WHAT IS ECONOMICS

Principles of Economics

Seven Big Questions

Agenda

1. Seven BIG Economic Questions
2. What is Economy All About?
3. Economics as a Science
4. Major Economic Schools and Theories
5. Positive and Normative Statements

1. Seven BIG Economic Questions

The 7 BIG economic questions

1. They affect the quality of life humans with great intensity
2. They reflect key issues of contemporary scientific research
3. They are no easy answers to them

M. Parking, Economics, Addison-Wesley Publishing, Toronto 1990, p. 6-8.

Question 1

PRODUCTION, CONSUMPTION

and ECONOMIC GROW

How people choose **WHAT** to consume and **HOW** to produce what they consume,

and how these choices (consumption, production) are affected by the discovery of **new technologies** (lifestyle, etc.)?

M. Parking, Economics, Addison-Wesley Publishing, Toronto 1990, p. 6-8.

Question 2

WAGES and EARNINGS

What determines people's incomes

and why do some people receive much larger reward (income) than others whose efforts appear to be similar?

M. Parking, Economics, Addison-Wesley Publishing, Toronto 1990, p. 6-8.

Question 3

UNEMPLOYMENT

What are the causes of unemployment

and why are some groups more severely affected than others?

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Question 4

INLFATION

Why do prices rise

and why do some countries sometimes experience rapid price increases while others have stable prices?

M. Parking, Economics, Addison-Wesley Publishing, Toronto 1990, p. 6-8.

Question 5

GOVERNMENT

How do government spending and taxes influence economic life

and what happens when government has a deficit, as it does at the present time?

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Question 6

INTERNATIONAL TRADE

What determines the pattern and the volume of trade between nations

and what are the effects of tariffs and quotas on international trade?

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Question 7

WEALTH and POVERTY

What causes differences in wealth among nations, making the people in some countries rich and in others poor?

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Big questions with no easy answers

- ✓ What does this questions have in common?
- ✓ What distinguishes them from non-economic questions?
- ✓ One of the hardest thing for scientis is to approach their work with objectivity in spite of passion, emotions and individual prefrences and background

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2. What is Economy All About?

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What is an ECONOMY?

An economy is a **mechanism** that allocates scarce resources among competing uses.

This mechanism achieves three goals (answers):

- **What** to produce
- **How** to produce
- **For whom** to produce

M. Parking, Economics, Addison-Wesley Publishing, Toronto 1990, p. 6-8.

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WHAT?

- What goods and services will be produced and in what quantities?
- What trade-off will be made?
- How much we will spend on civil goods and how much on military expenses?

M. Parking, Economics, Addison-Wesley Publishing, Toronto 1990, p. 6-8.

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HOW?

- ✓ How will all goods and services be produces?
- ✓ Will we employ capital or human means of production?
- ✓ What technology will we imply?

M. Parking, Economics, Addison-Wesley Publishing, Toronto 1990, p. 6-8.

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FOR WHOM?

- ✓ For whom will all the various goods and services be produce?
- ✓ What will be the distribution of economic benefits?
- ✓ What is the final distribution of wealth and income?

M. Parking, Economics, Addison-Wesley Publishing, Toronto 1990, p. 6-8.

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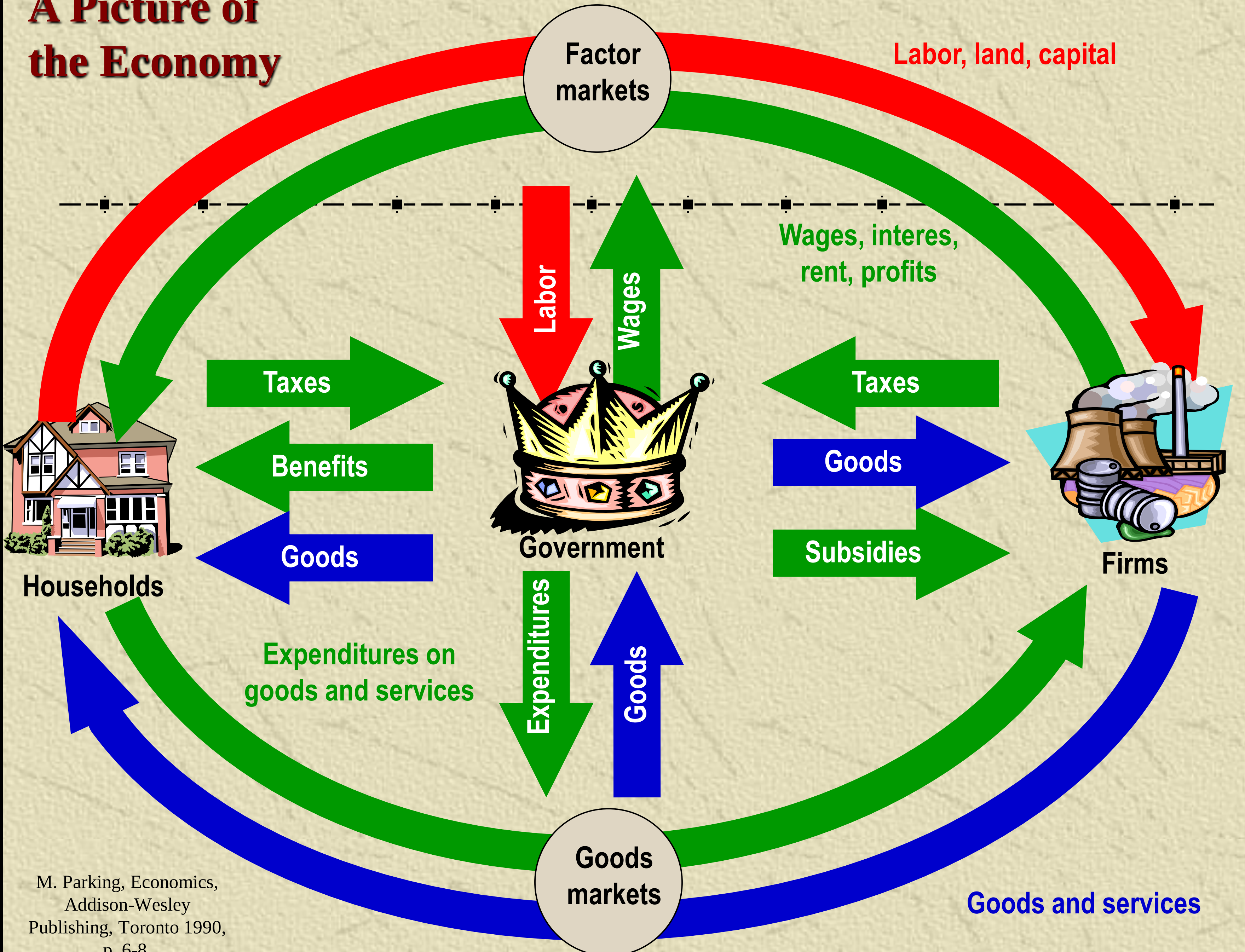
A Picture of the Economy as a One System

- ✓ **Decision makers**: Households, Firms and Government
- ✓ **Factors of production**: Labor, Land, Capital
- ✓ **Coordination Mechanisms**: Factor markets, Goods and services markets
- ✓ **Financial streams**: Wages, interest, rent, profits, expenditures, taxes
- ✓ **Products streams**: Goods and services
- ✓ **Government support**: Benefits and subsidies

M. Parking, Economics, Addison-Wesley Publishing, Toronto 1990, p. 6-8.

A Picture of the Economy



M. Parking, Economics, Addison-Wesley Publishing, Toronto 1990, p. 6-8.

A Picture of the Economy as a One System

- Households provide factors of production to both firms and government through the factor markets
- Firms and government pay households wages, interest, rent, and profits in exchange
- Firms supply goods and services to households and to government through the goods markets
- Households and government pay firms for these goods and services
- Government provide goods and services directly to households and firms
- Households and firms pay taxes to government, and government make transfer payments – subsidies and benefits

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Economic Facts

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FACT #1

- We live in a world of **scarcity**.
- Natural recourses are limited.
- Wants always exceed the resources available to satisfy them.
- Contrary, needs and wants are unlimited.
- No one is entirely satisfied with his or her well being.
- No one feels entirely secure.

M. Parking, Economics, Addison-Wesley Publishing, Toronto 1990, p. 6-8.

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FACT #2

- ✓ The confrontation of unlimited wants and limited resources results in **economic activity**.
- ✓ Economic activity is what people do to cope with scarcity.
- ✓ World of complete abundance would have no economic issues.

M. Parking, Economics, Addison-Wesley Publishing, Toronto 1990, p. 6-8.

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FACT #3

- ✓ Faced with scarcity, people must make **choices**.
- ✓ Economic is called the science of choice.
- ✓ To make a right choice we have to balance the benefits against the cost of having less of something else.

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FACT #4

- Balancing benefits against costs and doing the best within the limits of what is possible is called **optimizing**.
- **Economizing** – making the best use of the resources available.
- Once the choice has been made and has been optimized ones cannot have more of everything

M. Parking, Economics, Addison-Wesley Publishing, Toronto 1990, p. 6-8.

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FACT #5

- In making choices, we face costs – **opportunity costs**.
- In the face of scarcity costs are always implied.
- You have to choose among alternatives.
- The alternative forgone is the opportunity cost.
- Everything has an opportunity costs attached.

M. Parking, Economics, Addison-Wesley Publishing, Toronto 1990, p. 6-8.

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FACT #6

- Scarcity not only implies cost, it another fundamental future of human life – **competition**.
- If wants exceed resources, individual wants (people) must compete against each other for what is available.
- Competition is a contest for command over scarce resources.
- Fair competition has to follow rules based on voluntary exchange.

M. Parking, Economics, Addison-Wesley Publishing, Toronto 1990, p. 6-8.

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FACT #7

- ✓ Scarcity does not make competition inevitable.
- ✓ **Cooperation** could be better solving economic problems.
- ✓ Cooperation means working with others to achieve a common end (outcome).
- ✓ We cooperate when we agree to rules of the game that limit competition to avoid violence.

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Conclusions:

- ✓ Economics studies activities arising from scarcity.
- ✓ Scarcity forces people to make choices.
- ✓ Economists try to understand the choices that people make.
- ✓ To make efficient choices people optimize.
- ✓ To optimize people evaluate the costs, to emphasize that doing one thing removes the opportunity to do something else.
- ✓ Scarcity also implies that people must compete with each other.
- ✓ **Cooperation may, though, be one way to get the best use of scarce resources.**

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3. Economics as a Science

Economics as a Science

- ✓ **Economics** is the social science that studies the allocation of scarce resources to satisfy unlimited wants.
- ✓ **Economics** (deriving from the Greek words οίκω [okos], 'house', and νέμω [nemo], 'rules' hence household management)

http://en.wikipedia.org/wiki/Economics

Economics as a Science

Economics is broadly divided into two main branches:

- ✓ **microeconomics**, which deals with individual agents, such as households and businesses, and
- ✓ **macroeconomics**, which considers the economy as a whole.

http://en.wikipedia.org/wiki/Economics

Economics as a Science

- ✓ Aspects receiving particular attention in **economics** are **resource allocation**, **production**, **distribution**, **trade**, and **competition**.

- ✓ Economics may in principle be (and increasingly is) applied to any problem that involves **choice** under **scarcity** or determining **economic value**.

http://en.wikipedia.org/wiki/Economics

Economics as a Science

What makes Economics as a Science?

- ✓ Applied scientific research methods (observation, test)
- ✓ Terminology (scarcity, choice, cost, value)
- ✓ Subject (economy)
- ✓ Scientific tradition (Adam Smith 1776)

http://en.wikipedia.org/wiki/Economics

4. Positive and Normative Statements

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What Is and What Ought to Be?

Statements about what IS are **positive statements**.

Statemens about what OUGHT to be are **normative statemants**.

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What Is and What Ought to Be?

Economics is said

to be **positive** when it attempts to explain the consequences of different choices given a set of assumptions or a set of observations, and

normative when it prescribes that a certain action should be taken.

http://en.wikipedia.org/wiki/Economics

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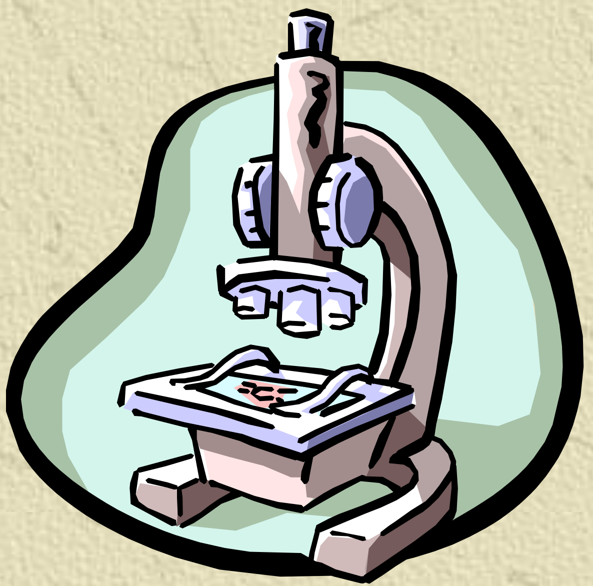
Positive statements versus normative statemants



5. Major Economic Schools and Theories

Schools and Theories

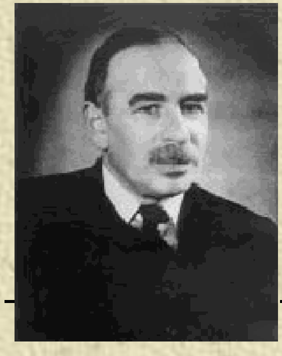
- Classical economics
- Marxian economics
- Keynesian economics
- Neoclassical economics
- Austrian School
- Monetarists
- New classical economics

http://en.wikipedia.org/wiki/Economics

Classical Economics

- ✓ Classical economics is a school of economic thought whose major developers include William Petty, **Adam Smith**, David Ricardo, Thomas Malthus, and John Stuart Mill.
- ✓ Classical economists attempted to explain growth and development.
- ✓ Classical economists developed a theory of value, or price, to investigate economic dynamics.
- ✓ **Market price** is one of a number of ways of establishing the monetary value of a transaction; there are others, such as historical cost; the resource cost of the good or service; the discounted present value

http://en.wikipedia.org/wiki/Economics

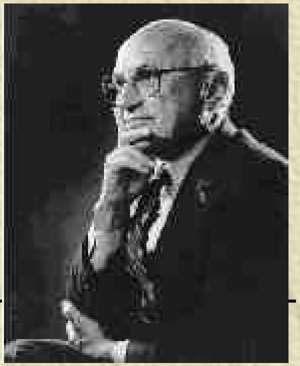


Keynesian economics

- **John Maynard Keynes** asserted the importance of the aggregate demand for goods as the driving factor, especially in downturns.
- From this he argued that government policies could be used to promote demand at a "macro" level, to fight high unemployment and deflation.
- A central conclusion of Keynesian economics is that there is no strong automatic tendency for output and employment to move toward full employment levels.

http://en.wikipedia.org/wiki/Economics

Monetarists



- ✓ **Monetarism** is a set of views concerning the determination of national income and monetary economics.
- ✓ It focuses on the supply and demand for money as the primary means by which economic activity is regulated.
- ✓ Monetary theory focuses on **money supply** and on inflation as an effect of the supply of money being larger than the demand for money.
- ✓ **Milton Friedman** advocated a central bank policy aimed at keeping the supply and demand for money at equilibrium, as measured by growth in productivity and demand.

http://en.wikipedia.org/wiki/Economics

Thank you