

WEEK 1: INTRODUCTION TO ECONOMICS

Economics comes from the Greek word, meaning '*household management*'.

Economics concerns

- (a) the allocation of a society's resources among alternative uses and the distribution of society's output among individuals and groups.
- (b) changes in production and the distribution of goods and services over time
- (c) the efficiencies and inefficiencies of different economic system

A *distinction* is made between *microeconomics* and *macroeconomics*.

- (a) *Micro* comes from the Greek word meaning *small* and microeconomics *is the study of individual economic units or particular parts of the economy*.
- (b) *Macro* comes from the Greek word meaning *large* and macroeconomics *is the study of global or collective decisions by individual households or producers. It looks at a national or international economy as a whole*.

Economic goods- those goods which are scarce in relation to the demand for them.



FACTORS OF PRODUCTION

The sum total of the economic resources which we have in order to produce for our economic wants are termed the *factors of production*. Factors of production are divided into

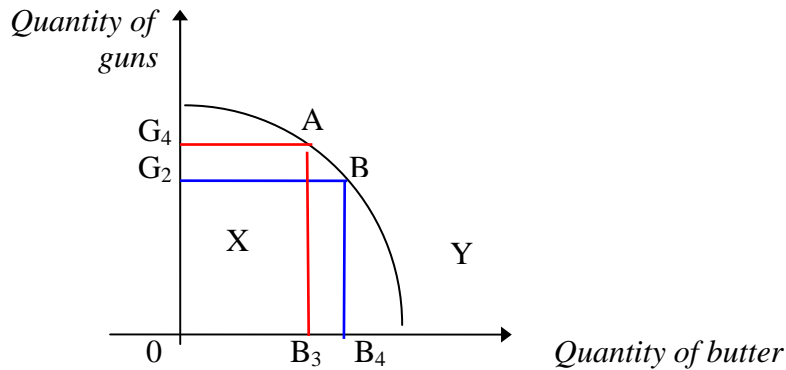
- (a) Primary factors - what we have to start with
 - (i) labour
 - (ii) land

- (b) Secondary factors - consequence or result of an economy system
 - (iii) capital
 - (iv) entrepreneur

OPPORTUNITY COST

The cost of an item measured in terms of the second best alternative *forgone*.
 An economy has to decide **what** to produce, **how** to produce and for **whom** to produce.

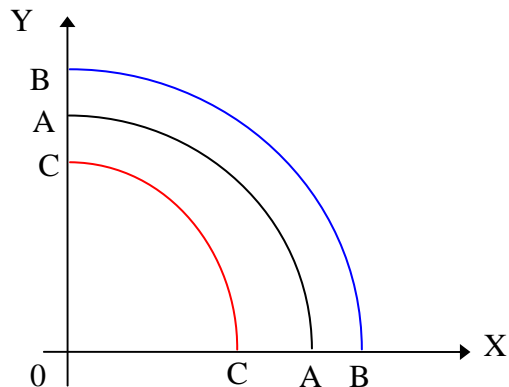
Production possibility curve illustrate the concept of *opportunity cost*.



If it is decided to switch from making G_2 units of guns and B_4 units of butter (point B) to G_4 units of guns and B_3 units of butter (point A), the opportunity cost of making more units of guns would be the less production of units of butter.

The combination of guns and butter at point X is within its production possibility curve. More than these quantities can be made of either or both guns and butter. Point X is therefore an *inefficient production* point for the economy, and if the firm were to produce only at this point, it would be using its limited resources *inefficiently*. The combination of guns and butter at point Y is outside the PPC and there are *insufficient resources* to make this quantity even by using all available resources as efficiently as possible. Point Y is therefore *unattainable*.

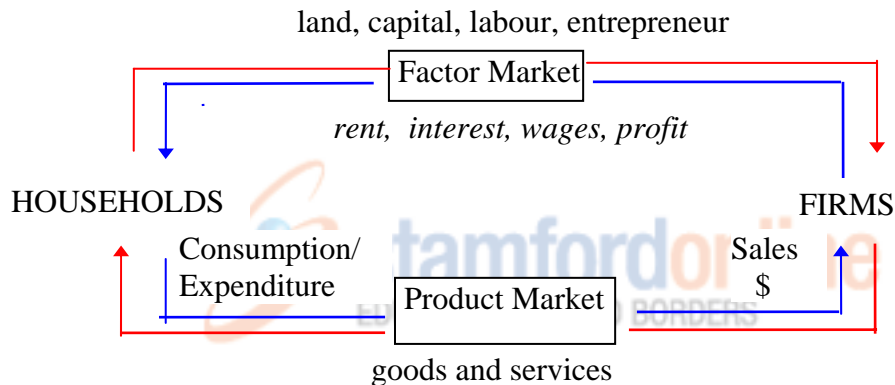
When the availability of resources changes, or there is development in technology, the production possibility curve might shift. Changes are made possible by developments such as a bigger labour force, more efficient methods of working, more efficient machinery or a new discovery of natural resources such as oil, natural gas or minerals.



If the PPC moves *outwards*, to the *right*, from AA to BB, it means that the economy is capable of producing more goods and services in total than it could before, and there is *economic growth*. If the PPC moves to the *left* from AA to CC (*inwards*), it means that the economy *cannot produce as much as before*. This could be due to a serious decline in population. It can also mean *economic depletion*.

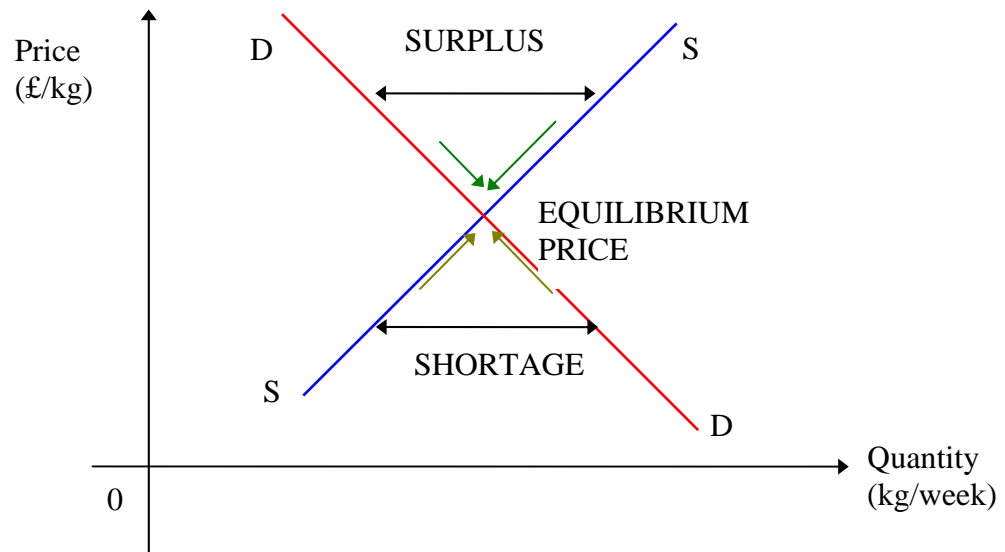
PRICE MECHANISM

Price mechanism is the process where goods and services and resources are allocated in the economy through the medium of price.



Equilibrium price is the price at which the wishes of buyers and sellers coincide.

Price of commodity X (£/kg)	Quantity demanded of commodity X (kg/week)	Quantity supplied of commodity X (kg/week)	Pressure on price
5	110	240	downward
4	120	200	downward
3	150	150	neutral
2	200	90	upward
1	250	0	upward



ECONOMIC SYSTEMS

There are three economic systems:

- (a) **Command Economies**
In a command economy, a central government either directly or indirectly sets output targets, incomes and prices
- (b) **Laissez-faire Economies**
In a laissez faire economy, individuals and firms pursue their own self-interests without any central direction or regulation. The distribution of output is also determined in a decentralized way. The amount that any one household gets depends on its income and wealth.
The basic coordinating mechanism is a free market system in price.
- (c) **Mixed Systems**
There are no purely planned economies and no pure laissez faire economies. All economies are mixed. Governments intervene and often play a major role in the economy. The goals are:
 - Minimize market inefficiencies
 - Provide public goods
 - Redistribute income
 - Stabilize the macro economy

Learning Outcomes:

Students should be able to:

- Identify the scope to study economics
- Explain scarcity, choice and opportunity cost
- Illustrate production possibility frontier
- Compare and contrast types of economic systems

Main Reference

Case, K. E., & Fair, R. C. (2007). *Principles of Economics* (8th ed.). Prentice Hall, Chapters 1 & 2.

Other Reference

Sloman, J. (1999). *Essentials of Economics* (3rd ed.). Prentice Hall, Chapter 1.

Review Questions

1. Why is the study of economics important?
 2. Distinguish between macroeconomics and microeconomics.
 3.
 - a. What is meant by the term *opportunity cost*?
 - b. How does opportunity cost relate to the problem of scarcity?
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