Economics 2   Professor Christina Romer
Spring 2020   Professor David Romer

LECTURE 1

SCARCITY AND CHOICE

January 21, 2020

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LECTURE 1
Scarcity and Choice

January 21, 2020

No Electronics Policy

- Please turn off and put away all phones, laptops, and tablets.

I. Overview of the Course

Microeconomics

- Study of economic behavior at a fairly narrow level.

- How individual consumers and producers make decisions; what happens in the market for particular goods; what determines the wages and employment of a particular type of worker.

- Examples of microeconomic questions.

- We will include much discussion of market failures.

Macroeconomics

- Study of the behavior of the economy as a whole.

- What determines the behavior of overall employment, total output, and prices?

- Examples of macroeconomic questions.

Two Key Features of Economic Analysis

- **Theory:** Start with assumptions and derive implications.

- **Empirical Evidence:** Are the implications and predictions of the theory verified by experience?

- In Econ 2 we will discuss both theory and evidence.

II. COURSE LOGISTICS

Course Website

https://www.econ.berkeley.edu/course/spring-2020/economics-2-spring-2020

Teaching

- It is essential that you come to lecture.

- Incomplete slides will be available by noon on the day of lecture. Complete slides will be posted after class.

- Section is also incredibly valuable.

- Office hours are on the syllabus and website.

Readings

- Textbook: Frank, Bernanke, Antonovics, and Heffetz, *Principles of Economics*, 7th edition.

    - It is available through the Cal Student Store.

- Journal articles:

    - Available (free of charge) through the University Library.

    - Links are on the syllabus.

Graded Assignments

- **Six Problem Sets**

- **Two Midterms:** Tuesday, February 25
  Tuesday, April 7

- **Final Exam:**   Monday, May 11,
  11:30 a.m.–2:30 p.m.

Enrollment

- Attend your first section meeting!

- Other questions, go to: https://www.econ.berkeley.edu/undergrad/home/enrollment-procedures

III. SCARCITY, CHOICE, AND OPPORTUNITY COST

Scarcity

- Economists' Definition: Someone or something faces a constraint.

- People, firms, and countries all face constraints.

- At a point in time, constraints are given. But they can change over time.

- A central subject of economics: How people, firms, and economies do the best they can, taking into account the constraints they face.

Choice

- Because individuals, firms, and whole countries face constraints, they have to make choices.

- Every choice has a cost.

- We refer to this cost as the opportunity cost.

Opportunity Cost

- Definition: The value of what must be forgone to undertake an activity.

- Opportunity cost is often obvious.

    - For example, if often reflects trade-offs in the production process.

- The opportunity cost of a good bought in the market is typically its price.

More Subtle Examples of Opportunity Cost

- Going to graduate school.
    - Out-of-pocket costs (tuition, books) and forgone earnings.

- Painting your own house.
    - Out-of-pocket costs (paint, brushes) and the value of your time.

- Using theater tickets whose market price has changed since you bought them.
    - What you could sell the tickets for at the time of use.

IV. THE PRODUCTION POSSIBILITIES CURVE

Production Possibilities Curve (PPC)

- Diagram showing the combinations of two types of goods that could be produced in an economy just using all of the available inputs.

- First example of an economic model.

Example: The PPC for the U.S. Economy Dividing Production into Consumption Goods and Investment Goods

- Consumption Goods: Goods (and services) that satisfy some current want.

  - Examples: Food, clothing, housing, policing.

- Investment Goods: Goods (and services) that will make us more productive in the future.

  - Examples: Machines, buildings, infrastructure, education, R&D.
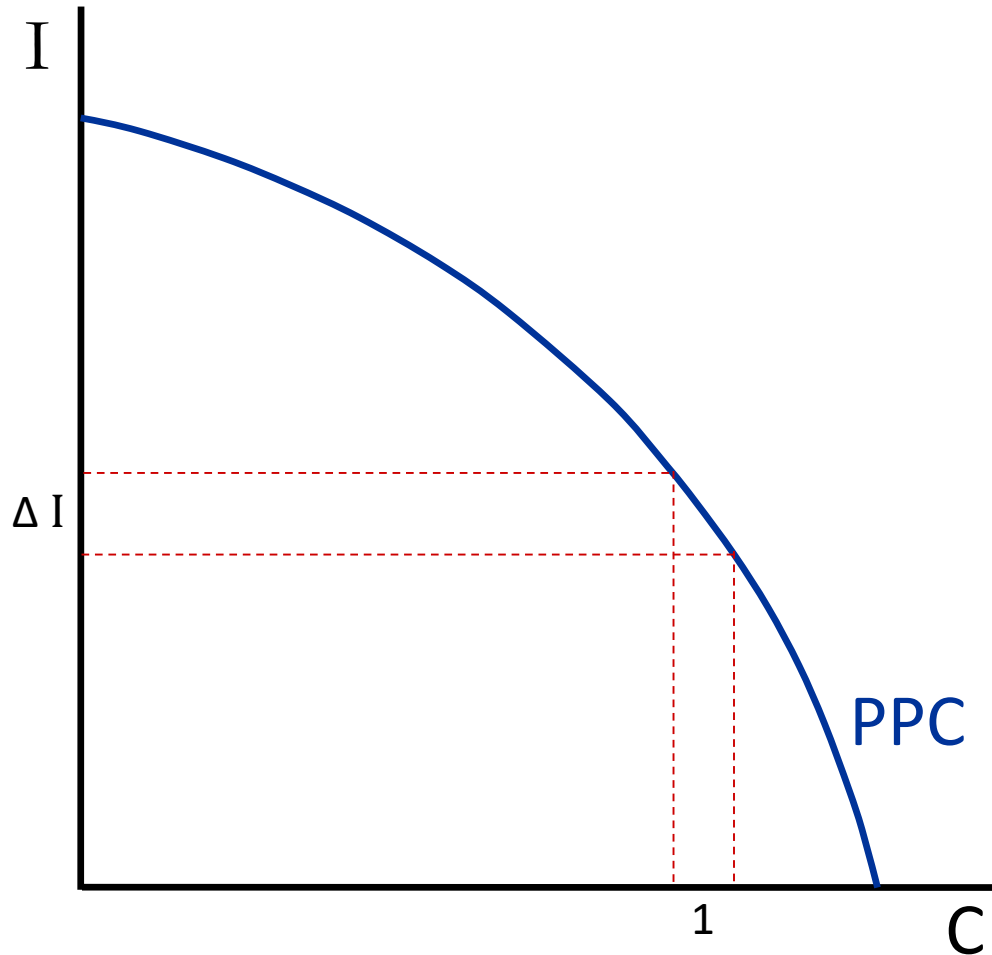
PPC for Consumption and Investment Goods
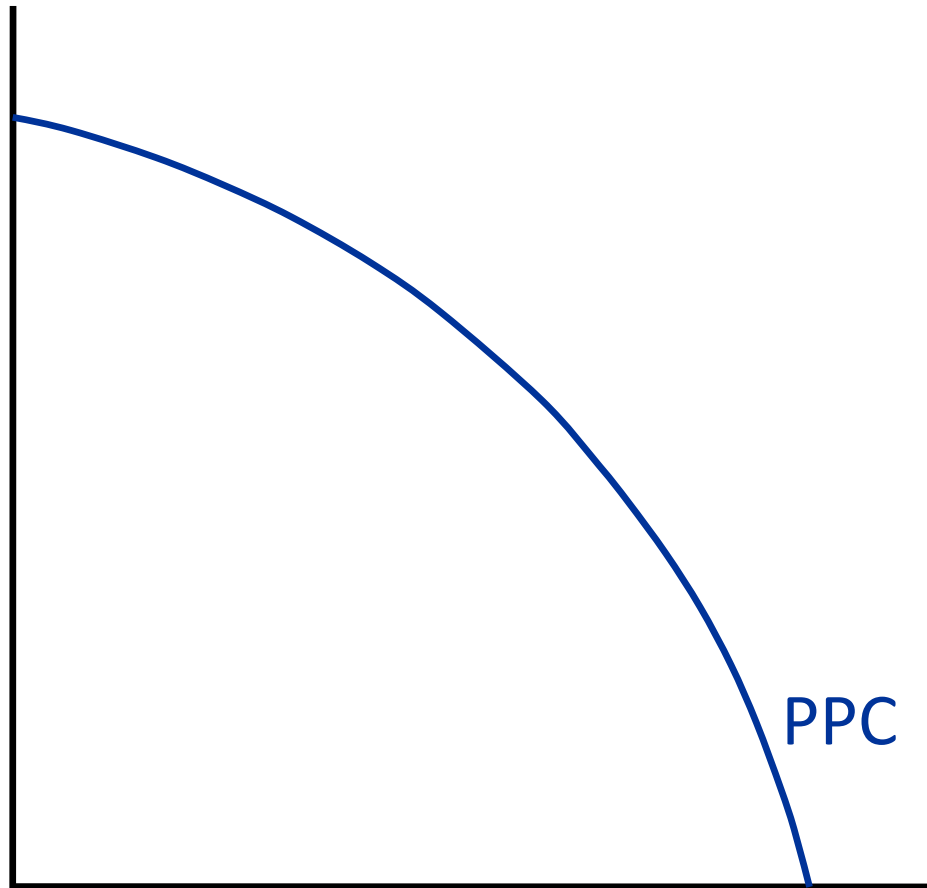
# Using the PPC to Visualize Scarcity and Choice
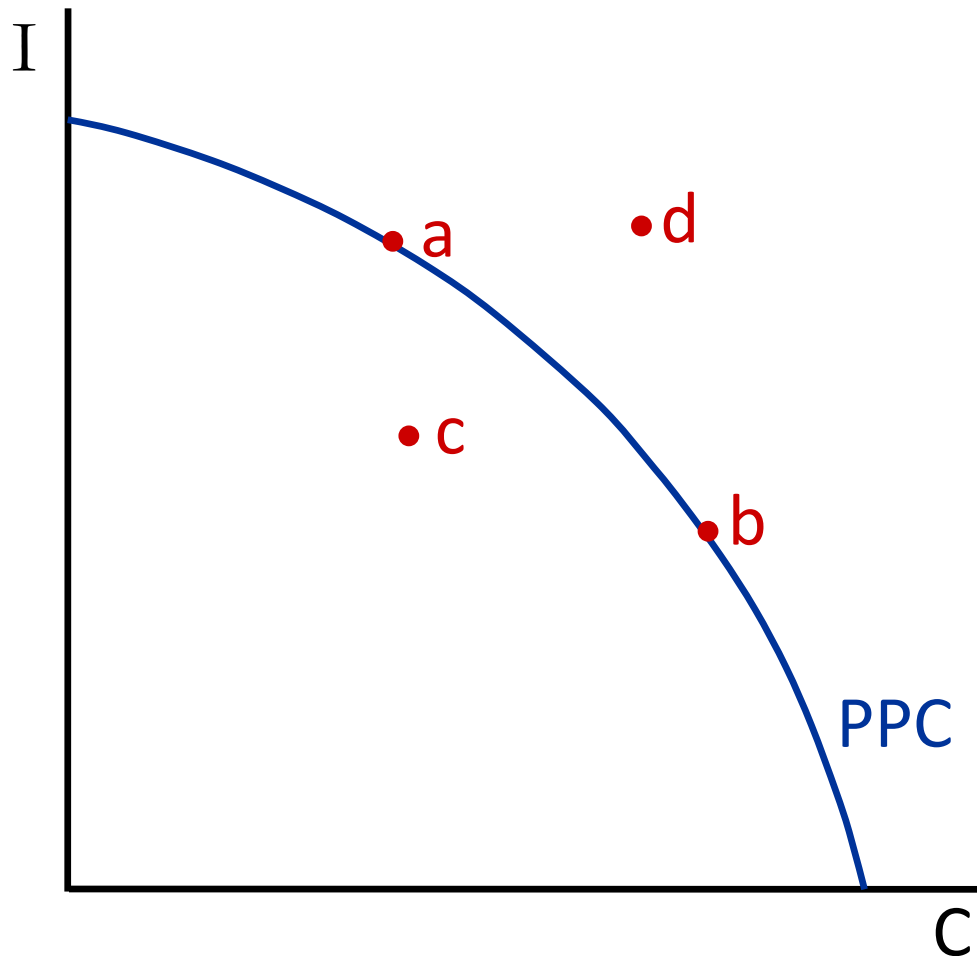
Scarcity is reflected by the fact that some combinations (such as d) are unattainable. Choice is reflected by the fact that a country has to choose which attainable combination to actually produce.

Opportunity Cost and the PPC

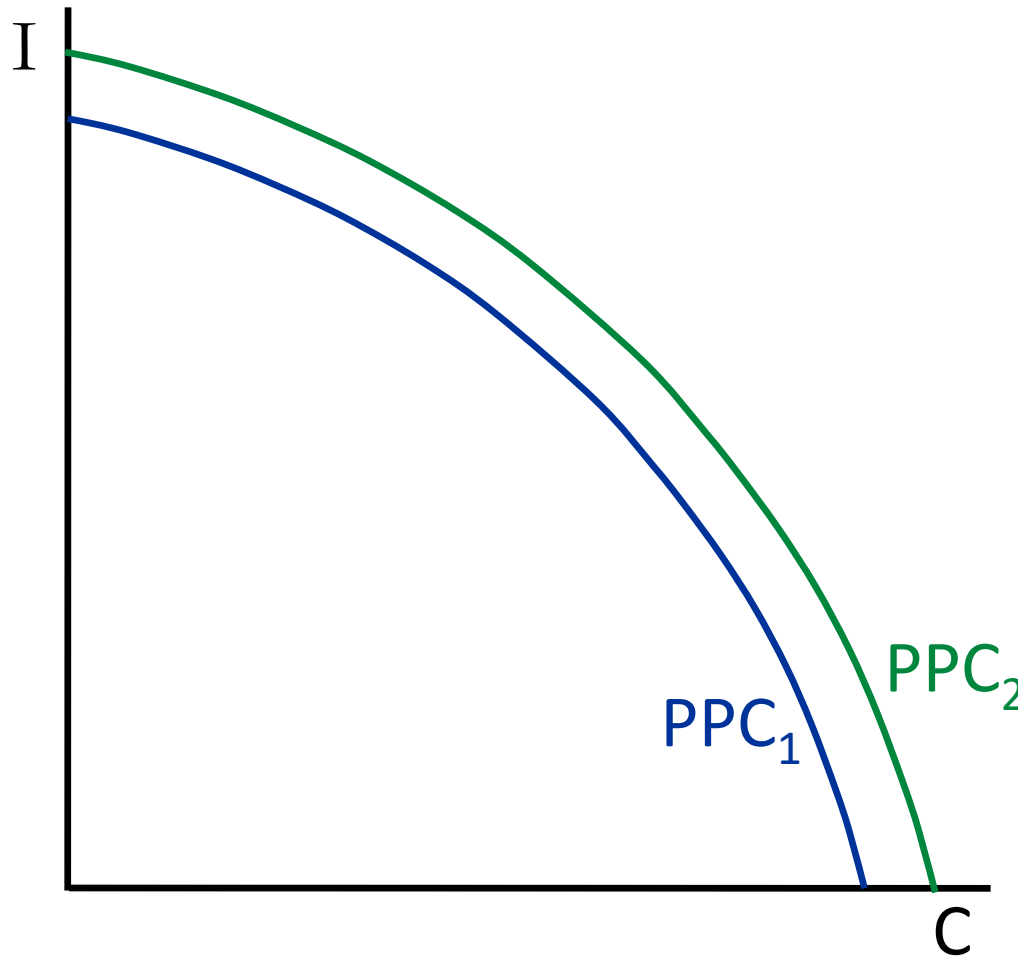The slope of the PPC is (minus) the opportunity cost of the good on the horizontal axis.

What Does It Mean If the PPC Is Curved?
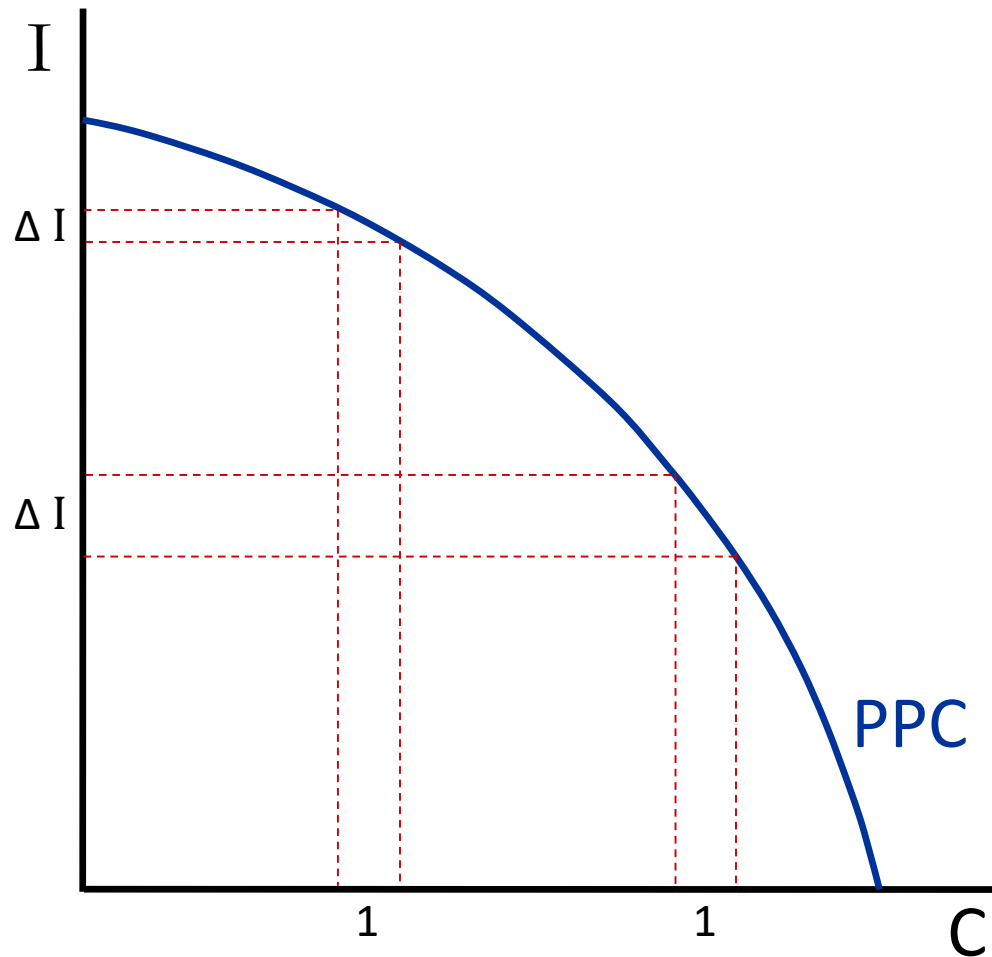
A curved PPC implies that the opportunity cost of the good on the horizontal axis is rising as more is produced.
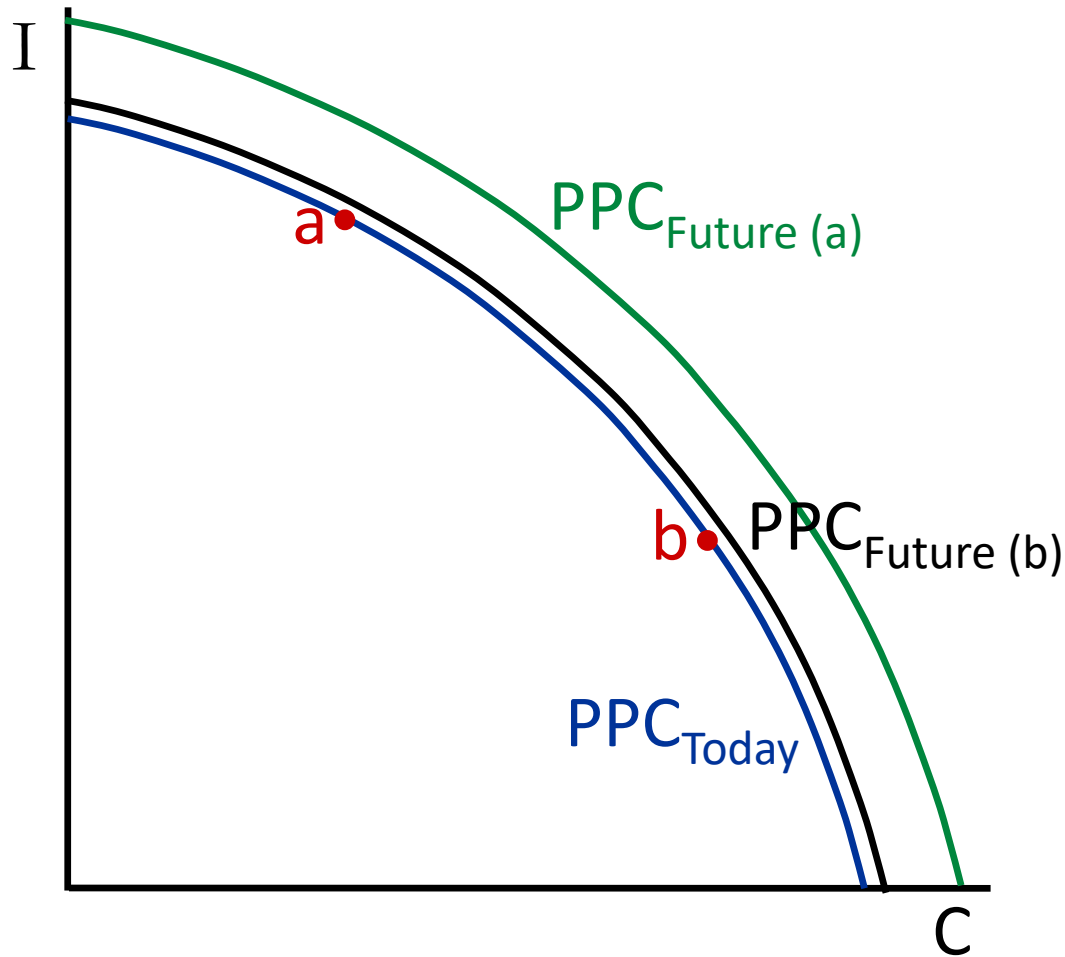
PPC for Consumption and Investment Goods
Immigration or Other Labor Force Growth

PPC for Consumption and Investment Goods
Choices Today May Affect PPC in the Future

I

PPC_Future (a)

a •

b • PPC_Future (b)

PPC_Today

C

What Are Some Policy Decisions That Might Correspond to Moving Along the PPC?