Markets and Economies

The Micro Model of Producer Behavior

Where are We?

In Chapter 1, we began looking at **economics** as a **social science** and **a way of thinking** about the world. We began developing **a theory of choice and the consequences** (both intended and unintended) of individual choice.

Chapter 1 also built a very basic **model of production** that reflected **scarcity** and **opportunity cost**. This model was the **production possibilities frontier**.

Production

In economics, **production** is the process of turning **valued inputs** into **valued output**.

Production is **not always physical**, and doesn’t even need to meaningfully transform the inputs. **Relocation** is productive.

Arbitrage (buying low to sell high) is also productive.

Factors of Production

- Land – land, natural resources, raw materials
- Labor – people's time and their mental/physical contributions
- Capital – manufactured goods, knowledge, information
- Entrepreneurship – potential to recognize opportunities along with the willingness and ability to take risks to seize those opportunities

The Players: Nested Individuals

- Households
- Firms
- Government actors (Congress, bureaucratic agencies)

Firms

Firms exist to enrich their owners through commercial activity. They enrich their owners, generally, by making **profits**.

Firms make profits by moving resources from **lower-valued uses** to **higher-valued uses**, i.e. **production**.

Firms do this by exploiting entrepreneurial alertness to new opportunities and overcoming transactions costs.

Firm Ownership

Firms exist to enrich their owners through commercial activity.

Those owners might be **private individuals** (sole proprietorships, partnerships, or private corporations) or **shareholders** in the case of **publicly-traded corporations**.

Ownership brings with it the **benefits of reaping profits** but also the **responsibility of bearing losses and liability**.

Ownership and Control

Firms exist to enrich their owners through commercial activity.

Managers control what the firm produces, what resources the firm employs, and how the firm goes about its business. **Ideally**, managers serve the **interest of enriching the owners**. Never perfectly.

The owners of a firm—especially in a proprietorship or partnership—might also be the managers of the firm. Or the managers might be the **employees** of the owners.

Entrepreneurship

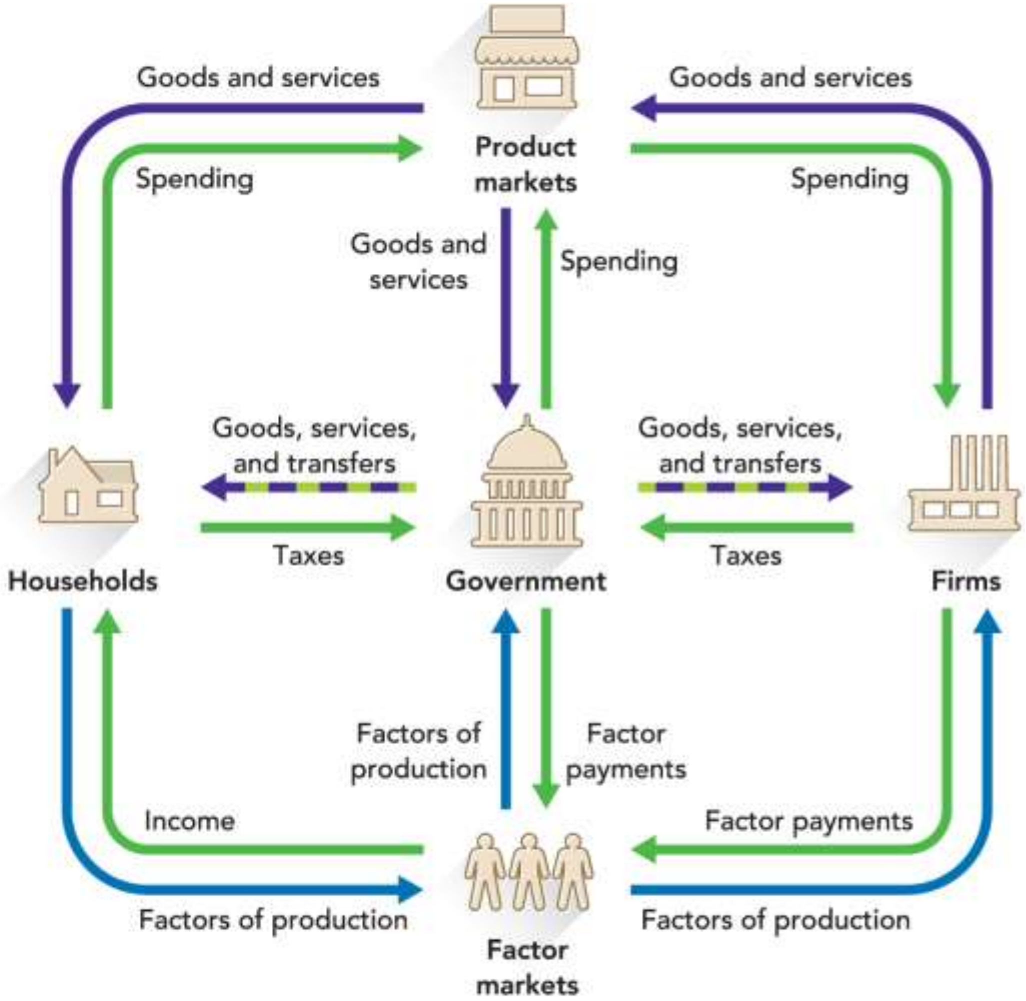
In modern English connotation, entrepreneurship seems to revolve around **innovation**, **start-ups**, and **small firms**.

In **economics**, entrepreneurship revolves around two ideas:

a. **Residual clamancy** (an ownership concern)

b. **Vision** and **direction** (an ownership and management concern)

The Scorecard: The Circular Flow



Anderson, *Survey of Economics*, © 2019 Worth Publishers

Efficiency? So what?

Like equality, fairness, equity, justice, honor, etc., **efficiency** is a **normative value**—an end, a goal.

It is sometimes **consistent** with these other values, and sometimes it is **in conflict** with those other values.

Economics, normatively, emphasizes efficiency. Economics, positively, analyzes efficiency.

Efficiency: What is it?

Individual choices can be analyzed as efficient or not—the use of means toward the satisfaction of ends. Value in *vs* value out.

More interesting is a **societal-level** analysis of efficiency: Are resources being used in the most valuable ways *given the opportunity costs* of choices people are making?

Individual efficiency and social efficiency can be in conflict.

Markets and Efficiency

Pareto Efficient — cannot improve anyone's situation without making another person worse off

Later in the course, we'll develop **additional ways** to think about and more concretely **quantify efficiency**, namely through **consumer** and **producer surplus**.

Comparative Economic Systems

Differences in economic systems stems almost entirely from differences in answering two related questions:

1. Who owns the means of production (factors of production), that is, who reaps the benefits or losses? and
2. Who decides the answers to these questions:
   a. WHAT: What gets produced?
   b. HOW: Using what means?
   c. For WHOM: For whom is it produced and to whom is it distributed?

Comparative Economic Systems (cont’d)

- Traditional economies
- Market economies or capitalist economies
- Command economies like communism/socialism
- Mixed economies