1.2 The Field of Economics

LEARNING OBJECTIVES

1. Explain the distinguishing characteristics of the economic way of thinking.
2. Distinguish between microeconomics and macroeconomics.

We have examined the basic concepts of scarcity, choice, and opportunity cost in economics. In this section, we will look at economics as a field of study. We begin with the characteristics that distinguish economics from other social sciences.

The Economic Way of Thinking

Economists study choices that scarcity requires us to make. This fact is not what distinguishes economics from other social sciences; all social scientists are interested in choices. An anthropologist might study the choices of ancient peoples; a political scientist might study the choices of legislatures; a psychologist might study how people choose a mate; a sociologist might study the factors that have led to a rise in single-parent households. Economists study such questions as well. What is it about the study of choices by economists that makes economics different from these other social sciences?

Three features distinguish the economic approach to choice from the approaches taken in other social sciences:

1. Economists give special emphasis to the role of opportunity costs in their analysis of choices.
2. Economists assume that individuals make choices that seek to maximize the value of some objective, and that they define their objectives in terms of their own self-interest.
3. Individuals maximize by deciding whether to do a little more or a little less of something. Economists argue that individuals pay attention to the consequences of small changes in the levels of the activities they pursue.

The emphasis economists place on opportunity cost, the idea that people make choices that maximize the value of objectives that serve their self-interest, and a focus on the effects of small changes are ideas of great power. They constitute the core of economic thinking. The next three sections examine these ideas in greater detail.

Opportunity Costs Are Important

If doing one thing requires giving up another, then the expected benefits of the alternatives we face will affect the ones we choose. Economists argue that an understanding of opportunity cost is crucial to the examination of choices.

As the set of available alternatives changes, we expect that the choices individuals make will change. A rainy day could change the opportunity cost of reading a book; we might expect more reading to get done in bad than in good weather. A high income can make it very costly to take a day off; we might expect highly paid individuals to work more hours than those who are not paid as well. If individuals are maximizing their level of satisfaction and firms are maximizing profits, then a change in the set of alternatives they face may affect their choices in a predictable way.

The emphasis on opportunity costs is an emphasis on the examination of alternatives. One benefit of the economic way of thinking is that it pushes us to think about the value of alternatives in each problem involving choice.

Individuals Maximize in Pursuing Self-Interest

What motivates people as they make choices? Perhaps more than anything else, it is the economist's answer to this question that distinguishes economics from other fields.

Economists assume that individuals make choices that they expect will create the maximum value of some objective, given the constraints they face. Furthermore, economists assume that people's objectives will be those that serve their own self-interest.

Economists assume, for example, that the owners of business firms seek to maximize profit. Given the assumed goal of profit maximization, economists can predict how firms in an industry will respond to changes in the markets in which they operate. As labor costs in the United States rise, for example, economists are not surprised to see firms moving some of their manufacturing operations overseas.

Similarly, economists assume that maximizing behavior is at work when they examine the behavior of consumers. In studying consumers, economists assume that individual consumers make choices aimed at maximizing their level of satisfaction. In the next chapter, we will look at the results of the shift from skiing to snowboarding; that is a shift that reflects the pursuit of self-interest by consumers and by manufacturers.

In assuming that people pursue their self-interest, economists are not assuming people are selfish. People clearly gain satisfaction by helping others, as suggested by the large charitable contributions people make. Pursuing one's own self-interest means pursuing the things that give one satisfaction. It need not imply greed or selfishness.

Choices Are Made at the Margin

Economists argue that most choices are made "at the margin." The **margin** is the current level of an activity. Think of it as the edge from which a choice is to be made. A **choice at the margin** is a decision to do a little more or a little less of something.

Assessing choices at the margin can lead to extremely useful insights. Consider, for example, the problem of curtailing water consumption when the amount of water available falls short of the amount people now use. Economists argue that one way to induce people to conserve water is to raise its price. A common response to this recommendation is that a higher price would have no effect on water consumption, because water is a necessity. Many people assert that prices do not affect water consumption because people "need" water.

But choices in water consumption, like virtually all choices, are made at the margin. Individuals do not make choices about whether they should or should not consume water. Rather, they decide whether to consume a little more or a little less water. Household water consumption in the United States totals about 105 gallons per person per day.

Think of that starting point as the edge from which a choice at the margin in water consumption is made. Could a higher price cause you to use less water brushing your teeth, take shorter showers, or water your lawn less? Could a higher price cause people to reduce their use, say, to 104 gallons per person per day? To 103? When we examine the choice to consume water at the margin, the notion that a higher price would reduce consumption seems much more plausible. Prices affect our consumption of water because choices in water consumption, like other choices, are made at the margin.

The elements of opportunity cost, maximization, and choices at the margin can be found in each of two broad areas of economic analysis: microeconomics and macroeconomics. Your economics course, for example, may be designated as a "micro" or as a "macro" course. We will look at these two areas of economic thought in the next section.

Microeconomics and Macroeconomics

The field of economics is typically divided into two broad realms: microeconomics and macroeconomics. It is important to see the distinctions between these broad areas of study.

Microeconomics is the branch of economics that focuses on the choices made by individual decision-making units in the economy—typically consumers and firms—and the impacts those choices have on individual markets. **Macroeconomics** is the branch of economics that focuses on the impact of choices on the total, or aggregate, level of economic activity.

Why do tickets to the best concerts cost so much? How does the threat of global warming affect real estate prices in coastal areas? Why do women end up doing most of the housework? Why do senior citizens get discounts on public transit systems? These questions are generally regarded as microeconomic because they focus on individual units or markets in the economy.

Is the total level of economic activity rising or falling? Is the rate of inflation increasing or decreasing? What is happening to the unemployment rate? These are the questions that deal with aggregates, or totals, in the economy; they are problems of macroeconomics. The question about the level of economic activity, for example, refers to the total value of all goods and services produced in the economy. Inflation is a measure of the rate of change in the average price level for the entire economy; it is a macroeconomic problem. The total levels of employment and unemployment in the economy represent the aggregate of all labor markets; unemployment is also a topic of macroeconomics.

Both microeconomics and macroeconomics give attention to individual markets. But in microeconomics that attention is an end in itself; in macroeconomics it is aimed at explaining the movement of major economic aggregates—the level of total output, the level of employment, and the price level.

We have now examined the characteristics that define the economic way of thinking and the two branches of this way of thinking: microeconomics and macroeconomics. In the next section, we will have a look at what one can do with training in economics.

Putting Economics to Work

Economics is one way of looking at the world. Because the economic way of thinking has proven quite useful, training in economics can be put to work in a wide range of fields. One, of course, is in work as an economist. Undergraduate work in economics can be applied to other careers as well.

Careers in Economics

Economists generally work in three types of organizations: government agencies, business firms, and colleges and universities.

Economists working for business firms and government agencies sometimes forecast economic activity to assist their employers in planning. They also apply economic analysis to the activities of the firms or agencies for which they work or consult. Economists employed at colleges and universities teach and conduct research.

Look at the website of your college or university's economics department. Chances are the department will discuss the wide variety of occupations that their economics majors enter. Unlike engineering and accounting majors, economics and other social science majors tend to be distributed over a broad range of occupations.

Applying Economics to Other Fields

Suppose that you are considering something other than a career in economics. Would choosing to study economics help you?

The evidence suggests it may. Suppose, for example, that you are considering law school. The study of law requires keen analytical skills; studying economics sharpens such skills. Economists have traditionally argued that undergraduate work in economics serves as excellent preparation for law school. Economist Michael Nieswiadomy of the University of North Texas collected data on Law School Admittance Test (LSAT) scores for the 12 undergraduate majors listed most often by students hoping to enter law school in the class of 2008–9. Table 1.1 "LSAT Scores for Students Taking the Exam in 2008" gives the scores, as well as the ranking for each of these majors in 2008. Economics majors tied philosophy majors for the highest average score.

Table 1.1 LSAT Scores for Students Taking the Exam in 2008

Rank	Major	Average LSAT Score	# of Students
1	Economics	157.4	3,047
1	Philosophy	157.4	2,184
3	Engineering	156.2	2,197
4	History	155.9	4,166
5	English	154.7	5,120
6	Finance	153.4	2,267
7	Political science	153.0	14,964
8	Psychology	152.5	4,355
9	Sociology	150.7	1,902
10	Communications	150.5	2,230
11	Business administration	149.1	1,971
12	Criminal justice	145.5	3,306

Here are the average LSAT scores and rankings for the 12 undergraduate majors with more than 1,900 students taking the test to enter law school in the 2008–2009 academic year.

Source: Michael Nieswiadomy, “LSAT Scores of Economics Majors: The 2008–09 Class Update” *Journal of Economic Education*, 41:3 (Summer 2010): 331–333.

Did the strong performance by economics and philosophy majors mean that training in those fields sharpens analytical skills tested in the LSAT, or that students with good analytical skills are more likely to major in them? Both were probably at work. Economics and philosophy clearly attract students with good analytical skills—and studying economics or philosophy helps to develop those skills.

Of course, you may not be interested in going to law school. One consideration relevant to selecting a major is potential earnings in that field. The National Association of Colleges and Employers conducts a quarterly survey of salary offers received by college graduates with various majors. The results for the summer 2011 survey for selected majors are given in Table 1.2 "Average Yearly Salary Offers, Summer 2011". If you are going for the big bucks, the best strategy is to major in petroleum engineering. But as the table suggests, economics majors as a group did quite well in 2011.

Table 1.2 Average Yearly Salary Offers, Summer 2011

Major	Average Offer
Petroleum engineering	$80,849
Chemical engineering	65,617
Computer engineering	64,499
Computer science	63,402
Electrical engineering	61,021
Engineering	60,465
Mechanical engineering	60,345
Information science	57,499
Economics	53,906
Finance	52,351
Accounting	49,671
Business administration	44,825
History	40,051
English	39,611
Psychology	34,000

Source: National Association of Colleges and Employers, *Average Salary Offer to College Class of 2011 Rises 4.8 Percent*, press release at http://www.naceweb.org/Press/Releases/Average_Salary_Offer_to_College_Class_of_2011_Rises_4_8_Percent.aspx. For psychology, median salary offer is reported.

One’s choice of a major is not likely to be based solely on considerations of potential earnings or the prospect of landing a spot in law school. You will also consider your interests and abilities in making a decision about whether to pursue further study in economics. And, of course, you will consider the expected benefits of alternative courses of study. What is *your* opportunity cost of pursuing study of economics? Does studying more economics serve your interests and will doing so maximize your satisfaction level? These considerations may be on your mind as you begin to study economics at the college level and obviously students will make many different choices. But, should you decide to pursue a major in economics, you should know that a background in this field is likely to serve you well.

KEY TAKEAWAYS

- Economists focus on the opportunity costs of choices, they assume that individuals make choices in a way that maximizes the value of an objective defined in terms of their own self-interest, and they assume that individuals make those choices at the margin.
- Economics is divided into two broad areas: microeconomics and macroeconomics.
- A wide range of career opportunities is open to economics majors. Empirical evidence suggests that students who enter the job market with a major in economics tend to earn more than do students in many other majors. Further, economics majors do particularly well on the LSAT.

TRY IT!

The Department of Agriculture estimated that the expenditures a middle-income, husband–wife family of three would incur to raise one additional child from birth in 2005 to age 17 would be $250,530. In what way does this estimate illustrate the economic way of thinking? Would the Department's estimate be an example of microeconomic or of macroeconomic analysis? Why?

Case in Point: Opportunity Cost with *The Simpsons*

In the animated television comedy *The Simpsons*, Homer's father, Grampa Simpson, faced a classic problem in the allocation of a scarce resource—his time. He wanted to spend the day with his girlfriend, Bea—it was, after all, her birthday. His alternative was to spend the day with Homer and the family, which he did not really want to do, partly because they never visited him anyway.

Homer and his family prevailed, however, and insisted on taking Grampa to "Discount Lion Safari," a local amusement park. The cost of Grampa's day with his family is the enjoyment he anticipated from spending time with Bea. It all ends up badly for Grampa anyway—Homer's car breaks down on the way to the park. As for the forgone alternative, Bea dies that day, possibly because of a broken heart from not being able to spend the day with Grampa.

Sources: R. Andrew Luccasen and M. Kathleen Thomas, "Simpsonomics: Teaching Economics Using Episodes of *The Simpsons*," *The Journal of Economic Education*, 41(2), Spring 2010, 136–149. *The Simpsons*, Episode no. 30, first broadcast 28 March 1991 by Fox, directed by David Silverman and written by Jay Kogen and Wallace Wolodarsky.

ANSWER TO TRY IT! PROBLEM

The information given suggests one element of the economic way of thinking: assessing the choice at the margin. The estimate reflects the cost of one more child for a family that already has one. It is not clear from the information given how close the estimate of cost comes to the economic concept of opportunity cost. The Department of Agriculture's estimate included such costs as housing, food, transportation, clothing, health care, child care, and education. An economist would add the value of the best alternative use of the additional time that will be required for the child. If the couple is looking far ahead, it may want to consider the opportunity cost of sending a child to college. And, if it is looking *very* far ahead, it may want to consider the fact that nearly half of all parents over the age of 50 support at least one child over the age of 21. This is a problem in microeconomic analysis, because it focuses on the choices of individual households.

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