Introduction to the Global Economy

What is Economics?

- Economics is the study of decision making
- Every time we make a decision, we are choosing between at least two possibilities
- How do you make that decision? You weigh up the 'costs' and 'benefits'.
- You take into account any incentives for taking one decision over another

- We have to make decisions because we cannot have everything – there is always a limitation:
    - The money we earn
    - The time we have
    - The pure physical existence of a particular resource

- There are resources, and they are *scarce*; there will always be more 'wants' than there are means to meet these wants.

- Economics therefore analyses <u>what</u> we do choose to make/produce, <u>how/where</u> we make this and <u>who/how</u> do we distribute these things to? (and how we deal with the waste or negative by products). It is the study of production, distribution and consumption of anything that involves human action.
- Economics is a social **science**, where theories or general explanations are developed through hypothesis testing, using evidence to argue for and against explanations, like a court of law.
- Economics is a **social** science because it is about human interaction.

Why is economics important?

- It addresses the questions:
    - Why is there such a gap between rich and poor countries?
    - How the prices of goods and services are determined and what determines them?
    - Why do we have governments, how do governments work and why do we have the *type* of governments we have?
    - What causes financial crises and how can we avoid them in the future?
    - Why global warming has become such a problem and what are some of the best ways to deal with environmental pollution?
    - Why are some things made locally yet other manufacturing is outsourced?
    - Why do international students choose to study in Australia?

- Economics provides a framework through which the world we live in can be understood.

INTRODUCTION TO THE GLOBAL ECONOMY (CHAPTERS 1-3)

Learning Objectives:

- Compare macroeconomics with microeconomics
- See that macroeconomics analysis can help decision making by individuals, governments and firms.
- Describe the role of macroeconomic models in economic analysis.
- Differentiate between normative economics and positive economics.
- Draw connections between macroeconomics and some broader social goals.
- Use a production possibility frontier to analyse opportunity costs and trade-offs
- Understand comparative advantage and explain how it is the basis for trade.

What is Macroeconomics?:

- Macroeconomics is the study of aggregates or whole systems (the economy).

- A central concern of macroeconomics is how the economy as a whole grows and changes over time.

Macroeconomic aggregates:

- *Gross domestic product (GDP):* total output of goods and services produced in a country over a given period of time, normally a year.
- *General price level:* measure of the average price of all the goods and services in an economy.

Macro vs Micro:

- Microeconomics: the branch of economics that examines individual decision making by firms and households, and the way in which they interact in specific industries and markets.
- Macroeconomics: the branch of economics that examines the workings and problems of the economy as a whole.

Economic models:

- Economic models and theories are used to describe and explain economic facts and observations, and to make predictions.
- For example; if the output of an economy grows by 10% this year, what is likely to happen to the inflation rate?
- To make our analysis manageable, we usually hold these other things constant so we can think through the effects of output change on inflation.
- Economic models use a ceteris paribus assumption, which means that our models hold "other things equal"

Macroeconomic models:

- A macroeconomic model is an explanation of how the economy or a large part of the economy works.
- They are abstractions, or simplifications, of the world that can be described with words, numerical tables, graphs and algebra.

Positive vs Normative statements:

- Positive economics is about what is observed as "facts", open to testing, verifiable or can be proved/disproved.
- Normative economics is about values, emotions, beliefs, involves "value judgements" about what 'should' be done.

Conflicting policy goals:

- Societies cannot necessarily achieve all their policy goals simultaneously.
- Some goals are quite compatible, but others tend to conflict.
- Ideally decision makers are looking for the best trade-off – minimising what you have to give up to achieve a policy goal.