INTRODUCTION TO ECONOMICS

~ Bharathi

Senior Faculty Member

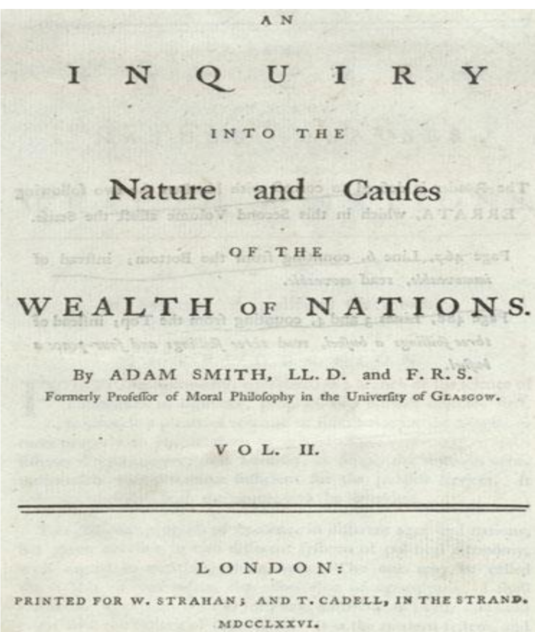
What is Economics?

What is Economics?

- A social science that studies and influences human behavior
- Economics is the study of what constitutes rational human behavior in the endeavor to fulfill needs and wants.

The "Father" of Modern Economics

Adam Smith (1723 - 1790)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INQUIRY

INTO THE

Nature and Caufes

OF THE

WEALTH OF NATIONS.

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- Author of the famous book "*An Inquiry into the Nature and Causes of the Wealth of Nations*" (1776)
- Adam Smith was a Scottish moral philosopher and a pioneer of political economy.
- Adam Smith is best known for two classic works: *The Theory of Moral Sentiments* (1759), and *An Inquiry into the Nature and Causes of the Wealth of Nations* (1776) (known as '*The Wealth of Nations*', is considered his *great work* and the first modern work of Economics.
- Smith is known as the "Father of Modern Economics".

Robbins

Robbins (1898 –1984)

- Lionel Robbins was a British economist and head of the economics department at the London School of Economics.
- He is known for his proposed definition of economics.
- His definition is "Economics is the science which studies human behaviour as a relationship between ends and scarce means which have alternative uses."

The Question of Scarcity

- Scarcity
  - Scarcity refers to our limited resources and our unlimited wants and needs.
  - For an individual, resources include time, money and skill.
  - For a country, limited resources include natural resources, capital, labour force and technology.

Needs and Wants

- A want is a good/service you "want" but can live without

- Most economic items are wants

- Few goods/services are needs
  - Food, clothing, shelter (usually in the generic sense)

What is the problem?

- Human wants are unlimited.
- We live in a world of limited resources.
- Scarcity is the problem.
- People try to balance needs and wants.

ECONOMICS

MICRO

MACRO

Micro Economics

- Micro Economics studies how the individual parts of the economy make decisions to allocate limited resources
- Microeconomics studies:
  - how individuals use limited resources to meet unlimited needs
  - the consequences of their decisions
  - the behaviour of individual components like industries, firms and households.
  - how individual prices are set
  - what determines the price of land, labour and capital
  - inquire into the strengths and weaknesses of the market mechanism.

MACRO ECONOMICS

- Macroeconomics studies about the functioning of the economy as a whole
- It examines the economy through wide-lens.
- Macroeconomics studies about
  - the total output of a nation
  - the way the nation allocates its limited resources of land, labor and capital
  - the ways to maximize production levels
  - the techniques to promote trade
- After observing the society as a whole, Adam Smith noted that there was an "invisible hand" turning the wheels of the economy: a market force that keeps the economy functioning.

Some Basic Economic Terminology

Utility = Satisfaction

Marginal = Additional

- **Scarcity** occurs at all times for all goods.
- **Shortages** occur when producers will not or cannot offer goods or services at current prices. Shortages are temporary.

Goods vs. Services

Examples…

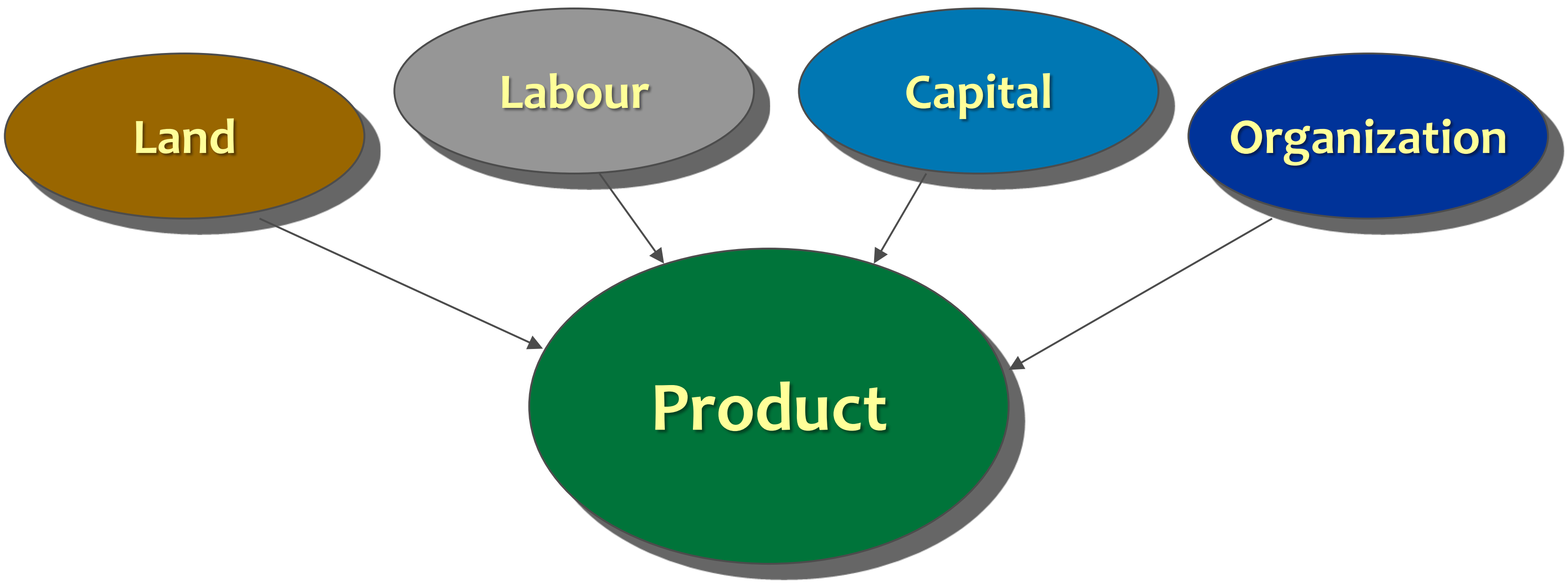
Goods= physical objects that satisfy needs and wants

- **Consumer Goods**- created for direct consumption (example: pizza)
  - **Capital Goods**- created for indirect consumption (oven, blenders, knives, etc.)
    - **Goods used to make consumer goods**

Services= actions or activities that one person performs for another (teaching, cleaning, cooking)

How are the goods produced?

The Factors of Production

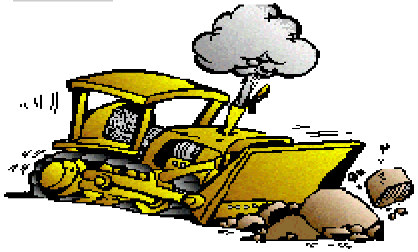


The Four Factors of Production

Land

Labour

Capital



Entrepreneurship

The Factors of Production

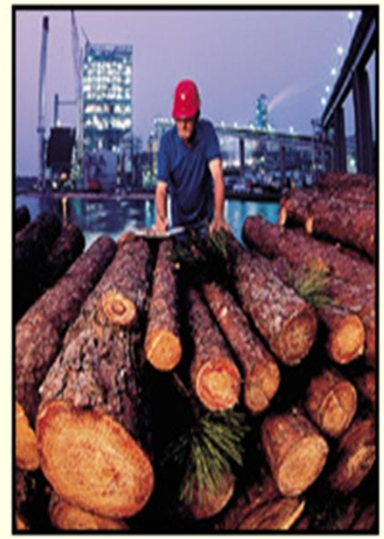
Land

Land includes the "gifts of nature," or natural resources not created by human effort.

Capital

Capital includes the tools, equipment, and factories used in production.

Labor



Labor includes people with all their efforts and abilities.

Entrepreneurs

Entrepreneurs are individuals who start a new business or bring a product to market.

The Four Factors of Production

Land = All natural resources that are used to produce goods and services. Anything that comes from "mother nature." **(Water, Sun, Plants, Oil, Trees, Stone, Animals, etc.)**

The Four Factors of Production

Labour = Any effort a person devotes to a task for which that person is paid. **(manual laborers, lawyers, doctors, teachers, waiters, etc.)**

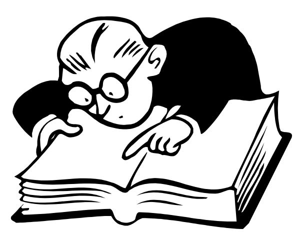



The Four Factors of Production

Two Types of Capital:

1. **Physical Capital** - Any human-made resource that is used to create other goods and services (tools, tractors, machinery, buildings, factories, etc.)
2. **Human Capital** - Any skills or knowledge gained by a worker through education and experience (college degrees, vocational training, etc.)



The Four Factors of Production

- **Entrepreneur** = A person that combine the other 3 factors of production to produce goods.

Entrepreneurs:

1. Take the Initiative
2. Innovate
3. Act as the Risk Bearers

So they can obtain PROFIT.

Profit= Revenue - Costs

What is Utility?

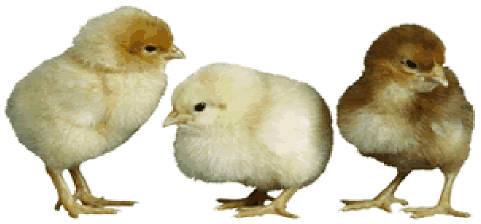
- Satisfaction
- Can not be measured
  - Marshall – Utility can be measured in Utils

What are kinds of Utility?

- Form Utility
- Place Utility
- Time Utility

Form Utility

- In what form is a product available
  - Whole chicken
  - Chicken parts
  - Cooked chicken
- Each step adds value




Place Utility

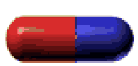
- The place where is a product available
- Convenience

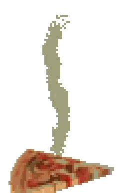
Time Utility

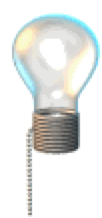
- **When is a product available**

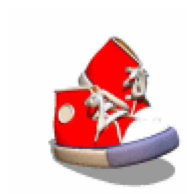
Rational Behavior

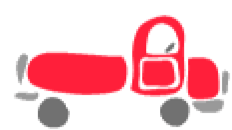
- People know what they want
- Their behaviors are consistent with what they want
- Assume that the market information is given.











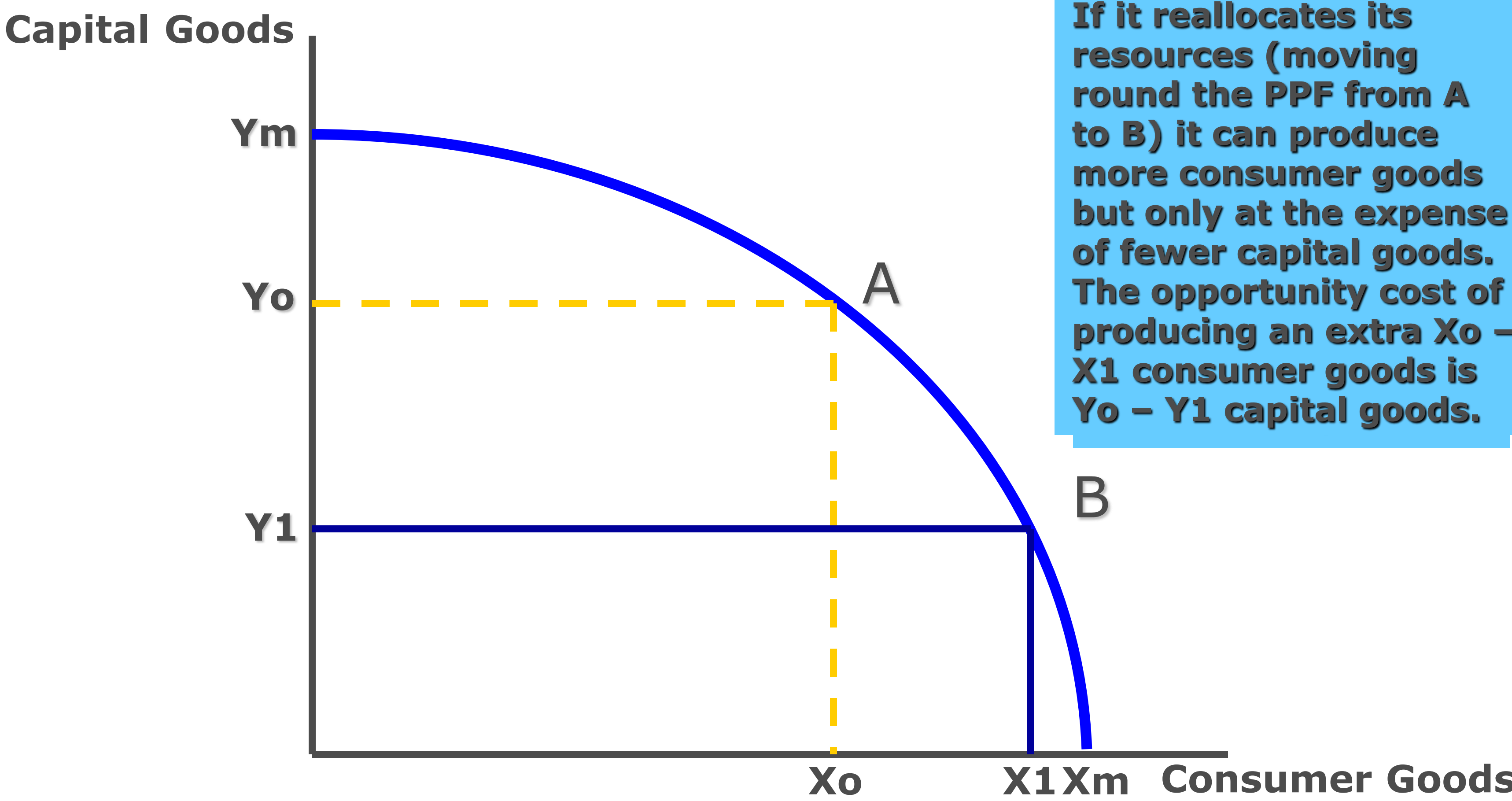
Opportunity Cost

- **Definition – the cost expressed in terms of the next best alternative sacrificed**
- **The cost of anything in terms of other things given up or sacrificed.**

Production Possibility Frontiers

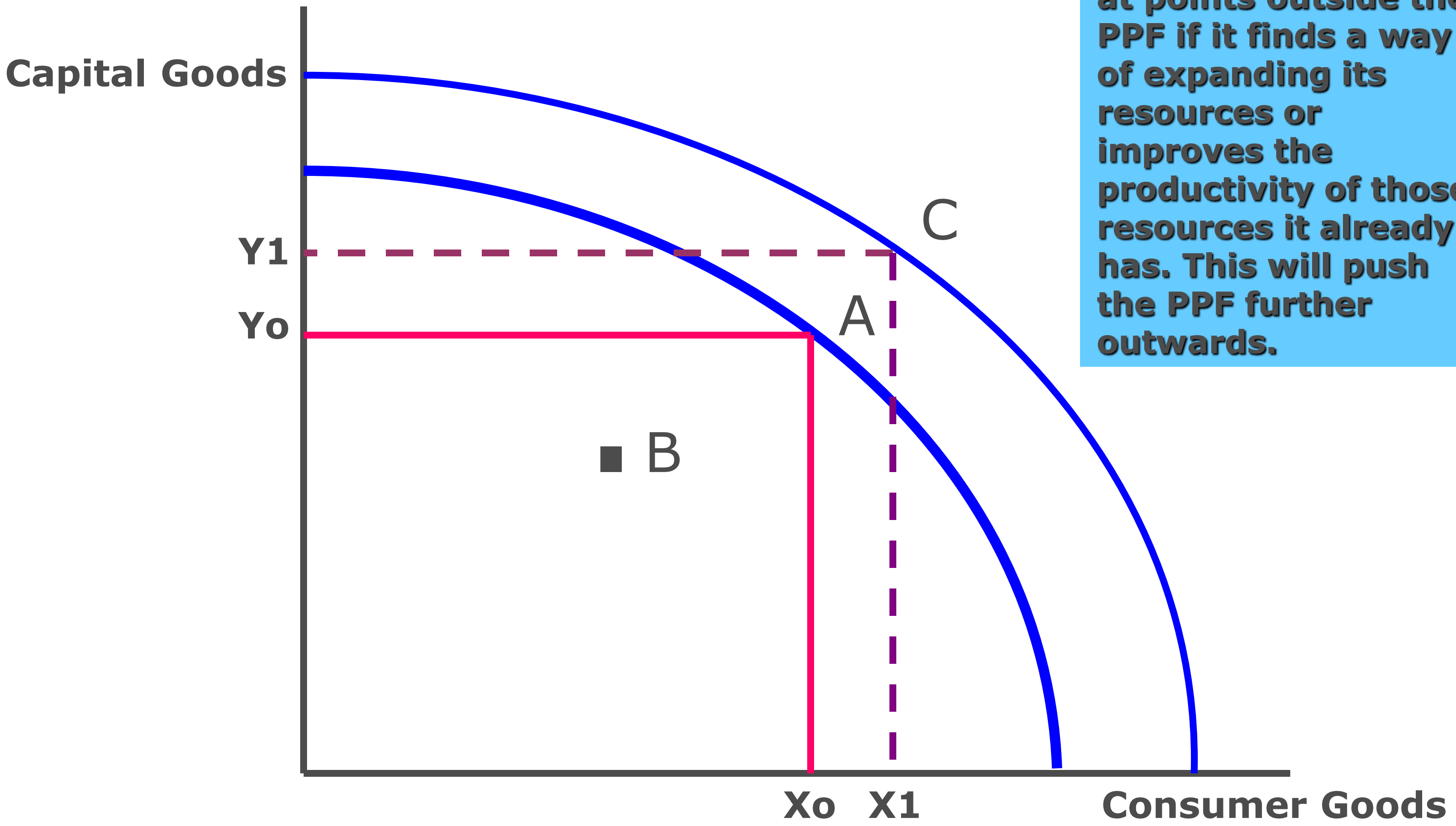
- PPF Shows the different combinations of goods and services that can be produced with a given amount of resources
- No ‘ideal’ point on the curve
- Any point inside the curve – suggests resources are not being utilised efficiently
- Any point outside the curve – not attainable with the current level of resources
- Useful to demonstrate economic growth and opportunity cost

Production Possibility Frontiers



If it reallocates its resources (moving round the PPF from A to B) it can produce more consumer goods but only at the expense of fewer capital goods. The opportunity cost of producing an extra Xo – X1 consumer goods is Yo – Y1 capital goods.

Production Possibility Frontiers



It can only produce at points outside the PPF if it finds a way of expanding its resources or improves the productivity of those resources it already has. This will push the PPF further outwards.

Principles of Economics

HOW DO PEOPLE MAKE DECISIONS?

1. People face trade-off

- Every decision involves choices, and more of one good means less of another good. Trade-off applies to individuals, families, corporations and societies.
- Trade off between Efficiency and Equity

  — Efficiency means the society is getting maximum benefits from its scarce resources

  — Equity means the distribution of the benefits among the members of the society equally

2. Cost of something is what you give up to get it

- When we make a decision we compare the costs and benefits of our choices.
- Opportunity cost is whatever must be given up to obtain something.
- People compare costs and benefits

3. Rational people think at the margin

- Basic economics assumes that people act rationally

- They try to act so as to gain the most benefit compared to the costs

- Microeconomics focuses on small or marginal changes

- Economists use the term marginal changes to describe small incremental adjustments to an existing plan of action

- Rational people often make decisions by comparing marginal benefits and marginal costs

4. People respond to incentives

- If rational people compare costs and benefits, then changes in either one may change decisions.
- An incentive is something that induces a person to act .
- An example of an incentive is that, people respond to changes in prices. In general, people are more likely to buy something if it is cheaper. If an action becomes more costly, then there is an incentive to switch to other choices. Note that all actions have substitutes.

HOW PEOPLE INTERACT?

Trade makes everyone better off

- Trade between two countries can make each country better off
- Trade allows each person to specialize in the activities he or she does best, whether it is farming or home building
- Trade with others enables people to buy a variety of goods at lower cost
- Countries as well as families benefit with the ability to trade with one another
- Trade allows countries to specialize in what they do best and to enjoy greater variety of goods

Markets are usually a good way to organize economic activity

- Firms decide whom to hire and what to make
- Households decides which firms to work for and what to buy with their incomes
- These firms and households interact in the market place, where prices and self interest guide their decisions

Government can sometimes improve market outcomes

- The invisible hand can work only if the Government enforces the rules and maintains the institutions that are key to a market economy

- Markets work only if the individual interests are protected by Government policy

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

- The living standards of various countries over time differ . This is due to the differences in productivity
- The quantity of goods and services produced from each hour of a worker's time is known as productivity
- There is relationship between the productivity and the living standards
- A rise in productivity helps to boost living standards


THANK
YOU