BASIC CONCEPTS

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Definition:

Economics is the study of how societies use scarce resources to produce valuable commodities and distribute them among different people.

Economics

- Analyzes how a society's institutions and technology affect prices and the allocation of resources among different uses.
- Explores the behavior of the financial markets, including interest rates and stock prices.
- Examines the distribution of income and suggests ways that the poor can be helped without harming the performance of the economy.
- Studies the business cycle and examines how monetary policy can be used to moderate the swings in unemployment and inflation.
- Studies the patterns of trade among nations and analyzes the impact of trade barriers.
- Looks at growth in developing countries and proposes ways of encourage the efficient use of resources.
- Asks how government policies can be used to pursue important goals such as rapid economic growth, efficient use of resources, full employment, price stability and fair distribution of income.

The most common division of economics is macroeconomics and microeconomics. The pre-fixes macro and micro come from the greek words that mean "Large" and "small" respectively. Thus macroeconomics is concerned with the economics of the entire society while microeconomics focuses on the behavior of the individual household or firm and activities in specific industries.

Macroeconomics:

Is the study of very large, economy-wide aggregate variables such as various indicators of the levels of total economic activity. Thus macroeconomic analysis is concerned with our banking and monetary systems and how the levels of gross national product, unemployment, inflation and economic growth are determined in a society.

Commonly agreed upon goals of macroeconomic policy include.

1) Full Employment

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2) Price-Level stability
3) Economic Growth.

Microeconomics:

Microeconomics is concerned with the individual parts of the economy. The allocation of resources; and how prices, production, and the distribution of income are determined. It is concerned with the demand and supply of particular goods and services and resources cars, butter, clothes and haircuts; etc.

Macroeconomics is concerned with the economy as a whole. It is thus concerned with aggregate demand and aggregate supply. By aggregate demand we mean the total amount of spending in the economy,

- Where by consumers
- By overseas customers for our exports
- By the government
- Or by firms when they buy capital equipment
- Or stock up on raw materials.

By aggregate supply we mean the total national output of goods and services.

Wants and Needs:

Economics, both macro and microeconomics, is about the satisfaction of material wants. It is necessary to be quite clear about this; it is people's wants rather than their need which provide the motive for economic activity. We go to work in order to obtain an income which will buy us the things we want rather than the things we need. It is not possible to define 'need' in terms of any particular quantity of a commodity, because this would imply that a certain level of consumption is right for an individual.

It is assumed that individuals wish to enjoy as much well-being as possible and if their consumption of food, clothing entertainment and other goods and reveries is less than the amount required to give them complete satisfaction they will want to have more of them.

Scarcity:

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Resources are scarce when they are insufficient to satisfy peoples wants. Scarcity is a relative concept. It relates the extent of peoples wants to their ability to satisfy those wants.

Resources:

The resources of a society consist not only of the free gifts of nature such as land, forests and minerals, but also human capacity, both mental and physical, and of all sorts of man-made aids to further production, such as tools, machinery, and buildings.

Resources are divided into three main groups.

(1) all those free gifts of nature, such as land, forests and minerals etc commonly called natural resources and known to economist as land.

(2) all human resources, mental and physical, both inherited and acquired, which economist call labour.

(3) all those man-made aids to further production, such as tools, machinery, and factories, which are used up in the process of making other goods and services rather than being consumed for their own shake, which economist call capital.

Often a fourth resource is distinguished. This is entrepreneur ship from the French word entrepreneur meaning who undertakes task.

Entrepreneurs take risks by introducing both new products and new ways of making old products. They organize the other factors of production and direct them along new lines.

Collectively these resources are called factors of production.

Production: The act of making goods and services is called production. In other words, the transformation of inputs into outputs by firms in order to earn profit.

Consumption: The act of using these goods and service to satisfy wants is called consumption. This will normally involve purchasing the goods and services.

Positive statements: are those that deal only with facts. Britain is an island. 'British coal employs x thousand worker's "Abdullah obtained grade A in economics are all positive statements. If a disagreement arises over a positive statement it can be settled by looking at the facts and seeing whether or not they support the statement. Positive statements must be either true or false, where the word 'true' is taken to mean consistent with the facts.

Normative statements: Normative statements usually include or imply the words 'ought' or should. They reflect peoples moral attitudes and are expressions of what some individual or group thinks ought to be done. Britain should leave the European Union, we ought to give more aid to underdeveloped countries, 'income should be distributed more equally' are all normative statements. These statements are based on value judgments and expresses views of what is good or bad, right or wrong. Unlike positive statements normative statements cannot be verified by looking at the facts. Disagreements about such statements are usually settled by voting on them.

Positive economics and normative economics:

Positive economics describes the facts of an economy while normative economics involves value judgments.

Positive economics deals with the questions such as: why do doctors earn more than rickshaw puller? Does free trade raise or lower the wages of most Americans? What is the impact of computers on productivity?

Normative economics involves ethical precepts and norms of fairness. Should poor people be required to work if they are to get government assistance? Should unemployment be raised to ensure that price inflation does not become too rapid? Should United states breakup Microsoft because it has violated the antitrust laws? There are no right or wrong answers to these questions because they involve ethics and values rather than facts. They can be resolved only by political debate and decisions not by economic analysis alone.

THE THREE PROBLEMS OF ECONOMIC ORGANIZATION:

Choice:

Because resources are scarce, choices have to be made. There are three main categories of choices that must be made in the society.

♦***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. How many curs, how much wheat, how much insurance, how many coats etc. will be produced? Will we use scarce resources to produce many consumption goods (like pizza)? Or will we produce fewer consumption goods and more investment goods (like pizza-making machines). Which will boost production and consumption tomorrow.

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♦*How are things going to be produced, given that there is normally more than one way of producing things?* What resources are going to be used and in what quantities? What techniques of production are going to be adopted? Will cars be produced by robots or by assembly line workers? Will electricity be produced from coal, oil, gas, nuclear fission, renewable resources or a mixture of these.

♦*For whom are things going to be produced?* In other word, how is the nations income going to be distributed? Are many people poor and few rich? Is the distribution of income and wealth fair and equitable? All societies have to make these choices, whether they be made by individuals, by groups or by government.

Choice and opportunity cost:

Choice involves sacrifice. The more food you choose to buy, the less money you will have to spend on other goods. The more food a nation produces, the fewer resources will there be for producing other goods. In other words the production or consumption of one thing involves the sacrifice of alternatives. This sacrifice of alternative in the production or consumption of a good is known as its opportunity cost.

If the workers on a firm can produce either 1000 tones of wheat or 2000 tones of barley, then the opportunity cost of producing 1 tone of wheat is the 2 tones of barley forgone. The opportunity cost of buying a textbook is the new pair of jeans you also wanted that you have had to go without. The opportunity cost of working overtime is the leisure you have sacrificed. So we can define **Opportunity Cost as** The cost of any activity measured in terms of the best alternative forgone.

Production possibility curve:

A curve showing all the possible combination of two goods that a country can produce within a specified time period with all its resources fully and efficiently employed.

The production possibility frontier is one of the simplest models of an economy. Three critical assumption underlie this graphical model:

1. The amounts of the various factors of production are fixed.
2. Technology is assumed constant.
3. All resources are fully and efficiently employed.

Economics is the study of scarcity the study of the allocation of scarce resources to satisfy human wants. Scarcity is a fundamental problem for every society. Decision must be made regarding

What to produce?

How to produce and

For whom to produce.

What to produce involves decisions about the kinds and quantities of goods and services to produce. How to produce requires decisions about what techniques to use and how the economic resources are to be combined in producing output. And for whom to produce involves decisions on the distribution of output.

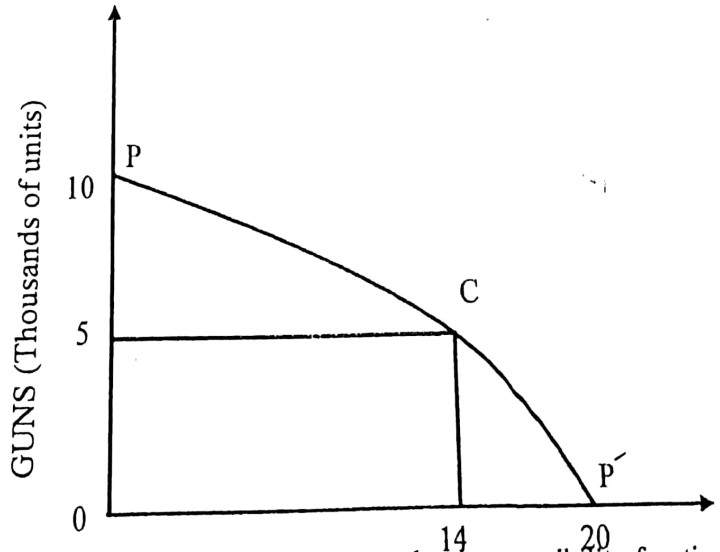
Decisions on what to produce and how to produce involve opportunity costs. An opportunity cost is what is sacrificed to implement an alternative action i.e. what is given up to produce or obtain a particular good or service.

The production possibility frontier:

A production possibility frontier shoes the maximum amount of alternative combinations of goods and services that a society can produce at a given time when there is full utilization of economic resources and technology.

The following table present alternative combination of guns and butter output for a hypothetical economy.

Alternative output	Guns (thousand units)	Butter (million units)
A	0	20
B	2	18
C	5	14
D	9	6
E	10	0



The curve labeled pp© is called the production possibility frontier. Point C on the production possibility curve represents a position of full emolument of the economy's resources and full use of its technology; A at point C, 5000 guns and 14 million units of butter are produced.

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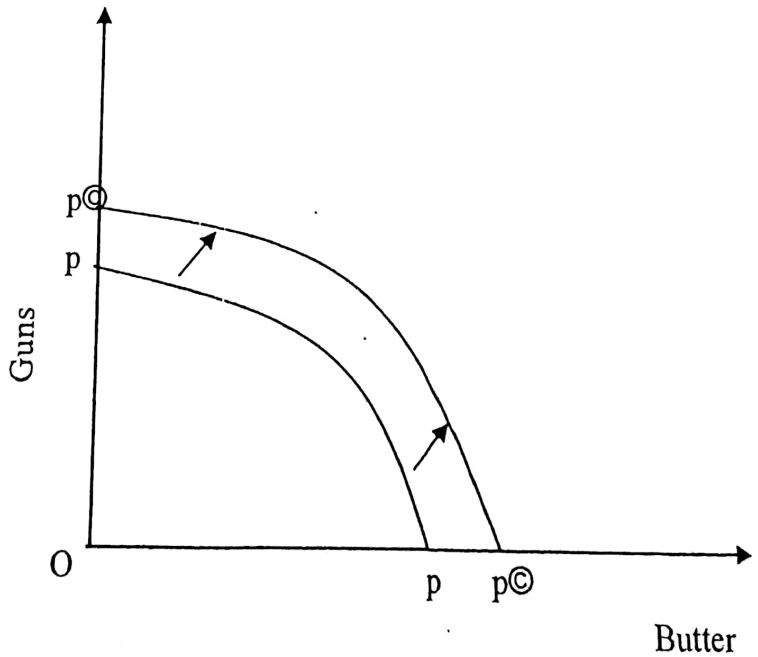
The production possibility frontier depicts not only limited productive capacity but also the concept of opportunity cost. When an economy is on the production possibility curve such as at point C, gun production can be increased only by decreasing butter output. Thus to move from alternative C to alternative D, 8 million fewer units of butter are produced in order to increase gun production 4000 units. The opportunity cost of the additional 4000 units of gun production is 8 million units of butter.

Points on a production possibility frontier are efficient because all the available resources are utilized and there is full use of existing technology. Points within a production possibility frontier are inefficient because some resources are either unemployed or underemployed. Points outside the production possibility frontier are unattainable since the production possibility frontier defines the maximum output that can be produced at a given time.

Shift in production possibility curves:

The production possibility frontier shifts outward over time as more resources become available and/or technology is improved. The growth in the economy's productive capability is depicted in the figure below by an outward shift of the production possibility frontier from pp to p© p©.



A country's ability to produce more goods and services of all types depends upon changes such as an increase in the labour force, an increase in the stock of