

1.0 Introduction to economics

Economics	The study of how society manages its scarce resources
Economist	Study how people make decisions, how much they work, what they buy, how much they save and how they invest their savings
Economic model	is a description of some aspect of the economic world that includes only those features that are needed for the purpose at hand
Externality	The uncompensated impact of one person's actions on the wellbeing of a bystander. A positive externality makes the bystander better off. The negative externality makes the bystander worse off.
Firm	is an economic unit that hires factors of production and organises those factors to produce and sell goods and services
Inflation	An increase in the overall level of prices in the economy
Normative Statements	Statements that attempt to prescribe how the world should be
Market	is any arrangement that enables buyers and sellers to get information and do business with each other.
Market Economy	An economy that allocates resources through the decentralised decisions of many firms and households as they interact in markets for goods and services
Market Failure	A situation in which a market left its own fails to allocate resource efficiently
Market Power	The ability of a single economic factor (or small group of actors) to have a substantial influence on market prices
Money	is any commodity or token that is generally acceptable as a means of payment.
Opportunity cost	is the best alternative that must be given up to obtain some item.
Phillips curve	The short term trade-off between inflation and unemployment
Productivity	The quantity of goods and services produced from each from each hour of a workers time
Positive Statements	Statements that attempt to describe the world as it is.
Property Rights	are the social arrangements that govern ownership, use, and disposal of resources, goods or services.
Scarcity	The limited nature of society's resources
Unscrambling Cause and Effect	The task of economic science is to discover positive statements that are consistent with what we observe in the world and that enable us to understand how the economic world works

1.1 Economics defined

Economics is the social science that studies the choices that individuals, businesses, governments, and entire societies make as they cope with scarcity, and the incentives that influence and reconcile those choices.

Economics can be divided into two main parts:

- Microeconomics
- Macroeconomics

Microeconomics is the study of how households and firms make decisions and how they interact in markets.

Macroeconomics is the study of economy-wide phenomena, including inflation, unemployment and economic growth.

Scarcity refers to the limited nature of society's resources which creates trade-offs.

Incentives are central to understanding how markets work, as the price rises of a product, consumers purchase less of the product and vice versa.

Economic Coordination

To reap gains from trade, the choices of individuals must be coordinated.

To make coordination work, four contemporary social institutions have evolved:

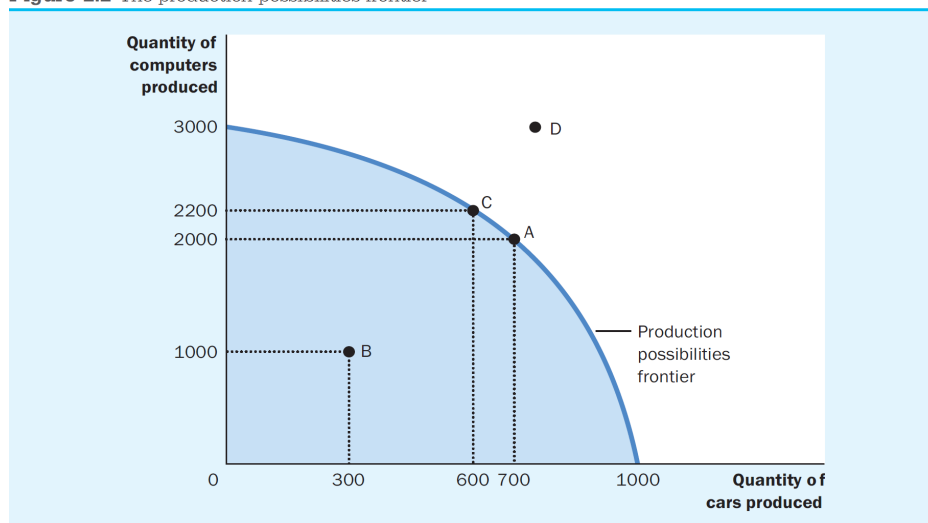
- Firms
- Markets
- Property Rights
- Money

1.2 Production Possibilities Frontier (PPF)

PPF shows the various combinations of output that the economy can possibly produce given the available factors of production and the available production technology.

The PPF is the boundary between those combinations of goods and services that can be produced and those that cannot and looks at a model economy in which everything remains the same except the two goods we're considering.

Figure 2.2 The production possibilities frontier



- If this economy devotes all its resources to making computer's it will produce 3000 computers
- If this economy devotes all its resources to building cars it will produce 1000 cars
- This economy can also produce a combination of computers and cars
- Focuses on two goods at a time
- Point B inside the frontier is possible but inefficient
- Point D outside the frontier is not possible
- With the resources it has, the economy can produce at any point on or inside the PPF
- Every point along the PPF involves a trade-off.
- Moving from point C to point A increases the number of cars by 100, but reduces the number of computers by 200.
- We can say that the opportunity cost of these 100 cars is 200 computers.

The PPF shows trade-offs at a particular point in time, changes in technology and resources change the combination of goods and services that can be produced.

An outcome is said to be *efficient*, if the economy is getting all it can from the scarce resources it has available (along or inside the PPF).

1.3 Economists, Unscrambling & an Economic Model

Economists:

- may be asked to explain the causes of economic events, or to recommend policies to improve economic outcomes.
- Are experts
- All the policy questions on which economists provide advice involve a blend of the positive and the normative
- Consulted on policies

Unscrambling Cause and Effect

The task of economic science is to discover positive statements that are consistent with what we observe in the world and that enable us to understand how the economic world works.

An economic model:

is a description of some aspect of the economic world that includes only those features that are needed for the purpose at hand. Economists create and test economic models. A model is tested by comparing its predictions with the facts.

But testing an economic model is difficult, so economists also use:

- Natural experiments
- Statistical investigations
- Economic experiments