

# Introduction to Economics

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# What is Economics?

- The study of the Economy—What is the Economy?
- How societies organize themselves to provide for their material well-being.
- All human communities throughout history have had to address the questions concerning *material provisioning*.
- In order to survive, at the very least societies must combine *resources* to *produce* food to meet biological and nutritional requirements and shelter to protect against the vagaries of nature.

# RESOURCES

- Natural resources (“Land”)
  - Exhaustible resources (coal, oil)
  - Renewable resources (solar, wind)
- Human resources (“Labor”)
  - Mental and physical expenditures of human energy
  - All labor is some combination of brain work and manual work
- reproducible inputs (“capital??”)
  - Produced means of production

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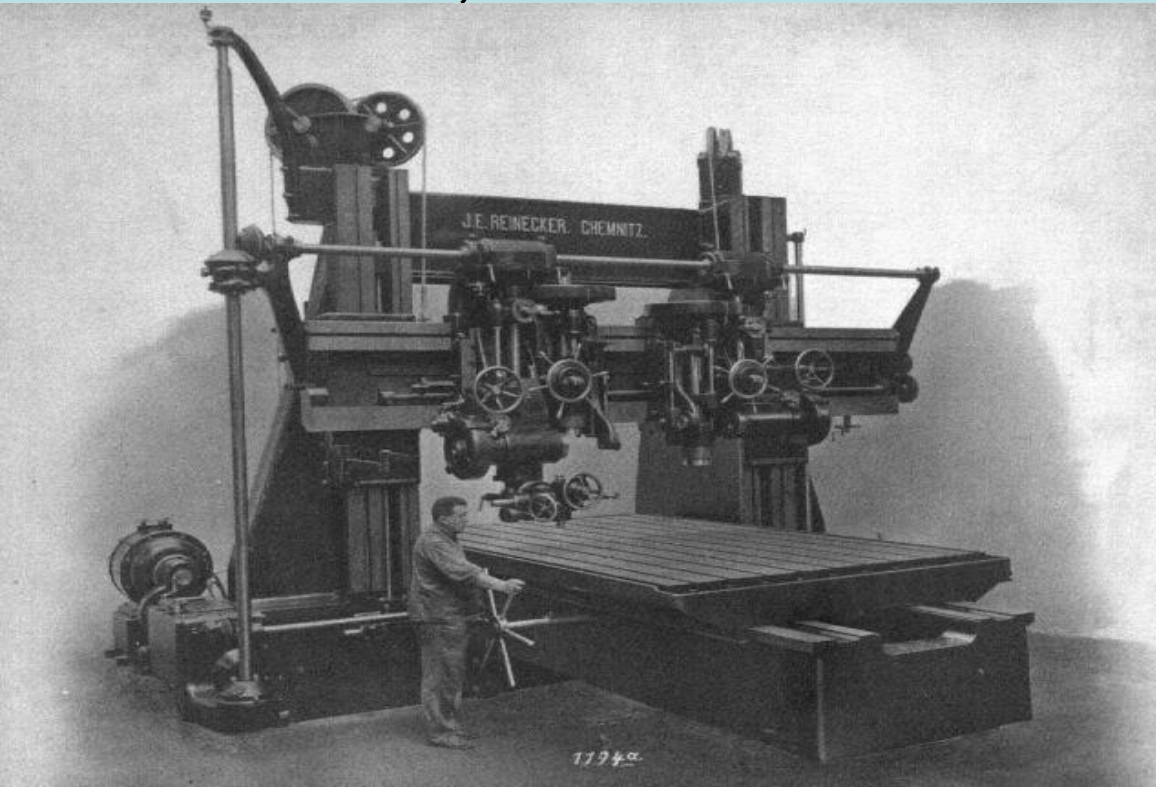
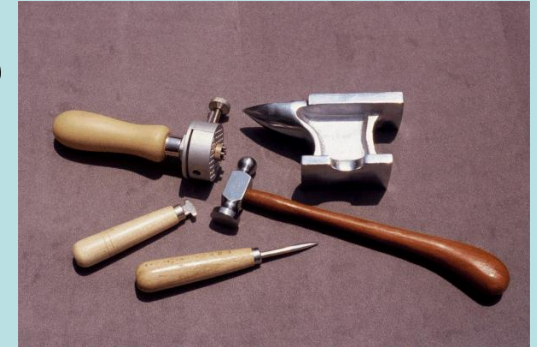
# RESOURCES

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# RESOURCES

- reproducible inputs
  - Produced means of production
  - Tools, machines



# Reproducible inputs

- Outputs of production process that are used as inputs in other production processes
- Not necessarily “capital”
- Capital can refer to financial or “money capital” (not an input, but can be used to purchase any inputs) or to industrial capital or “capital goods”
- Reproducible input only becomes a capital good when it is used to produce “commodities”
- Commodity: anything produced for sale in a market

# PRODUCTION

- Production is key to material provisioning
- Not just production of “whatever”
- Society must produce those goods that are sufficient to guarantee human survival
- So society must decide *what to produce*



# PRODUCTION

- Often there is more than one way to produce the same good
- Alternative methods of production
- Which to use?
- Society must decide *how to produce* those goods it has decided will make up the output

# PRODUCTION

- If society decides what to produce, how to produce it, and does so effectively, will that guarantee the continuing viability of the community, or social reproduction?

# The Economic Problem

- No. Society must also determine how to distribute the production in such a way as to guarantee the reproduction of the community.
- The Economic problem at the most fundamental level concerns these three questions concerning production and distribution.

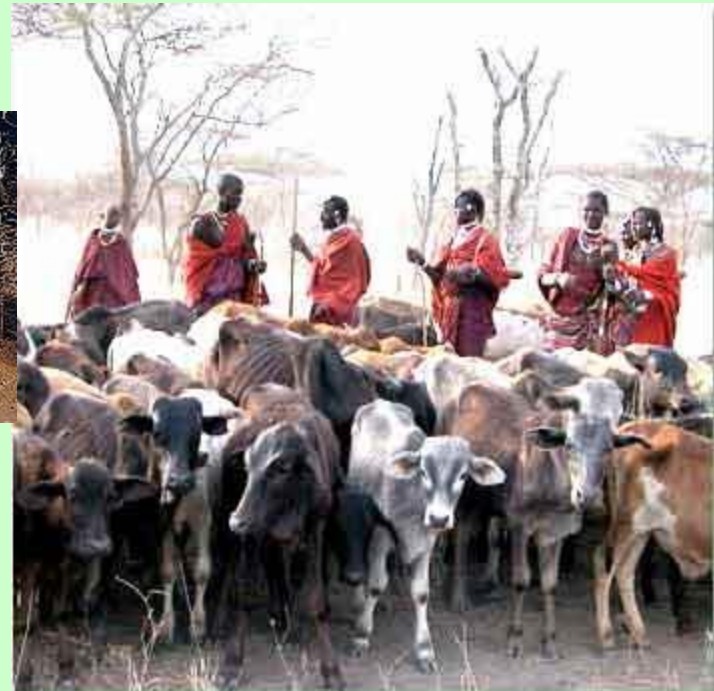
# The Economic Problem

- How, historically, have societies answered these questions of production and distribution?
- Most societies, for most of human history, have addressed these questions by what we may call “tradition.”



# TRADITION

- In traditional societies, over long periods of time, through processes of trial and error, social institutions evolved that determined production and distribution.



# Tradition—Institutions

- Social rules and codes of behavior that determine:
  - who does what? (division of labor)
  - Who gets what? (distribution of the social product)
- In traditional societies, often some combination of age, gender, and kinship relations

# age, gender, and kinship

- Young men herd large animals, women tend gardens and build the home, children take care of small animals and fetch firewood and water, elders make management decisions and settle disputes, senior elders are keepers of history and ritual.

# Reciprocity: Mutual Gift Giving

- From early on in life, members/families of traditional societies begin giving gifts to their neighbors, kinfolk, and others.
- Giving of a gift imposes on the recipient an obligation to give back some time in the future.
- Families accumulate these reciprocal obligations, which serve as a kind of 'insurance system' in traditional societies.



# Reciprocity

- Reciprocal gift relations protect against localized drought, livestock epidemics, crop failure and other localized shocks.
- Family on one side of the mountain has a very good year, with more than usual livestock growth and above average crops. Giving is an *economic necessity*—they don't have the labor or pasture to take care of more livestock and no refrigeration.

# Reciprocity

- Family on other side of the mountain needs livestock and crops because they had low rainfall or other problems, so they need the gifts to live.
- The next year, the situation is reversed, and the second family reciprocates.

# Traditional Institutions: Redistribution

- Similar to reciprocity, but in this case crops, fish, meat, etc. are redistributed throughout the community. Sometimes takes the form of a harvest festival.
- Community gathers together and eats, sings, dances, and celebrates. Members of the community pledge to continue to follow the rules of the community.

# The Economic Surplus

- Surplus is production above and beyond just what it takes to reproduce the society, including labor and inputs used up in production.
- Suppose the society produces one good—corn—using corn seed and labor.
- Suppose that they produce 10,000 bushels of corn output per year using 1,000 bushels of corn seed and 8,000 bushels of corn food to feed the population and so reproduce the labor force.



# Traditional Corn Model

- 10,000 bu. Corn output
- 8,000 bu. Corn food (viewed as an input)
- 1,000 bu. Corn seed
- Inputs = 8K + 1K = 9,000 bu.
- 10,000 bu. Output – 9,000 bu. Inputs  
= 1,000 bu. Corn Surplus
- 1,000 bu. may be redistributed throughout the community, used for the harvest feast, given to ritual leaders (or anyone who does not directly produce corn), traded with neighbors, etc.

# Corn Model

- Suppose one year the Elders meet and one says, “I was thinking that this year we could take some of the extra corn and put it in the seed bin.”
- If 100 bu. of the corn surplus were added to the seed bin and technology stayed the same, and labor/population stayed the same, then 1,100 bu. of corn seed would produce 11,000 bu. of corn output.

# More inputs → more output and surplus

- 1,100 corn seed + 8,000 corn food =  
9,100 corn inputs  
11,000 corn output – 9,100 corn inputs  
= 1,900 corn surplus

They can have the feast, add more seed, redistribute more corn food, trade it with their friends!

What is happening here?

# Corn in Traditional Society

- In modern terms:

Using surplus to increase the size of the inputs is called “investment.”

The higher output resulting from more inputs is called “economic growth.”

Surplus would be “profits.”

# Follow the Surplus

- What can happen as a result of this process?
  - More output can support a growing population, and larger labor force.
  - More people can lead to territorial expansion.
  - Meet new peoples, intermarry, martial alliance, trade, new products, new technologies, more output and surplus, and so on.

# Growth and Expansion

- All these developments may lead to a situation where the old rules and institutions that used to satisfy the needs of the community no longer are capable of doing so, and new ways of organizing production and distribution are necessary.
- May mean a transition from a “traditional” society to a “command” system.”

# Command

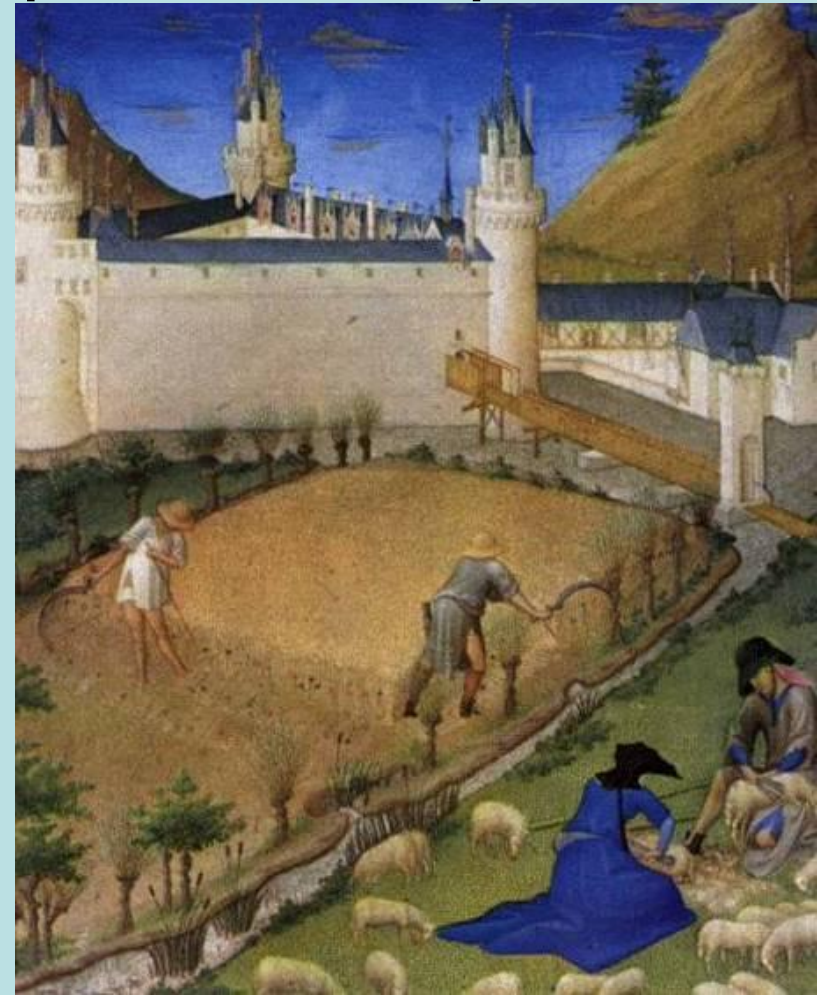
In tradition society, religious or *cultural* institutions determine production and distribution.

- In a command system, *political* institutions determine production and distribution. Some central political authority—a Chief, Lord, King, Central Planning Board—decides ‘who does what’ and ‘who gets what’.



# Command

- European feudalism is a prime example of a command system.
- Lords and Serfs.



# Command

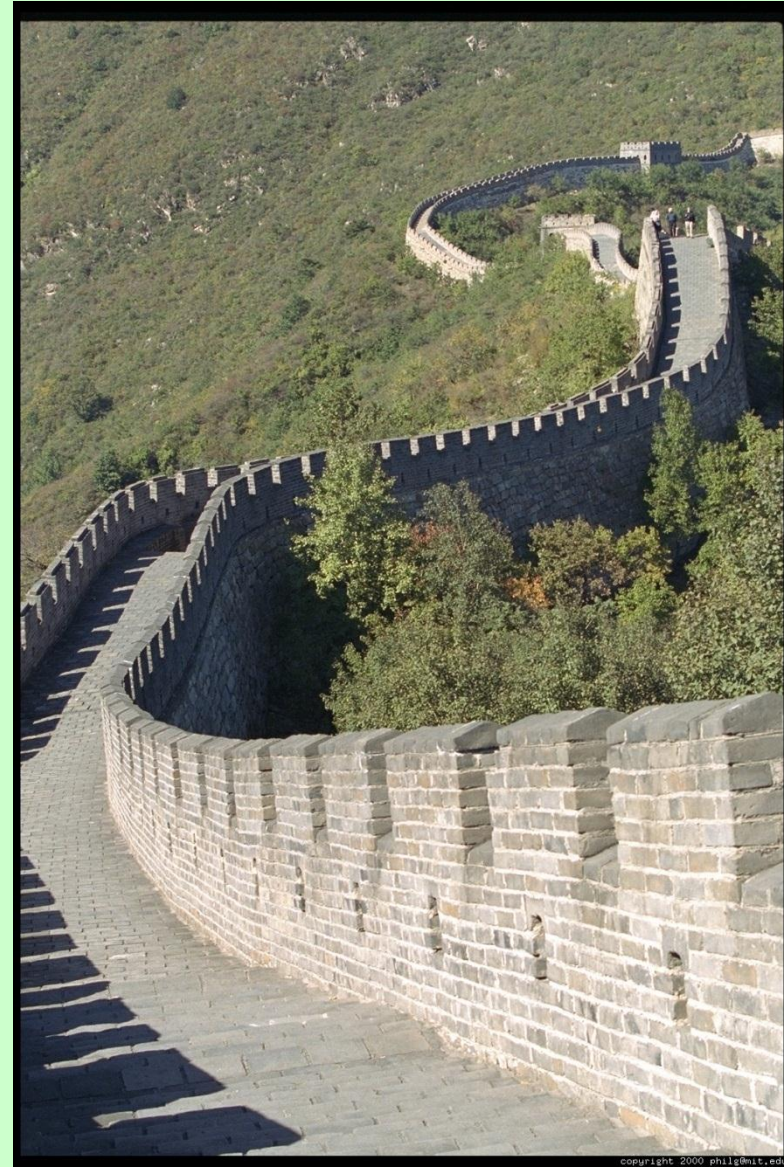
- Slavery is another form of command. (The Enslavement of Africans to perform plantation labor in the ‘new world’ may be a special case of “capitalist slavery”).





# Command

Command can be a very effective way of marshalling resources—many of the great ‘public works’ projects of the ancient world were the result of a command-type system.



# Command

- But command can also be very brutal.



ANCIENT SLAVERY.





# Tradition, Command, and...

- The third historical system of organizing production and distribution is the *market*.
- The market is a very curious means of organizing production and distribution because it has no central organization.
- The market appears to be just millions and billions of independent decisions concerning buying and selling.

# The Market

- If the market was only millions and billions of independent decisions concerning buying and selling it would not have lasted a week. It must be more than that—it is a *system*. While markets are not perfect—there are booms and busts, crises, recessions and depressions—but there is something orderly about a market's systematic operation.

# Market

- It was to discover or uncover the rules that govern the market's systematic operation that economics, or political economy as it was first called—came into being.
- In traditional societies the economy was 'embedded' in cultural institutions; in command societies, the economy was 'embedded' in political institutions; in market societies, for the first time, a distinctly economic institution governed production and distribution. The economy became 'dis-embedded.'



# Market System

- What are the institutions that govern a market's systematic operation?
- Competition...supply and demand forces...price mechanism...'higgling and haggling.'



# Mixed Systems

- There are no 'pure' systems of any type—tradition, command, and market—except some traditional societies with virtually no command or market. But most historical societies were some combination of the three. Command systems still had markets on the edges and tradition at the local level, traditional societies trades with neighbors and had some command elements.

# Modern Mixed Systems

- If most systems are mixed, whether they are labeled tradition, command, or market depends on the dominant way in which production and distribution are organized.
- In our modern market dominated societies, there is still a good dose of tradition and command. Examples?

# Command in Contemporary Society

- All government production and distribution is command. Government decisions to build schools, bridges, hospitals, tanks, is production determined by command.
- All taxation and redistribution (Social Security, etc.) is distribution determined by command.



# Tradition in Modern Market Society

- Tipping, holiday gift-giving, bonuses, do-it-yourself (gardening, auto repair, painting your house), cooperative ventures—fix your friends car, they buy pizza; unpaid housework and child-rearing; volunteerism, etc.—actually a lot of tradition!
- Some say market could not exist without healthy amounts of tradition and command.

# Political Economy and Economics

- It was to discover or uncover the rules that govern the market's systematic operation that economics, or political economy as it was first called—came into being.
- There was not and is not one theory as to the market's systematic operation. There are contending perspectives.

# Models and Abstraction

- Economics uses models
- Makes unrealistic assumptions
- But that can be ok, when done right
- Identify the key features and abstract from the “noise” to highlight the relationship between variables. Findings are preliminary, some of the noise can be added back in to see how it affects the results. Think of velocity of falling objects.



# Ceteris paribus

- “All other things remaining the same”
- “All else held constant”
- Find results, then allow some variables to change and see how that affects the outcome.
- Still, we must always pay close attention to the assumptions and ask: are they reasonable?

# Fallacy of composition

- The logic of the “whole” is not necessarily the same as the logic of the “part.” If you are watching a parade and stand up to see better it does not mean that if everyone stands up everyone will see better, because the behavior of others cancels out the effect.
- *Very important* for **MACRO**-economics

# Schools of Macro Thought

- There are many schools and sub-schools of economic thought and even macroeconomic thought. In this course we will mainly be comparing and contrasting two broad schools:
  - **“Neoclassical”** (often wrongly called **“Classical”**)
  - **“Keynesian”**

# Neoclassical

- Mis-named, it is not “near classical”—  
Classical economics is the economics of Adam Smith, David Ricardo—the “surplus approach”
- Neoclassical—1860s-70s onward:  
Marshall, Jevons, Menger, Walras
- The “Gang of Four”
- Marginalism or demand-and-supply-equilibrium theory (DSE)

# neoclassical

- Main principle: resource scarcity
- Not absolute scarcity, relative scarcity
- Scarcity relative to “unlimited human wants”
- Opportunity cost – “the value of what could have been produced if resources were used in the best alternative way”

# Production Possibilities

- Two goods: guns and butter
- Given (constant) amounts of resources of land (T), labor (L) and capital (K), and given (constant) technology
- Time period is given—one year
- Neoclassical goal— efficiently allocating given T, L, and K among competing industries to maximize consumer satisfaction per time period.