

INTRODUCTION TO ECONOMICS

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The basic economic problem - Scarcity

- All human beings have various **needs** (e.g. hunger, thirst, education, etc)
- All their needs can be met/satisfied with the use of specific **resources**.
- The problem is that *our needs are unlimited...*
- *... and the resources that satisfy them are limited.*
- The problem is the same for individuals, the society as whole as well as Governments.
- This is known as the problem of **scarcity**.

Scarcity explored

- There are many constraints we need to take into considerations in our daily lives.
- We cannot buy and consume an infinite amount of goods and services.
- Firms cannot produce an infinite quantity of output.
- The Government cannot provide an unlimited quantity of public goods (e.g. roads, schools, hospitals, etc)
- *We are all constrained by our available resources*

Scarcity in our lives!

	Needs (unlimited)	Resources (limited)
Individuals	Thirst	Water
	Hunger	Food
	Sleep	Time
Society	Public goods	Tax revenues
	0% illiteracy rate	Schools
	0% unemployment rate	Jobs

Choice is therefore inevitable...

- In the face of scarcity, **choice** is inevitable.
- We want to make **rational** choices in order to make the most out of the relatively limited resources we have.
- A rational choice is one that puts more emphasis on the most pressing needs first and the less important ones later.
- It is one that maximizes benefits (gains) and minimizes costs (losses).

What is economics?

- Economics analyzes how choices are made.
- It is the field that analyzes the behavior of individuals, societies and Governments as they cope with the problem of scarcity.
- It is primarily interested in how economic agents allocate their relatively scarce resources in order to satisfy their unlimited needs.

The subfield of economics

- Again, the basic economic problem is the problem of scarcity.
- And as we saw, it is a universal problem (it exists in every single aspect of human life), therefore the principles of economics can be applied to a large range of human activities. Therefore, we have:
- Financial economics, mathematical economics, health economics, oil economics, development economics, business economics, agricultural economics...
- However, all these variations of economics can be grouped into two major subdivisions: **microeconomics** and **macroeconomics**.

Microeconomics

- “Micro” means small
- Microeconomics focuses on the study of the units that make up the entire economy. Some examples of these units are: people, individual households and individual industries.
- It deals with economics at the *micro* level:
 - The price of phones in Alabama, the demand for pork in Côte d’Ivoire, the profit earned by firms in the auto industry...

Macroeconomics

- “Macro” means big
- Macroeconomics is concerned with major economic totals or aggregates. Its focus is not on individual economic agents or individual markets but on the economy as a whole as it analyzes major economic indicators.
- It deals with economics at a *macro* level:
- Gross Domestic Product (GDP), inflation, aggregate demand/supply, unemployment rate...

Economic thinking

- Remember, choices are inevitable because of the problem of scarcity.
- Therefore, we need to make rational choices.
- However, making a rational choice requires a certain way of thinking.
- In order to make rational choices in the face of scarcity, we need to use *the economic thinking process*.
- *Economic thinking can be defined as way of looking at and analyzing the way the world works by comparing the cost of an action with the benefit generated.*
- Studying economics is making use of economic thinking in order to understand the issues related to the problem of scarcity.

The Five Foundations of Economics

- Economics can quickly become very complex and challenging.
- However, we can break it down into five fundamental components in order to make it more accessible:
 - Incentives
 - Trade-offs
 - Opportunity cost
 - Marginal thinking
 - Trade

Incentives

- Incentives are factors that motivate people to act.
- When faced with making a decision, we usually go for the alternative that gives us the greatest benefit.
- Your favorite team is playing tonight and you have an economics exam tomorrow. Will you watch the match or study for your exam?
- ‘Serious’ students will choose to study because they believe doing well in the exam would give them a greater benefit than watching the match (which might give them a heart attack!)
- *Our choices are driven by incentives.*

Positive and negative incentives

- Positive incentives encourage action.
 - Extra credits can be used to incentivize students to participate more in class
 - A tax cut in the agricultural sector is a good incentive for people to invest more in the sector
- Negative incentives also encourage action.
 - Tickets encourage people to follow the rules of driving.
 - Late payment penalties provide an incentive for people to make their rental payments within the time limit.

Direct and indirect incentives

- *A direct incentive is an action taken with the objective of causing another action (or other actions). It is easy to recognize.*
 - A gas station lowers gas price in order to attract more customers.
 - The Government provides unemployment benefits so that the unemployed do not live in abject poverty.

Direct and indirect incentives (2)

- *An indirect incentive is less easy to recognize. It is usually the unintended consequence of a direct incentive.*
- If gas price is lower, drivers may decide to travel more often than they used to.
- The unemployment benefits provided by the Government may provide an incentive to the unemployed NOT to actively look for a job.

Trade-offs

- You must be familiar with the expression: *“There ain’t no such thing as a free lunch.”*
- It is a clear depiction of the principle of trade-offs in economics.
- *To get something you like, you must give up something else that you also like. What you give up is called a cost.*
 - The money spent on books could have been used to buy clothes, shoes, a new laptop or a new phone.
 - The time spent studying economics could have been spent sleeping, playing video games, hiking or hanging out with friends.

Opportunity cost

- Because of trade-offs, we are often faced with hard decisions.
- When faced with many choices, *incentives* motivate us to choose so as to get the *highest benefit*.
- You have \$10 and you need the following:
 - . Food (\$6)
 - . Sunglasses (\$7)
 - . Hairstyle (\$8)
- The rational person would purchase food thereby giving up on the other two choices.

Opportunity cost (2)

- Now, we want to know what would your second choice be. Let's assume 'hairstyle'.
- This means that the most valuable alternative that was given up to buy food was 'hairstyle'.
- Hairstyle is called the opportunity cost (or the opportunity given up) to buy food.
- *The opportunity cost of a choice is the next-best alternative given up.*

Marginal thinking

- The economic thinking process involves assessing all the available opportunities in order to make the best decision available.
 - Marginal thinking is at the heart of economic thinking.
 - *It requires the evaluation of whether one more unit of something has higher additional benefits than additional costs.*
- If a company has 10 workers, the decision-makers will only hire one more worker if the additional benefit of hiring an additional worker (the revenue he/she will bring to the company) is higher than the additional cost (the salary that the company will pay him/her).

Marginal thinking (2)

- You just get your bachelor's degree and get a huge job opportunity. However, your parents advise you to go to grad school. You will actually go to grad school if you think the additional benefits provided in the job market by a master's degree outweigh the loss of the huge job opportunity.

Trade

- We have need for numerous goods and services daily: potatoes, bus rides, tables, ...
- Yet, we do not need to produce all of them ourselves (we all do not need to be farmers, and bus drivers, and carpenters at the same time)
- We only need to *specialize* and *trade*.
- Therefore, some people will specialize in farming, others in driving and so on and then sell their goods and/or services.

Trade (2)

- *Trade is the voluntary exchange of goods and services between two or more parties in markets.*
- *A market is an organizational setting that brings buyers and sellers of a particular good/service together.*
- Trade is usually beneficial for the parties involved even though the benefits can often be unequal.

You should now be able to...

- Explain the basic economic problem (scarcity) and give examples.
- Define the concept of rationality and explain why it is important.
- Explain what economics is.
- Identify the subfields of economics and explain what their focus is respectively.
- Explain what economic thinking is
- Identify and explain the five foundations of economics

THANK YOU 😊