Introduction to Economics

by
Saba Bukhari

Lecture 1

Learning Outcomes

- After this lecture you will be able to learn:
- What is economy and economics
- Scarcity and choices
- Opportunity cost
- Positive and Normative economics
- Micro and macroeconomics
- Trade off
- Economic problems
- Economic efficiency

Economics


Social Security
Neoclassical
Demand
Economic Development
Marxian
Keynesian
Public Finance
Small Business
Social Security
Government
Well-being
Marxian
Inclusion
International Trade
Macro
Demand
Economics
Economic History
Economics
Nudge
Nudge
Neoclassical
Marxian
Demand
Inclusion
History of Thought
Inclusion
Keynesian
Small Business
Neoclassical
Well-being
Nudge
Justice
Nudge
Doughnut Economics
Well-being
E&H
Micro
Supply
Sustainable Growth
Economic History
Public Finance
International Trade
Sustainable Growth
Doughnut Economics
Government
Economics
E&H
E&H
Macro
Supply
Nudge
Macro
E&H
Micro
Justice
Micro
Nudge
Marxian
Small Business
Nudge
Supply
Health Econ
Demand
Supply
Justice
Nudge
Keynesian
Macro
Sustainable Growth
Economics
Government
Health Econ
Justice
Health Econ
Micro
History of Thought

Chapter 1. Introduction

- **Economics**

It is the study of how to make use of limited
it
resources to fulfil unlimited human wants.

Economics

- The word ***economy*** comes from a Greek word okinomous for "one who manages a household."

- *Economics* is the study of production, consumption and distribution of goods and services.

- Economics is the study of how individuals and societies choose to use the scarce resources that nature and previous generations have provided.

- Economics, is the social science concerned with how individuals, institutions, and society make optimal (best) choices under conditions of scarcity (McConnell, Brue and Flynn, 2012).

Economics

- **Economics:**
  - Analyze how individuals, firms and states use their scarce resources in order to satisfy their unlimited needs.
  - Develop theories and laws trying to explain these phenomena and predict the future trends.

- **Economics = Science about Wealth**
  - How to use scare resources, how to distribute them among society members and how to use them.

Economic activities

- A household and an economy face many 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?

BASIC CONCEPTS:

- Scarcity - the fundamental economic problem that human wants exceed the availability of time, goods, and resources.

- Choice – Because individuals and society can never have everything they desire, they therefore are forced to make choices

- Opportunity cost – the second best alternative foregone for a chosen option.

Economic activities

Society and Scarce Resources:

– *Scarcity*. . . means that society has limited resources and they have alternative uses also therefore a society cannot produce all the goods and services people wish to have.

– The management of society’s resources is important because resources are scarce.

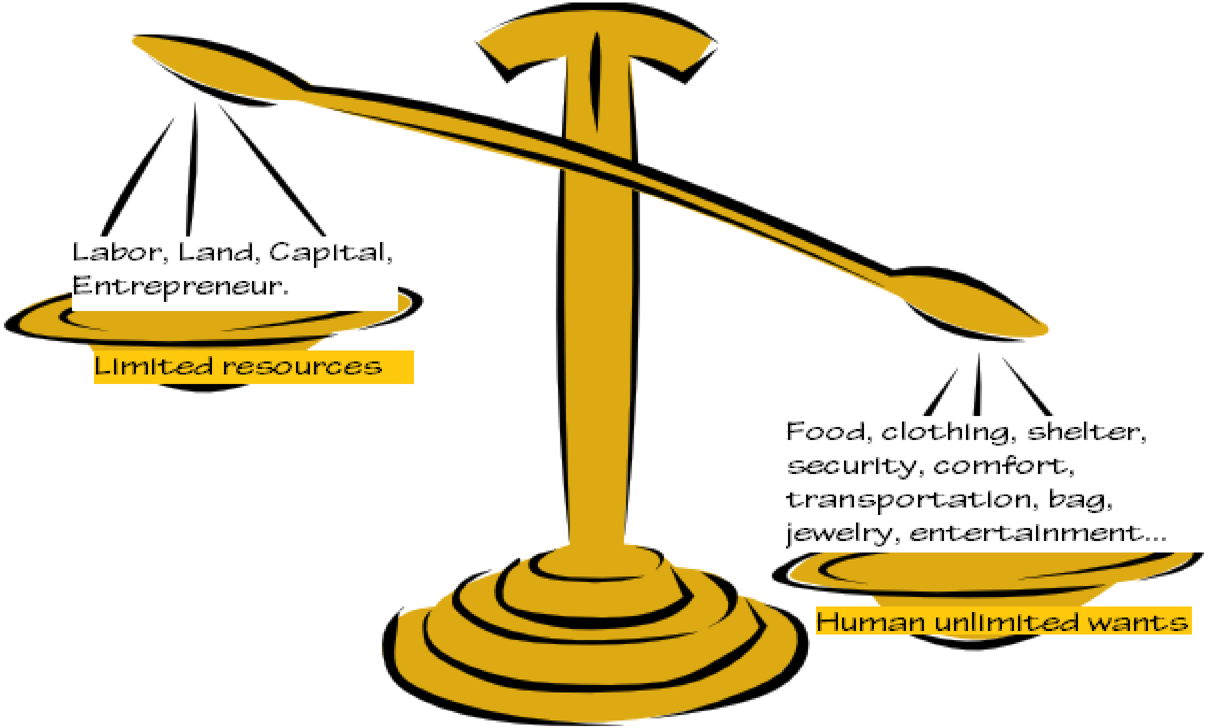
Scarcity and Choice

– Scarce economic resources mean limited goods and services.
– Scarcity restricts options and demands choices. Because we “can’t have it all,” we must decide what we will have and what we must forgo.
– For example: At the core of economics is the idea that “there is no free lunch.” You may be treated to lunch, making it “free” from your perspective, but someone bears a cost. Because all resources are either privately or collectively owned by members of society, ultimately society bears the cost.

- Scarce inputs of land, equipment, farm labor, the labor of cooks and waiters, and managerial talent are required. Because society could have used these resources to produce something else, it sacrifices those other goods and services in making the lunch available.
- Economists call such sacrifices **opportunity costs**: To obtain more of one thing, society forgoes the opportunity of getting the next best thing. That sacrifice is the opportunity cost of the choice.
- In a world of scarcity, choosing one thing means giving up something else. The **opportunity cost** of a decision is the value of the good or service forgone.
- **opportunity cost the price of best alternative forgone is opportunity cost**

SCARCITY

by LIM CHER CHER



Microeconomics vs macroeconomics

Two levels of Economics

1. Microeconomics

- Is focused on analysis of market structures, consumer behavior and company behavior (production, costs, prices of input / output, profit, investments).
- Object of interest is a single (or small number of) household or firm.
- **Microeconomics** is the part of economics concerned with decision making by individual customers, workers, households, and business firms.

- Microeconomics is the part of economics concerned with decision making by individual customers, workers, households, and business firms. We measure;
  - The price of a specific product,
  - The number of workers employed by a single firm,
  - The revenue or income of a particular firm or household, or
  - The expenditures of a specific firm, government entity, or family.
- In microeconomics, we examine the sand, rocks, and shells, not the beach.

Two levels of Economics (continued)

2. Macroeconomics

- Macroeconomics deals with aggregates, problems of economic growth, money supply, unemployment and inflation. It also help in understanding monetary and fiscal policies of state, theory of international market and balance of payments.
- Object of interest is the entire economy. We care mostly about:
  1. Growth
  2. Fluctuations

Two levels of Economics (continued)

- **Macroeconomics** examines either the economy as a whole or its basic subdivisions or aggregates, such as the government, household, and business sectors.
- An aggregate is a collection of specific economic units treated as if they were one unit.
- Therefore, we might sum together the millions of consumers in the U.S. economy and treat them as if they were one huge unit called "consumers."

The Scope of Economics

Microeconomics and Macroeconomics

TABLE 1.1 Examples of Microeconomic and Macroeconomic Concerns

Divisions of Economics	Production	Prices	Income	Employment
Microeconomics	*Production/output in individual industries and businesses*	*Price of individual goods and services*	*Distribution of income and wealth*	*Employment by individual businesses and industries*
	How much steel How much office space How many cars	Price of medical care Price of gasoline Food prices Apartment rents	Wages in the auto industry Minimum wage Executive salaries Poverty	Jobs in the steel industry Number of employees in a firm Number of accountants
Macroeconomics	*National production/output*	*Aggregate price level*	*National income*	*Employment and unemployment in the economy*
	Total industrial output Gross domestic product Growth of output	Consumer prices Producer prices Rate of inflation	Total wages and salaries Total corporate profits	Total number of jobs Unemployment rate

Three players of Microeconomics

- **Consumer**
  - Maximize individual happiness (utility)
  - Choose that bundle of goods and services that will max their utility st their given income
- **Producer**
  - Maximize profit, minimize cost
- **Government**
  - Maximize public happiness (utility)

Positive Economics vs Normative Economics

Positive and Normative Economics

- **Positive Economics** deals with facts and avoids value judgements. It basically describes reality.

- **Normative Economics** describes how the reality should look like.

Positive Economics

Seeks to understand behavior without making judgments about outcomes



Does a currency devaluation fuel inflation?

Are oil prices contributing to a GDP slowdown?

Disposable income has declined by 15% over the past four years.

When disposable incomes fall the demand for own-label supermarket foods rises

Raising tax on beer will have a negative effect on the profits of brewers.

Higher interest rates will dampen house prices.

Normative Economics

Analyzes outcomes of economic behavior, evaluates them as good or bad, and sometimes prescribes a course of action



Higher education should be free.

Should alternative fuels be subsidized?

We must try to boost disposable income.

Basic healthcare to all citizens should be free.

Unemployment is more harmful than inflation.

The minimum wage should be raised by 20%.

Market mechanisms should be allowed to work freely in order to make sure resources are best allocated.

Alcohol consumption should be controlled by enforcing minimum prices for alcoholic beverages sold in supermarkets.

Trade-Offs

- In modern market economies, consumers, workers, and firms have much more flexibility and choice when it comes to allocating scarce resources.
- Microeconomics describes the **trade-offs** that consumers, workers, and firms face, and shows how these trade-offs are best made.

Example: **Consumers Trade-Offs**

- **Consumers** have limited incomes, which can be spent on a wide variety of goods and services, or saved for the future.
- Consumer theory, describes how consumers, based on their preferences, maximize their well-being by trading off the purchase of more of some goods for the purchase of less of others.
- For example; how consumers decide how much of their incomes to save, thereby trading off current consumption for future consumption.

Trade-off

- Choices people must make when faced with scarcity

THE THREE ECONOMIC PROBLEMS

The Three Economic Problems

1. ***What*** **commodities are produced**

2. ***How*** **these goods are made**

3. **and** ***For Whom*** **they are produced**

1. What commodities are produced

- *What* commodities are produced and in what quantities? A society must determine how much of each of the many possible goods and services it will make and when they will be produced.

- Will we use scarce resources to produce many consumption goods (like pizzas)?

- Or will we produce fewer consumption goods and more investment goods (like pizza-making machines)?

2. *How* are goods produced?

- *How* are goods produced? A society must determine who will do the production, with what resources, and what production techniques they will use. Who farms and who teaches?

- Is electricity generated from oil, from coal, or from the sun? Will factories be run by people or robots?

3. For whom are goods produced?

- *For whom* are goods produced? Who gets to eat the fruit of economic activity? Is the distribution of income and wealth fair and equitable? How is the national product divided among different households?

Inputs and Outputs

- **Inputs** are commodities or services that are used to produce goods and services. An economy uses its existing technology to combine inputs to produce outputs.

- **Outputs** are the various useful goods or services that result from the production process and are either consumed or employed in further production.

Economic Efficiency

- Given unlimited wants, it is important that an economy make the best use of its limited resources. That brings us to the critical notion of efficiency. **Efficiency** denotes the most effective use of a society’s resources in satisfying people’s wants and needs.

- **Economic efficiency** requires that an economy produce the highest combination of quantity and quality of goods and services given its technology and scarce resources