

## **CHAPTER ONE**

# **The Economic Problem**

### **Overview Comments**

In Chapter One, we decided to begin by giving students an idea of how diverse and how engaged our discipline is by looking at a number of current controversies. This, we hope helps to correct the perception that many students have of economics as being a dry and theoretical subject with little relevance to the real world. We next focus on what is, arguably, the most important idea in economics: that scarcity forces choice and choice involves the concept of opportunity cost. We then look at the three fundamental questions in economics and four methods of co-ordinating an economy and we have found that students react well to a discussion of both of these topics. Perhaps we should remind ourselves that introductory chapters are probably the only opportunity for us to encourage students to look beyond the market structure and realize that it is only one of various possible ways for society to organize its economic affairs.

Next, we discuss the fact that the discipline's methodology is, by necessity, abstract, since this is the only way one can deal with such a broad range of topics. The discussion of the use of abstract methodology leads naturally into a discussion of the role of models in economics.

We then look at our first model in economics, production possibilities, and show how illuminating this idea can be since it allows us to illustrate some of the basic, but vital topics in economics: choice, cost, economic growth, technological improvement and the immense importance of investment.

### **Suggested Approaches and Helpful Hints**

As a starting point in a new course, it may be useful for you to walk students through the Study Guide (as well as the *Test your Understanding* questions in the body of each chapter) and explain that answers can be found in the Connect Answer Key.

It is our experience that if we spend enough time on production possibilities we can illustrate six distinct aspects of economics: the necessity of choice, economic growth, unemployment, efficiency, technological change and opportunity cost. This makes production possibilities a powerful model and, more importantly, demonstrates what we

mean by the word model. Given the huge role that models play in economic theory, understanding exactly what a model is can be an important step for any student.

### **Answers to Problems for Further Study**

1. a) normative;                      b) positive;                      c) positive;                      d) normative.
2. a) K                      b) L                      c) N                      d) N                      e) E
3. a) C                      b) K                      c) C                      d) B
4. Economics is interested in how society makes choices about the production and allocation of resources and products. All societies must make choices since they will never be able to produce everything that people want. The reason for this is that resources are scarce in relation to unlimited human wants.

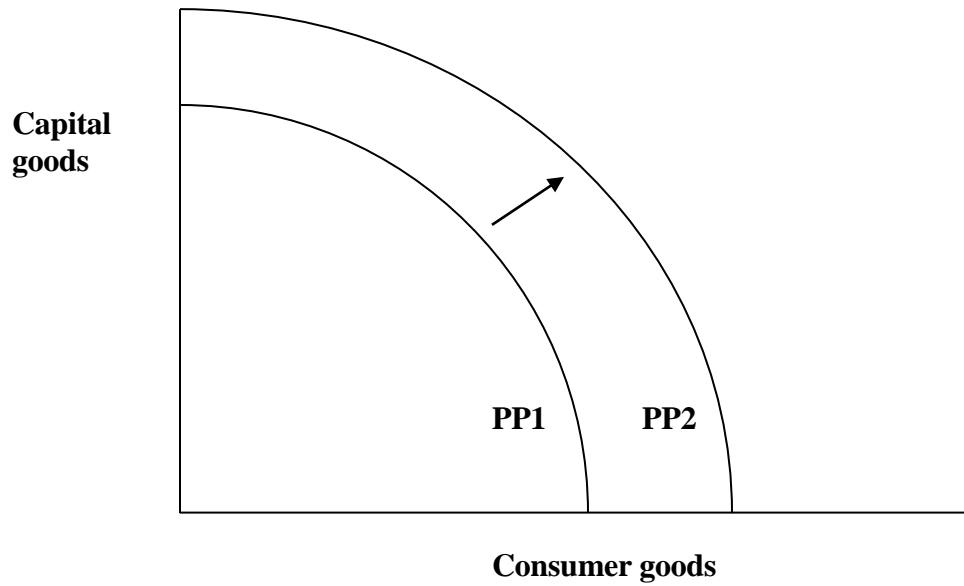
5.

<b>Factors of Production</b>	<b>Factor explained</b>	<b>Factor Payments</b>
Labour	human physical and mental effort	wages
Capital	human made resources	interest
Land	natural resources	rent
Enterprise	the innovator and risk-taker	profit

6. Normative statement: There are too many poor people in Canada.

Positive statement: In 2010, there were more than 2.5 million Canadians earning less than \$15 000.

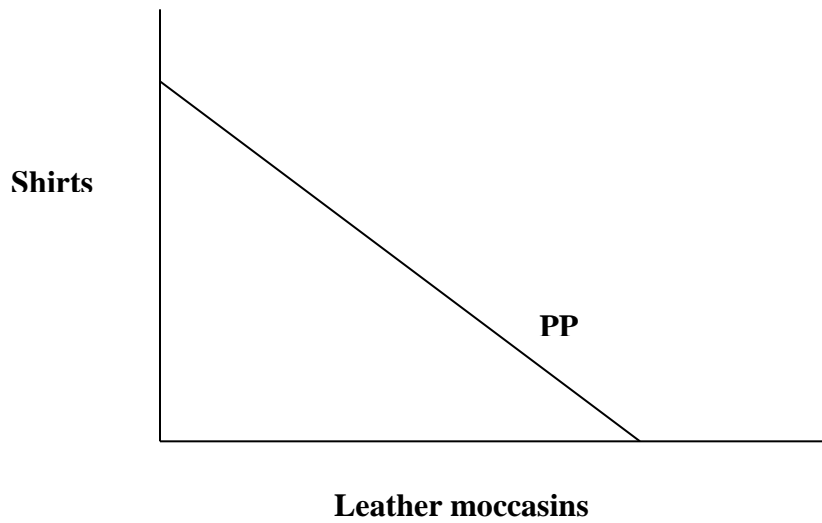
7.



There are two major causes of economic growth:

- an increase in the quantity or quality of productive resources
- an improvement in technology

8. The production possibility curve would look as follows:



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The production possibilities curve would plot as a straight line because the per unit cost of production would remain constant. In other words, it would always cost the same number of moccasins to produce additional shirts, and vice versa.

9. Both a map and a theory abstract from reality and highlight only the most important relationships.
10. Command comes in the form of parents insisting that children do certain things such as cleaning their room. Most “big” decisions like where to take a holiday are often made co-operatively. Custom comes in the form of parents using the same values to raise their children as was used by their own parents. Competition might be used, for example where siblings compete with each other to earn increments of allowance. The second half of the question is asked only to stimulate thought on the effectiveness of incentives (rewards) and disincentives (penalties) within the family structure.
11. Since Kant is a high school dropout with no work experience, we would have to recognize that his next best alternative is probably a minimum wage job. (On the other hand, if some employer considers Kant enough of a celebrity to hire him for a public image job, then Kant might do better.) Assuming a minimum wage job, his opportunity cost of continuing to play hockey would be the minimum wage rate (say \$10 an hour) times 40 (hours per week) times 52 (weeks per year) which equals \$20,800 per year.
12. See the following figure:

