand
- Lesson 3: Costs and the Supply of Goods
- Lesson 4: Markets, Competition, and Monopoly
- Lesson 5: Supply and Demand for Productive Resources
- Lesson 6: Government and the Economy
- Lesson 7: The Macroeconomy
- Lesson 8: Aggregate Supply and Aggregate Demand
- Lesson 9: Keynesian Macroeconomics and Fiscal Policy
- Lesson 10: Money and Monetary Policy
- Lesson 11: Stabilization Policy, Output, and Employment
- Lesson 12: Economic Growth
- Lesson 13: Gaining from International Trade