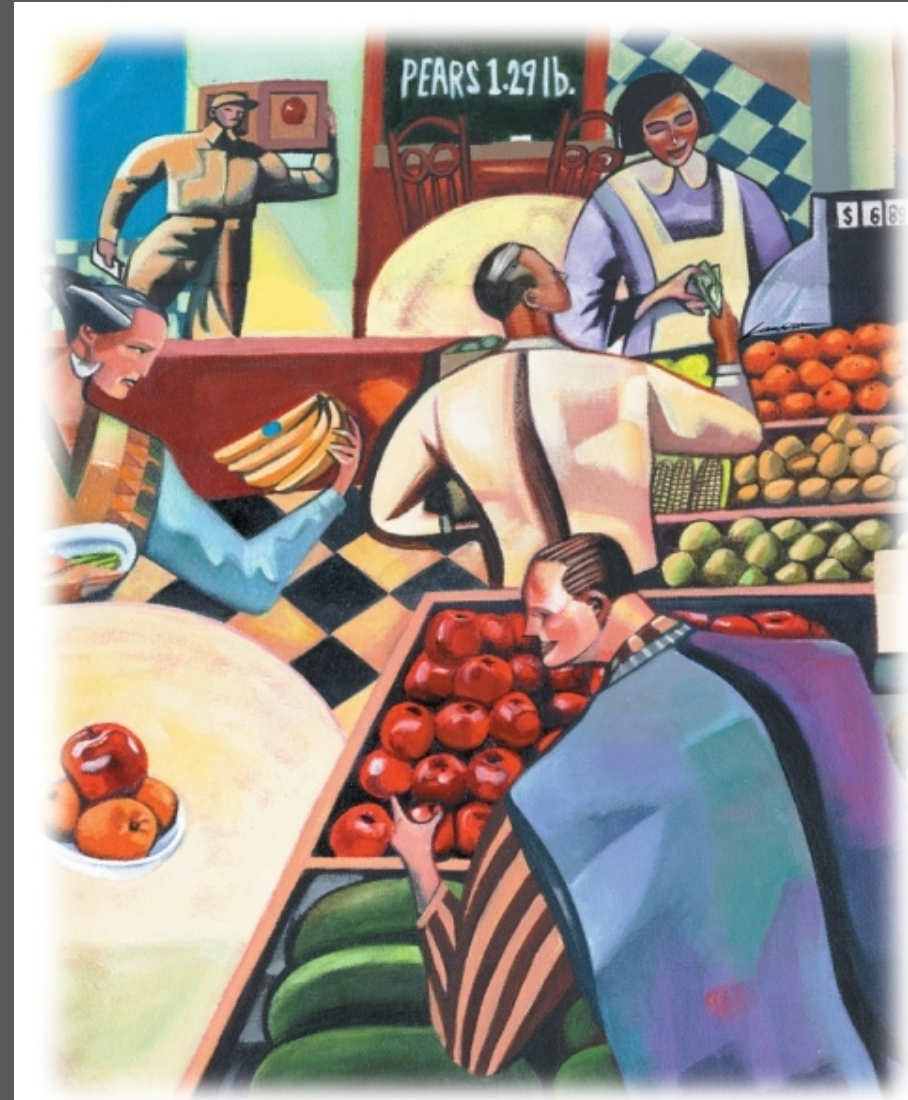


TOPIC 1

Introduction: Thinking Like an Economist



Definition of Economics

According to Prof. Lionel Robbins,
“Economics is the science which studies human behavior as a relationship between ends and scarce means which have alternative uses”.

Economics is the study of how society manages its scarce resources

Definition of Economics

Scarcity is the fundamental **economic** problem of having seemingly unlimited human wants in a world of limited resources.

It states that society has insufficient productive resources to fulfill all human wants and needs.

Microeconomics and Macroeconomics

Economics is divided into two subfields:

- ❑ **Microeconomics focuses on the individual parts of the economy**

- How households and firms make decisions and how they interact in specific market

- ❑ **Macroeconomics looks at the economy as a whole.**

- Economy-wide phenomena, including inflation, unemployment, and economic growth

Microeconomics

Microeconomics deals with the behavior of individual economic units.

- Microeconomics explains how and why these units make economic decisions.
- These economic units include consumers, workers, investors, owners of land, business firms.
- How consumers make purchasing decisions, how firms decide how many workers to hire.

Economy: In Microeconomics

The word economy comes from a Greek word “**Oikonomia**” which basically means “**one who manages a household.**”

A household and an economy face many similar decisions:

- Who will work?
- What goods and how many of them should be produced?
- What resources should be used in production?
- At what price should the goods be sold?

Reiterating : Economics is the study of how society manages its scarce resources.

Positive Versus Normative Statements

Economic analysis: Economists use two types of statements for analysis:

Positive statements are statements that **attempt to describe the world as it is.**

- Called descriptive analysis

Normative statements are statements about **how the world should be.**

- Called prescriptive analysis

Positive or Normative Statements?

- An increase in the minimum wage will cause a decrease in employment among the least-skilled. (POSITIVE)
- Higher federal budget deficits will cause interest rates to increase. (POSITIVE)
- The income gains from a higher minimum wage are worth more than any slight reductions in employment. (NORMATIVE)
- State governments should be allowed to collect from tobacco companies the costs of treating smoking-related illnesses among the poor. (NORMATIVE)

Basic Problem of Economics

There are **three** basic problems:

- What commodities should be produced and in what quantities?
- How shall goods be produced (by whom and with what resources and in what technical manners to be produced)?
- For whom shall goods be produced?

Economic Models

Economists use models to simplify reality in order to improve our understanding of the world.

The most basic economic models include:

The Production Possibilities Frontier

It is used to solve the basic problems in economics.

Assumptions of PPF

1. Full employment and full production.
2. Available supply of factors of production (Land, Labor, Capital and Entrepreneurship) are fixed but they can be shifted or reallocated.
3. State of technology does not change.

Alternative Production Possibilities

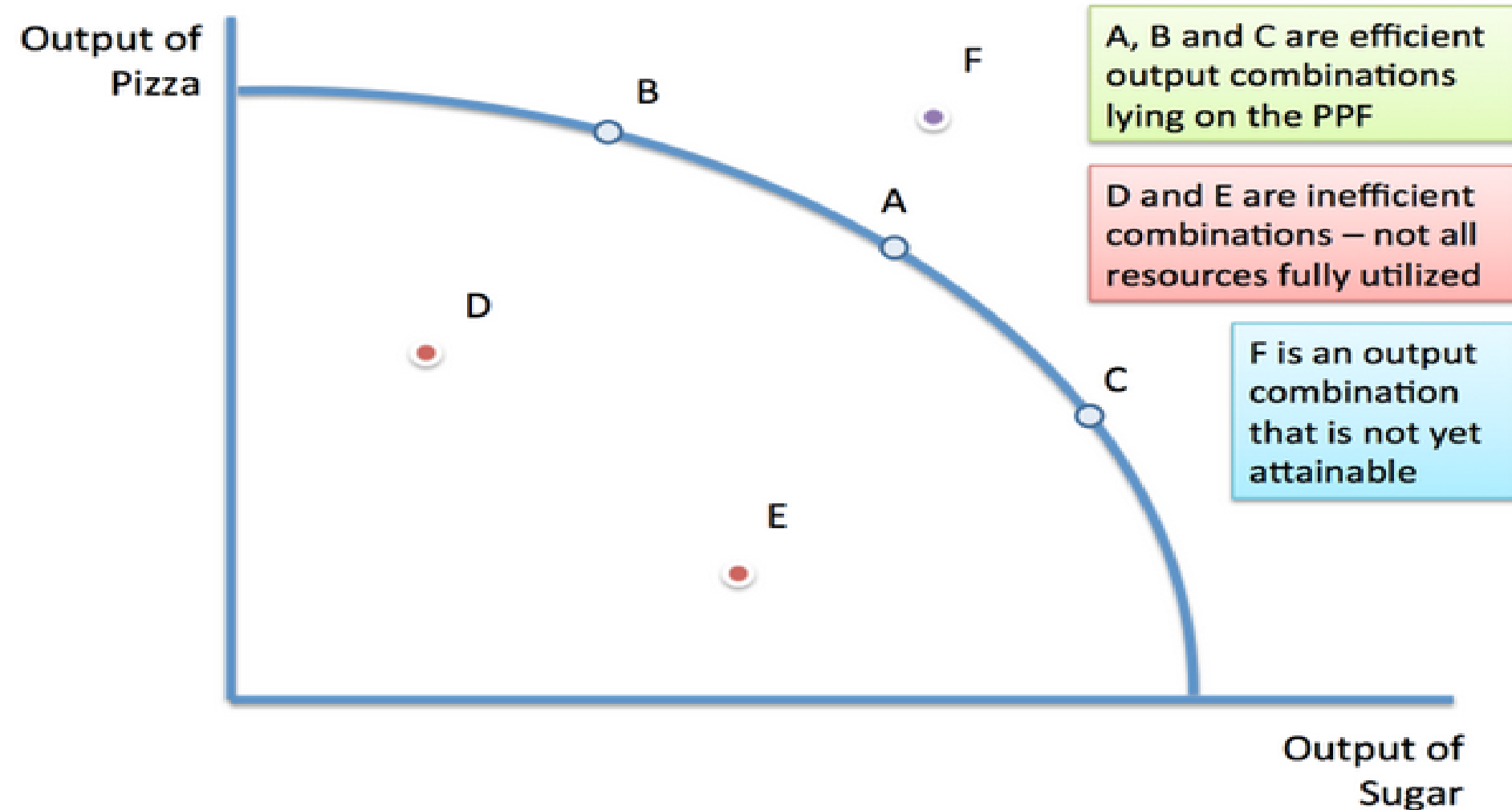
Production Possibilities Schedule		
Possibilities	Sugar (millions of pounds)	Pizza (thousands)
A	0	15
B	1	14
C	2	12
D	3	9
E	4	5
F	5	0

Model: The Production Possibilities Frontier

The production possibilities frontier is a graph that shows the various alternative combination of the two commodities that a country can produce most efficiently by fully utilizing its factor of production with the available technology.

- It was introduced by Prof. Paul A. Samuelson.

Production Possibilities Frontier



Every point along the curve is efficient; points outside the curve are unobtainable or inefficient

Shifts in the PPF

Causes of Shifts in the PPF

Shifts in the production possibilities curve are caused by changes in these things:

- Advances in technology
- Changes in resources
- More education or training (that's what we call human capital)
- Changes in the labor force

Production Possibilities Frontier

Concepts Illustrated by the Production Possibilities Frontier :

- Efficiency
- Trade-offs
- Opportunity Cost
- Economic Growth

Significance of PPF:

- Where shall the choice of society lie?
- It helps to solve 3 basic problems : what to produce; how to produce; for whom to produce.
- To study economic development.

The End