

The Basic Economic Framework

Much of the power of economics is rooted in the fact that a single set of assumptions (rationality, welfare maximization) and a single set of analytical concepts (demand, supply, price, quantity) have proven useful in explaining behavior in such diverse settings as commodity markets, labor markets and foreign exchange as well as non-market phenomena such as marriage, education and crime. The central features of this framework are as follows.

People are constantly confronted with the necessity of making choices - as consumers, workers, investors, parents, and in many other roles.

In making these choices, economists assume that people are "rational," which does not mean that they are brilliant, but just that they act in a purposeful manner--being better off is preferred to being worse off. They try to do the best they can, given the constraints they face - constraints of money, time, abilities, and information. In other words, people act in a manner that tends to maximize their welfare.

Their choices are influenced by relative "prices" -using this term in its broadest sense to include not only money costs but time costs, psychic costs, alternative costs, and others.

Their choices may also be influenced by a host of other factors, such as religion, social class, physical and psychological needs, and external pressures. When we observe large-scale, systematic changes in behavior, however, a sensible research strategy is to look first to see if there have been changes in the constraints or in relative prices rather than a change in these other factors.