

ECO5002 Introduction to Economics

Lecture 1: An Overview

Long Ma

School of Management and Economics
Chinese University of Hong Kong, Shenzhen

July-August, 2024

Before Start

- Long Ma (longma@link.cuhk.edu.cn)
 - Third-year PhD candidate in ECON at CUHKSZ.
 - Master in ECON at LSE; Bachelor in FIN at CUFE.
 - Interest: Macro (Monetary & Innovation), FinTech.
- No fixed office hour, but you can always send me email.
- No exam. Three take-home quizzes (30%+30%+40%).
- A preterm mini-course for those who have no ECON (FIN, ACCT, etc.) background. Quite easy and basic!
- Textbook: *Principles of Economics*, by N. Gregory Mankiw.

I. Definition of Economics

- Economics is a study of man in the ordinary business of life. It enquires how he gets his income and uses it. (Marshall)
- Economics is the science which studies human behaviour as a relationship between ends and scarce means which have alternative uses. (Robbins)
- Economics is the study of how societies use scarce resources to produce valuable commodities and distribute them among different people. (Samuelson)
- Economics is the study of how society manages its scarce resources. (Mankiw)
 - **Scarcity** means that society has limited resources and therefore cannot produce all the goods and services people wish to have.
 - Can you come up with any goods that are not scarce?

II. Ten Principles of Economics

Principle 1: People face trade-offs.

- To get something that we like, we usually have to give up something else that we also like.
- Efficiency v.s. Equality
 - the property of society getting the most it can from its scarce resources.
 - the property of distributing economic prosperity uniformly among the members of society.

Principle 2: The cost of sth. is what you give up to get it.

- Because of trade-offs, making decisions requires comparing the costs and benefits of alternative courses of action.
- Opportunity cost
 - whatever must be given up to obtain some item.
 - what's your cost of being a post-graduate student in CUHKSZ?

II. Ten Principles of Economics

Principle 3: Rational people think at the margin.

- Rational v.s. Irrational
 - systematically and purposefully do the best to achieve objectives.
 - people are not always rational, e.g., altruism or irrationality.
 - psychology and behavioral economics.
- Rational people often make decisions by comparing marginal benefits and marginal costs.
 - optimal choices are often determined when $MC = MR$.
 - why do you always get so full every time you go to a buffet?

Principle 4: People respond to incentives.

- An incentive is something that induces a person to act.
- Incentives are key to analyzing how markets work.
 - if people do not react to price changes, markets fail.
- Public policymakers should never forget about incentives.

II. Ten Principles of Economics

Principle 5: Trade can make everyone better off.

- A person cannot be good at everything. Hence, specialization and trade are needed and can benefit all people.
 - absolute advantage: the ability to produce a good using fewer inputs than another producer.
 - comparative advantage: the ability to produce a good at a lower opportunity cost than another producer.
- An example with 2 agents and 2 goods:

(a) Production Opportunities

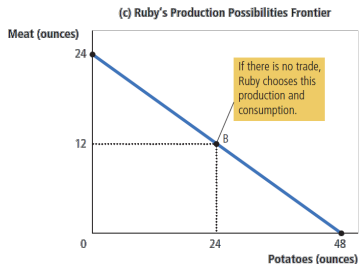
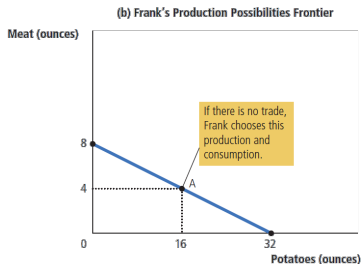
	Minutes Needed to Make 1 Ounce of:		Amount Produced in 8 Hours	
	Meat	Potatoes	Meat	Potatoes
Frank the farmer	60 min/oz	15 min/oz	8 oz	32 oz
Ruby the rancher	20 min/oz	10 min/oz	24 oz	48 oz

- Frank: 1 oz meat = 4 oz potatoes; 1 oz potatoes = 0.25 oz meat.
- Ruby: 1 oz meat = 2 oz potatoes; 1 oz potatoes = 0.50 oz meat.

II. Ten Principles of Economics

■ Production Possibilities Frontier (PPF):

- the absolute value of the slope = opportunity cost
- for Frank: $\Delta \text{meat} = -0.25 \cdot \Delta \text{potato}$
- for Ruby: $\Delta \text{meat} = -0.50 \cdot \Delta \text{potato}$



II. Ten Principles of Economics

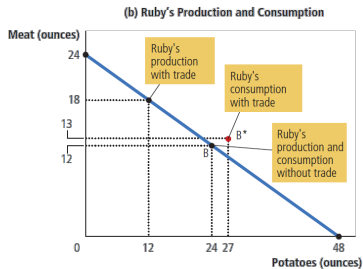
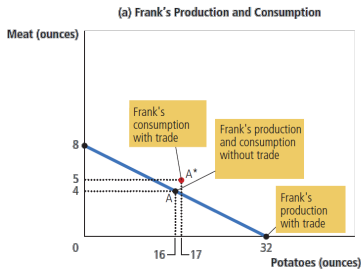
- No absolute advantage for Frank.
- Frank has the comparative advantage in producing potatoes.
Ruby has the comparative advantage in producing meat.
- Gains from trade:

(c) The Gains from Trade: A Summary

	Frank		Ruby	
	Meat	Potatoes	Meat	Potatoes
Without Trade:				
Production and Consumption	4 oz	16 oz	12 oz	24 oz
With Trade:				
Production	0 oz	32 oz	18 oz	12 oz
Trade	Gets 5 oz	Gives 15 oz	Gives 5 oz	Gets 15 oz
Consumption	5 oz	17 oz	13 oz	27 oz
GAINS FROM TRADE:				
Increase in Consumption	+1 oz	+1 oz	+1 oz	+3 oz

II. Ten Principles of Economics

- The new consumption bundle lies outside the PPF.



II. Ten Principles of Economics

Principle 6: Markets are good in organizing econ. activities.

- Market economy: an economy that allocates resources through the decentralized decisions of many firms and households as they interact in markets for goods and services.
- Prices can 'automatically' adjust to guide individual buyers and sellers to reach outcomes that, in many cases, maximize the well-being of society as a whole. (Invisible Hand)
 - why did Soviet Union collapse?
 - the central planning doesn't work at all. why?

II. Ten Principles of Economics

Principle 7: Governments can improve market outcomes.

- Market economies need institutions to enforce property rights so that individuals can own and control scarce resources.
 - the ability of an individual to own and control over scarce resources.
 - the most important role of a government.
- Market failure: a situation in which the market on its own fails to produce an efficient allocation of resources.
 - externality: the impact of one's actions on the well-being of a bystander.
 - market power: the ability of a single economic actor (or small group of actors) to have a substantial influence on market prices.
- Governments want to promote equality.
 - Inequality may lead to social conflicts, turmoil, or even war and hence may increase the risk of subversion and destroy the market.

II. Ten Principles of Economics

Principle 8: A country's standard of living depends on its ability to produce goods and services.

- Almost all variation in living standards is attributable to differences in countries' productivity.
 - productivity: the quantity of goods and services produced from each unit of labor (or capital) input.
 - 'new quality productive forces'.

Principle 9: Prices rise when printing too much money.

- In almost all cases of large or persistent inflation, the culprit is growth in the quantity of money.
 - inflation: an increase in the overall prices in the economy.

Principle 10: Society faces a short-run trade-off between inflation and unemployment.

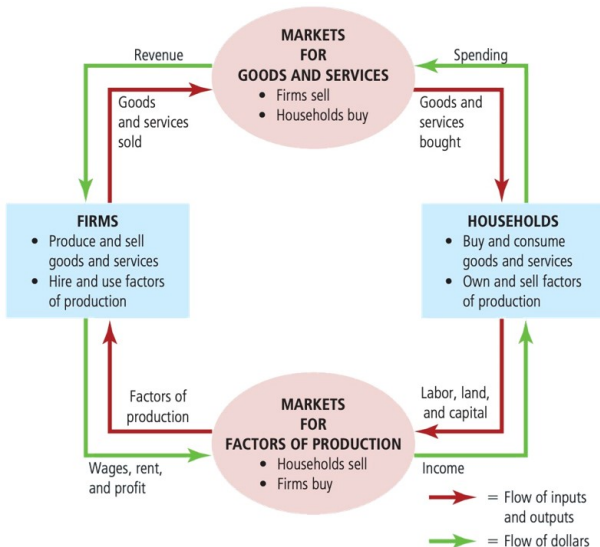
- negative relationship: printing money \uparrow , demand \uparrow , workers \uparrow .

III. General Methodology

- Economics is a subject of social science.
 - Observation: data and phenomena.
 - Theory: explanation.
 - Experiment*.
- Positive analysis v.s. Normative analysis
 - positive: claims that attempt to describe the world as it is.
 - normative: claims that attempt to prescribe how the world should be.
- Empirical study v.s. Theoretical study.
- Micro v.s. Macro
 - Micro: the study of how households and firms make decisions and how they interact in markets.
 - Macro: the study of economy-wide phenomena, including inflation, unemployment, and economic growth.
- Economists use models to learn about the world. Their models mostly consist of diagrams and equations. All the models are built with assumptions.
 - Assumptions can simplify the complex world and make it easier to understand. (From concrete to abstract.)

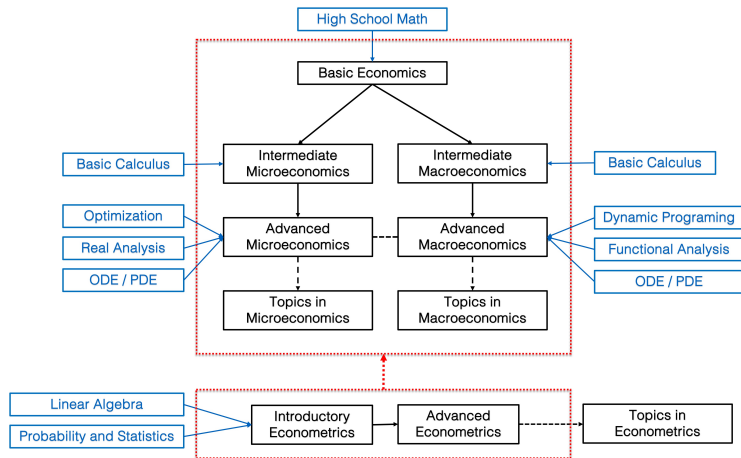
III. General Methodology

The Circular-Flow Diagram:



III. General Methodology

Paths of Learning Economics



III. General Methodology

How to be a good economist?

- Math is important in modern economics.
 - but, economics \neq math for sure.
 - math is only a tool.
- Economic sense (or intuition) is essential.
 - ideas and thoughts from different schools of economics.
 - other subjects in social science: political science, history, psychology, sociology, anthropology, geography, etc.
 - phenomena in your real life (from your observation, Internet or TV)

Reading

- Chapter 1 ~ 3, *Principles of Economics* by Mankiw.