



ECONOMICS



- ☀️ The word economy comes from a Greek word "oikonomia" for "one who manages a household."
- ☀️ is the study of how society manages its scarce resources.
- ☀️ Traditionally - land, labor, and capital resources
- ☀️ Entrepreneurial abilities :
Time, money, energy, etc.

+ What is Economics?

- That way of *unders tanding* behavior that starts from the assumption that individuals have objectives and tend to *choose* the correct way to achieve them (Friedman, 1996).
- . The study of how societies use *scarce resources* to produce valuable commodities and distribute them among different people (Samuelson & Nordhaus, 2000).
- The study of how individuals and societies choose to use scarce resources that nature and previous generations have provided. (Case and Fair, 2002)

+ Why Study economics?

- To learn a way of thinking for decision making
 - opportunity cost, marginalism, sunk cost, efficient markets “no free lunch”
- To understand global affairs
 - trade ,OFWs, MNCs,
- To understand society
 - utility,, externalities, public good,
- To get the connections between
 - Disciplines
 - Countries
 - People





Scarcity . . .

- . . . means that society has limited resources and therefore cannot produce all the goods and services people wish to have.



Resources

Human

People working to produce goods and services



Capital

Goods made by people and used to produce other goods and services (machines, tools, buildings)



Natural

Materials that come from nature (water, soil, wood, coal)



+ Scarcity and Choice



- All resources are scarce, so a decision to have more of one thing is a decision to have less of something else.
- Cost of any decision is its opportunity cost – value of the next best alternative that is given up.



Scarcity and Individual Choice



- There are an unlimited variety of scarcities, however they are all based on two basic limitations
 - Scarce time
 - Scarce spending power
- Limitations force each of us to make choices
- Economists study
 - choices we make as individuals, and consequences of those choices
 - more subtle and indirect effects of individual choice on our society



Scarcity and Social Choice

- Resources in our society —land, labor, and capital—are limited
- Scarcity of Labor
 - Time human beings spend producing goods and services
- Scarcity of Capital
 - Something produced that is long-lasting, and used to make other things that we value
 - Human capital
 - Capital stock
- Scarcity of land/natural resources
 - Physical space on which production occurs, and the natural resources that come with it
- Scarcity of entrepreneurship
 - Ability and willingness to combine the other resources into a productive enterprise





Agents and Scarcity in Economics



- Who are involved in resource allocation?
 - *Households* allocate limited income / time among goods and services
 - *Business firms* choices of what to produce and how much are limited by costs of production
 - *Government* agencies work with limited budgets and must carefully choose which goals to pursue
- Economists study these decisions to
 - Explain how our economic system works
 - Forecast the future of our economy
 - Suggest ways to make that future even better



Opportunity Cost - Concept



- Remember that scarcity in time and money results in choice making in real world
- Definition: *Opportunity cost of any choice*
 - What we forego when we make that choice
- Most accurate and complete concept of cost we should use when making decisions



Opportunity Cost - Components



- Direct money cost of a choice may only be a part of opportunity cost of that choice

- Opportunity cost of a choice

= explicit costs + implicit costs

- Explicit cost—pesos actually paid out for a choice (Accounting cost)
- Implicit cost—value of something sacrificed when no direct payment is made

+ Opportunity Cost and Society



- Resources in whole society are limited.
- All production carries an opportunity cost
 - To produce more of one thing
 - Must shift resources away from producing something else
- No free lunch!



Microeconomics vs Macroeconomics

- Micro
 - Micro comes from Greek word *mikros*, meaning “small”
- Microeconomics
 - Study of behavior of individual households, firms, and governments
 - Choices they make
 - Interaction in specific markets
- Focuses on individual parts of an economy, rather than the whole



+ Microeconomics vs Macroeconomics



- Macro
 - Macro comes from Greek word, *makros*, meaning “large”
- Macroeconomics
 - Study of the economy as a whole
- Focuses on big picture and ignores fine details

+ Microeconomics and Macroeconomics



- **Microeconomics** is the study of individual choice, and how that choice is influenced by economic forces.
- **Macroeconomics** is the study of the economy as a whole.



Microeconomics and Macroeconomics



- **Micro**economics studies such things as:
 - the pricing policy of firms.
 - households decisions on what to buy.
 - how markets allocate resources among alternative ends.
- **Macro**economics deals with:
 - inflation.
 - unemployment.
 - economic growth.



Microeconomics



- Scarcity, opportunity cost and comparative advantages
- Price determination -- theory of Supply and Demand
- Elasticities
- Consumer Choice
- Production and cost, Producer Choice
- Perfect competition and imperfect competition
- Labor market and Economic Inequality
- Capital and investment
- Economic Efficiency



division	production	prices	income	employment
micro	Output in industries	Individual price of goods and services	wages	Work in each industry
macro	National output	Price index, inflation	National income	Unemployment rate

+ For Policy Analysis



- **Positive economics** – the study of what is, and how the economy works.
- **Normative economics** – the study of what the goals of the economy should be.



Positive Economics v.s. Normative Economics

- Positive economics
 - Study of how economy works
 - Accessing the expected, objective outcomes
 - Accuracy of positive statements can be tested by looking at the facts—and just the facts



Positive Economics v.s. Normative Economics



■ Normative Economics

- Study of what should be
 - Used to make value *judgments*, identify problems, and prescribe solutions
 - Statements that suggest what we *should do* about economic facts, are normative statements
 - Based on values
 - Normative statements cannot be proved or disproved by the facts alone



Positive and Normative Economics

- PhilHealth can be improved with more tax funding
 - Pollution control is effective through a system of fines
 - PagIbig ought to provide homes for all
 - Any strategy aimed at reducing factory closures in deprived areas would be helpful
- Positive Statements:
 - Capable of being verified or refuted by resorting to fact or further investigation
 - Normative Statements:
 - Contains a value judgement which cannot be verified by resort to investigation or research



- **Positive statements** are about *what is*.
 - Can be proven right or wrong.
 - Can be tested by comparing it to facts.

Example: “Universal health care will cut the amount of work time lost to illness”.

- **Normative statements** are about *what ought to be*.
 - Depend upon personal values and cannot be tested.

Example: “Every Filipino should have equal access to health care”.

+ The Methods of Economics



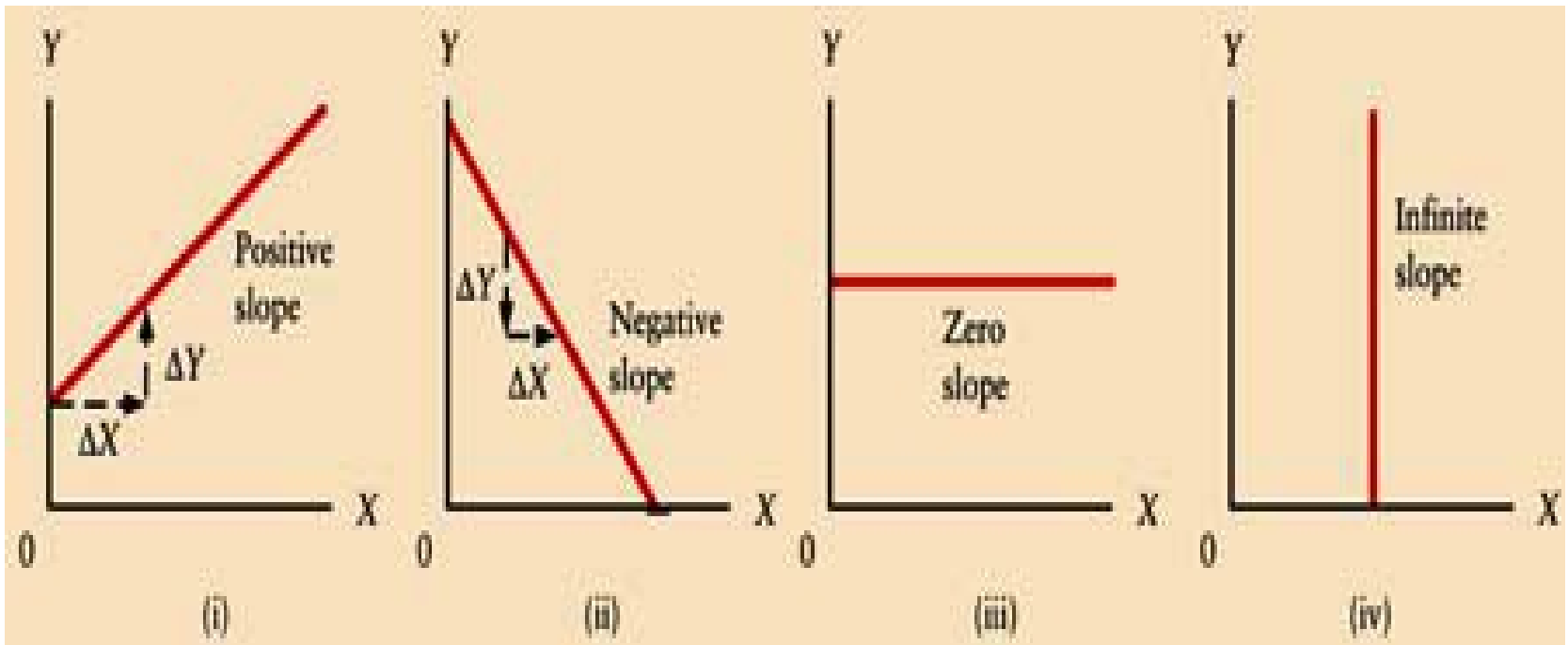
- Modeling
 - Model: Abstract representation of reality
 - Economic theories must have a well-constructed model
- While most models are physical constructs
 - Economists use words, diagrams, and mathematical statements

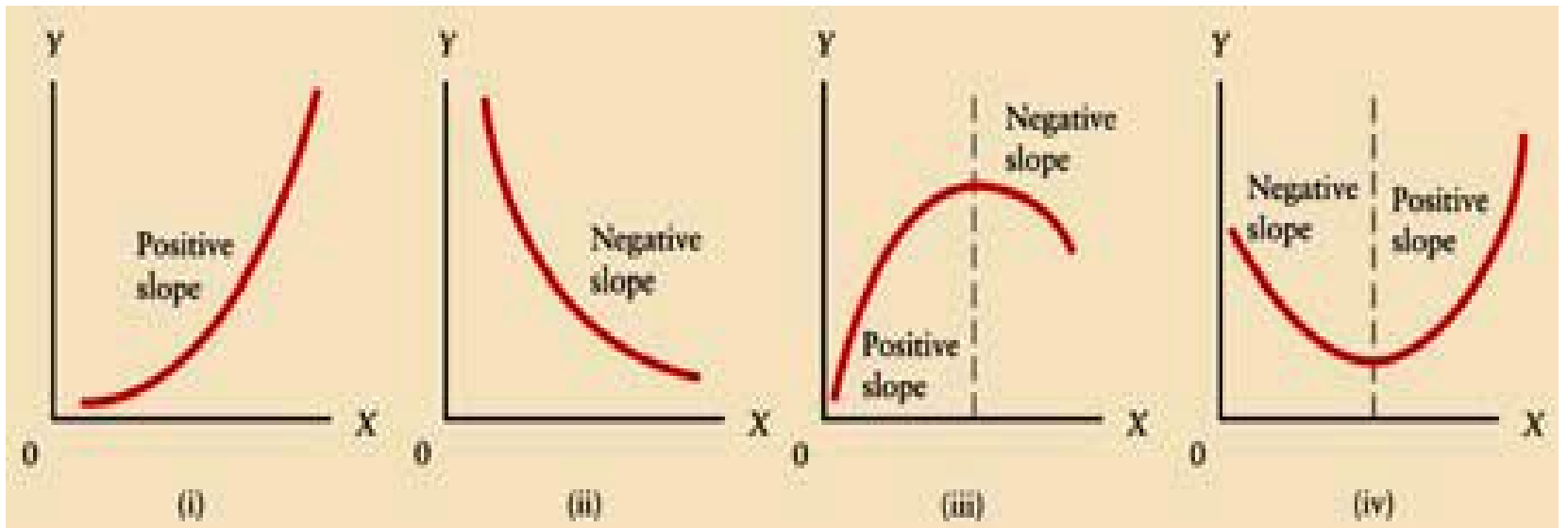


Prelims: graphs and pitfalls



- Graphs and slopes (refer to the lecture)
- Pitfalls
 - Post hoc, ergo propter hoc = “after this (in time) therefore because of this” (correlation as opposed to causation)
 - Fallacy of Composition = The belief that what is true for a part is necessarily true for the whole
 - Objectivity
 - Failure to keep other things constant (ceteris paribus)





+ The Economic Problem

- Microeconomic issues
 - choices:
 - what
 - how
 - for whom
 - the concept of opportunity cost
 - rational decision making
 - weighing up marginal costs and marginal benefits
 - the social implications of choice



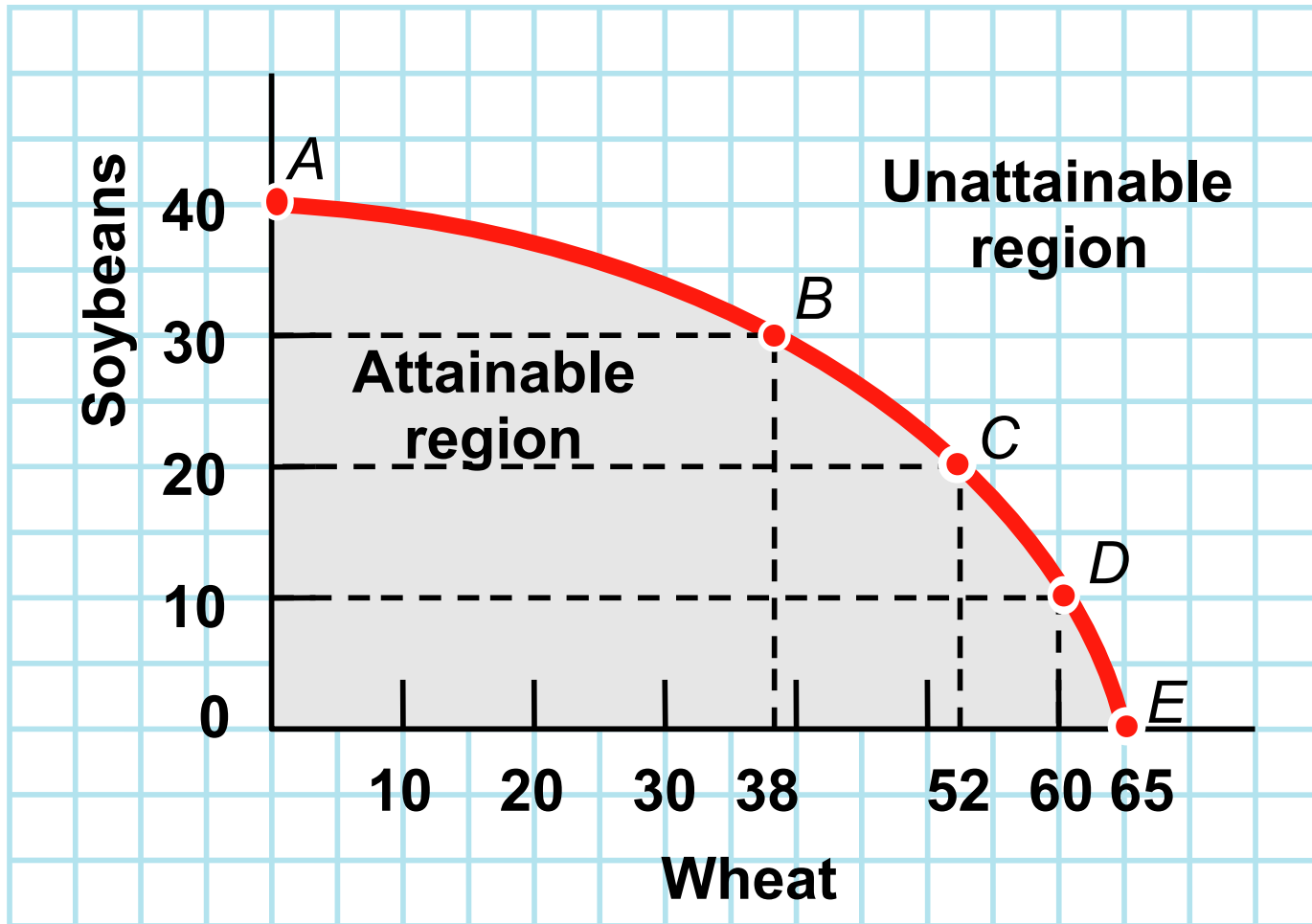


Production Possibilities Frontier



- Production Possibilities Frontier (PPF) shows the combinations of two goods that can be produced with resources and technology available

FIGURE 1. PPF for a Farmer

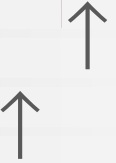


Features of the PPF

- Negatively sloped
 - \uparrow Q wheat by moving resources out of soybean production and into wheat production
- Slope = opportunity cost
- Bowed outward
 - \uparrow Opportunity cost of wheat as \uparrow wheat production
 - **Why?** Inputs tend to be specialized. E.g., some land may be better suited for wheat vs. soybean production.

Principle of Increasing Costs

- Principle of increasing costs:
production of one good \Rightarrow
opportunity cost of producing another unit
- PPF is bowed outward
- Reason: inputs tend to be specialized



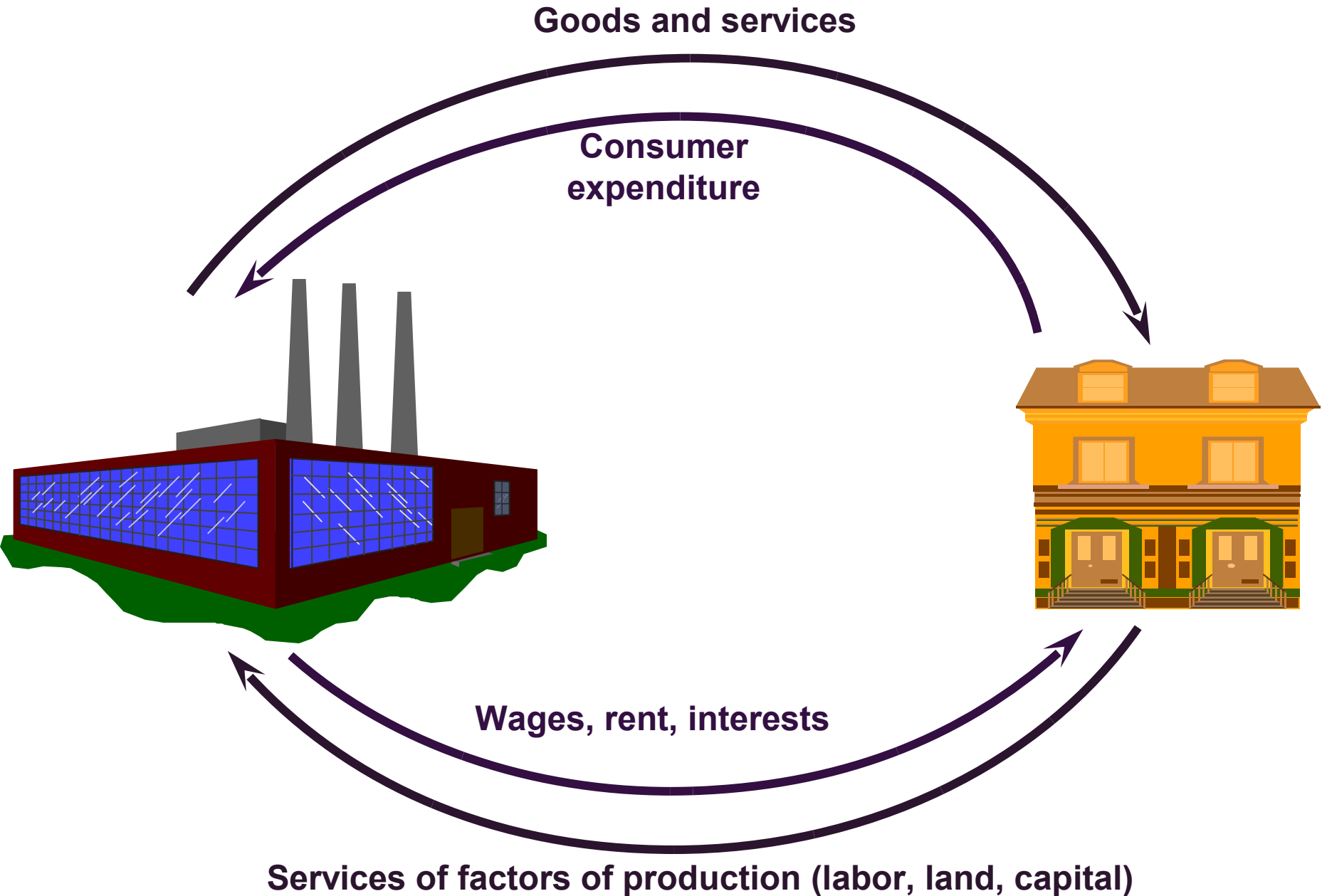
+ Characteristics of PPF

- The points on the curve show the maximum number of goods capable to be produced
 - Unit in the horizontal and vertical axis is quantity of the two different goods
 - The points inside the curve show the possible other combinations of goods possible to be produced
 - Inefficient production
 - The shape of the curve is concave toward the origin in most cases
 - The law of increasing opportunity cost
 - The points outside the curve show the impossible combinations of goods
- Society's choices are limited to points *on* or *inside* the PPF

+ Economic Growth

- Many factors contribute to economic growth, but they can be divided into two categories
 - Quantities of available resources—especially capital—can increase
 - An increase in physical capital enables economy to produce more of everything that uses these tools
 - More factories, office buildings, tractors, or high-tech medical equipment
 - Same is true for an increase in human capital
 - Skills of doctors, engineers, construction workers, software writers, etc.
 - Technological change enables us to produce more from a given quantity of resources
 - Capital and technological change usually go hand in hand

The circular flow of goods and incomes



+ The Economic Problem

- The circular flow of income
 - firms and households
 - goods markets
 - real flows: goods and services
 - money flows: consumer expenditure
 - factor markets
 - real flows: services of labor and other factors
 - money flows: wages and other incomes

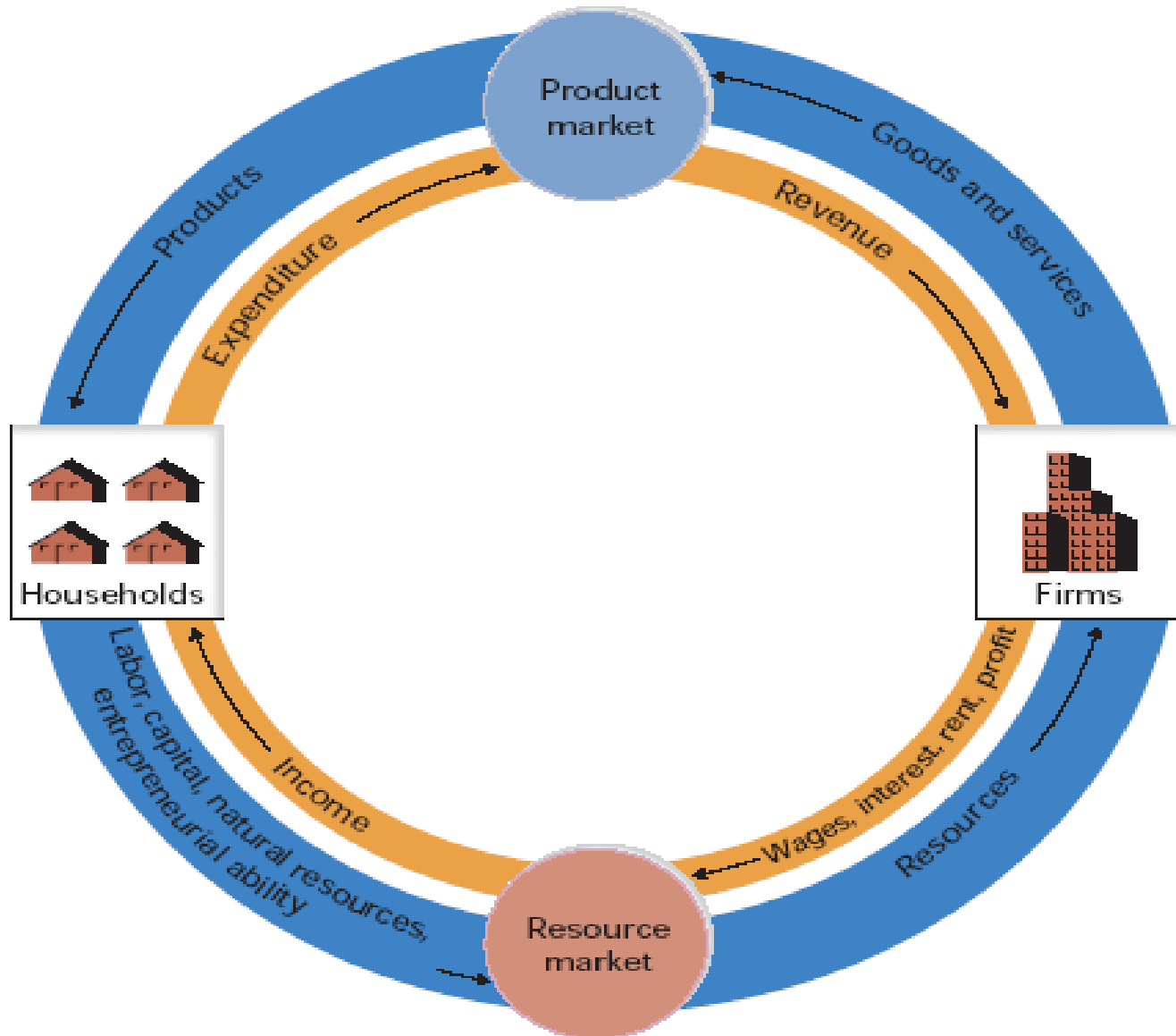


+ The Economic Problem

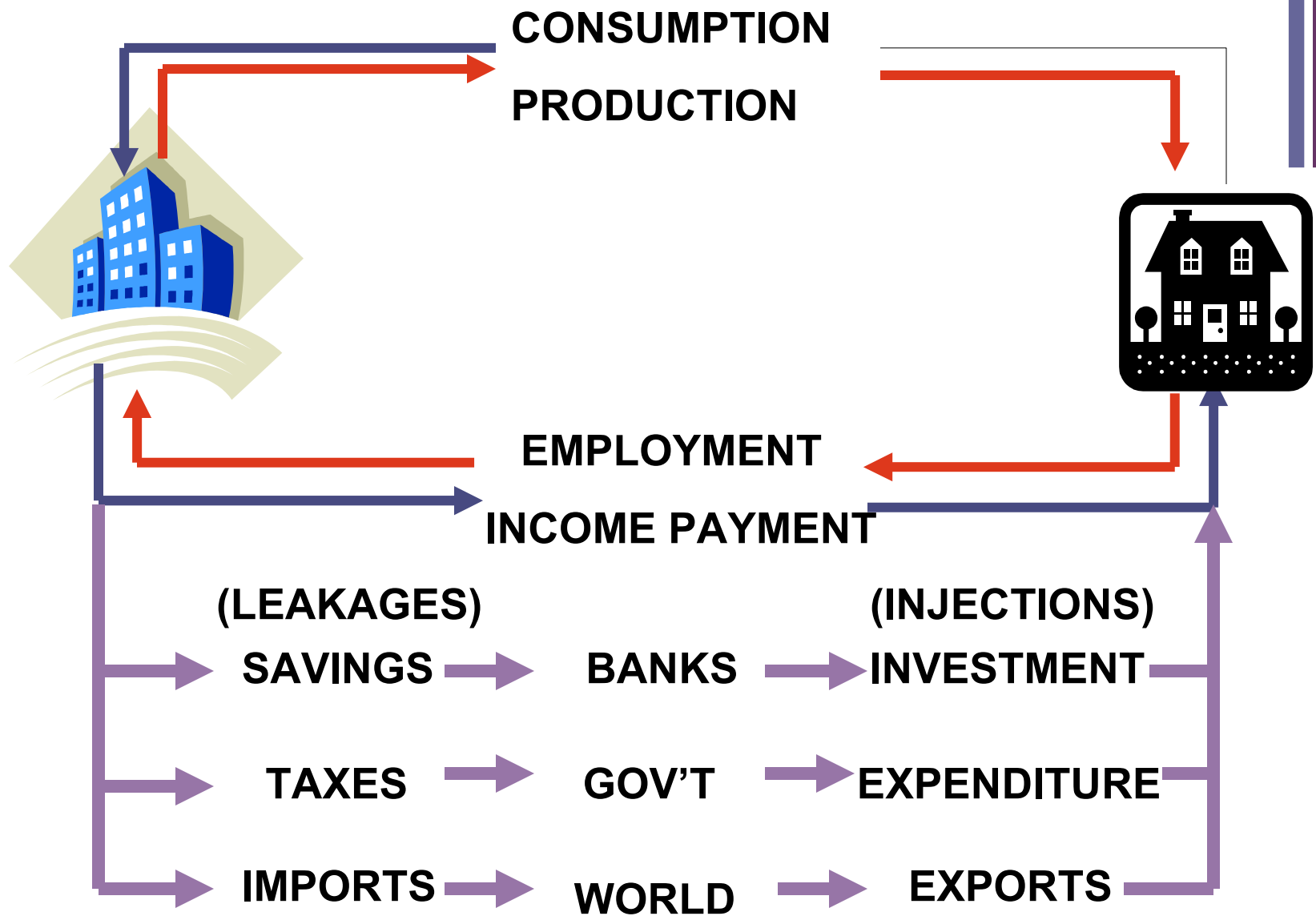


- The circular flow of income (cont.)
 - macroeconomic issue
 - the size of total flows
 - microeconomic issue
 - individual markets
 - choices within goods and factor markets

+ The Simple Circular-Flow



The Circular-Flow Diagram



+ Three Big Questions

What

How

Whom

+What?

- **What** goods and services are produced ?

(Do we produce houses or rice?)

- Five largest categories of goods: construction, electronic equipment, food, industrial equipment and chemicals.

+How?

How are goods and services produced?

Do we use humans or machines to produce the goods we want?

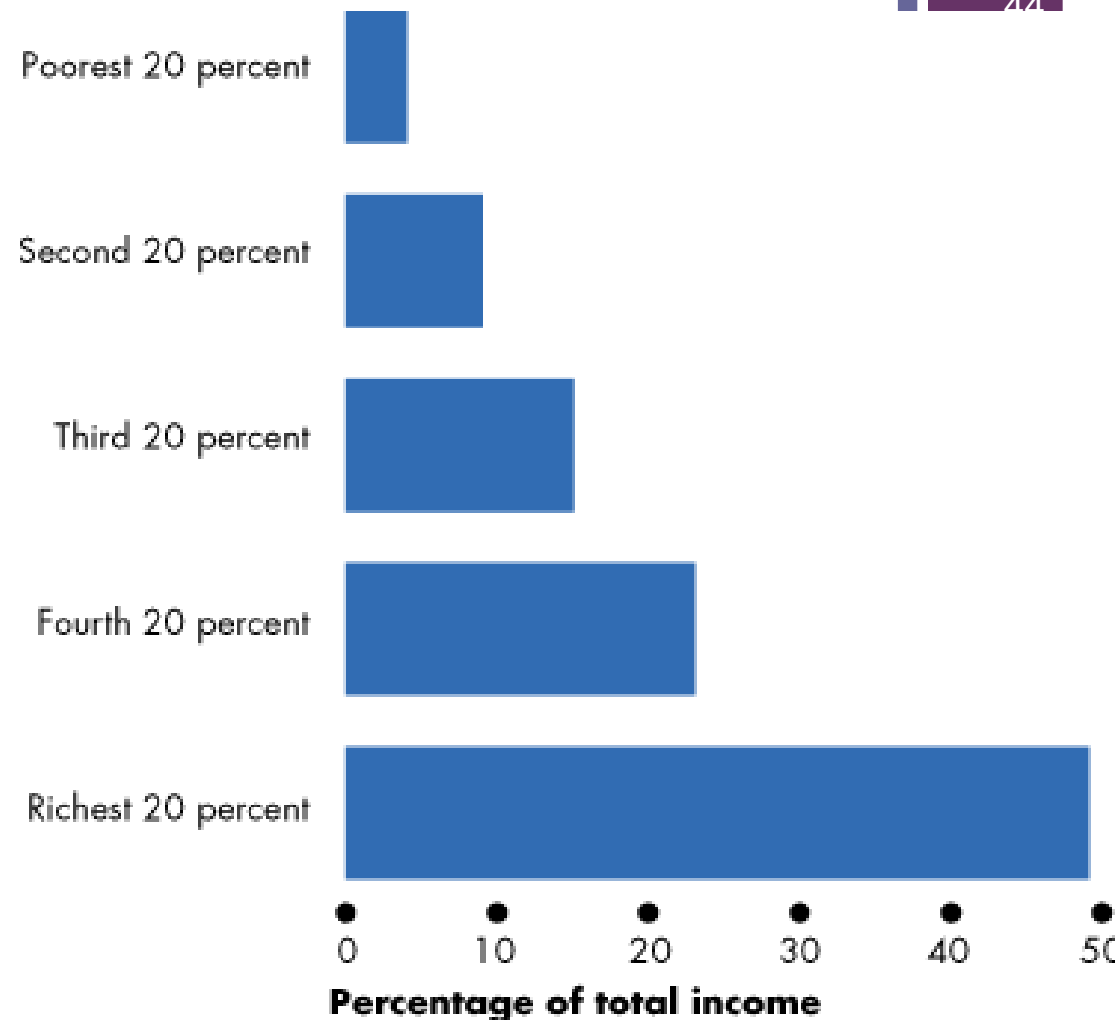
- There are four categories of factors of production:
 - land, “gift of nature”
 - labor, work time and work effort
 - human resources—quality of labor: education, training, experiences
 - Capital, tools, instruments, machines, buildings and other constructions
 - Entrepreneurship, who organizes land, labor and capital

+ Whom?

- For whom are goods and services produced? It depends on the incomes that people earn.
 - Land earns rent.
 - Labor earns wages.
 - Capital earns interest.
 - Entrepreneurship earns profit.



- Figure shows the distribution of income.
- The richest 20 percent earn almost 50 percent of total income while the poorest 20 percent earn only 4 percent of total income.



+ Important Ideas (Market economy)

- Free Enterprise
- Consumer sovereignty
- Private Property
- Invisible Hand
- Many buyers and sellers
- Free entry
- Minimal government intervention (all most zero)

+ Important Ideas (command economy)

- Equity vs equality
- Economic stability (GNP, GDP, Inflation, Unemployment rate)
- Economic security
- Economic growth
- Regulatory powers
 - Externalities
 - Public goods
 - Subsidies, transfer payments



	sellers	products	entry	Defining characteristics
Perfect competition	Many (price-taker)	Homogenous (w/ substitutes)	Free entry	Price competition
Monopolistic competition	Many (limited price-setting)	differentiated	Free entry	Price and quantity competition
Oligopoly	Few (price-setting)	either	limited	Strategic behavior (cartel and collusion)
Monopoly	One (price-setting)	unique	w/ restrictions	Price setting



+ Households and firms

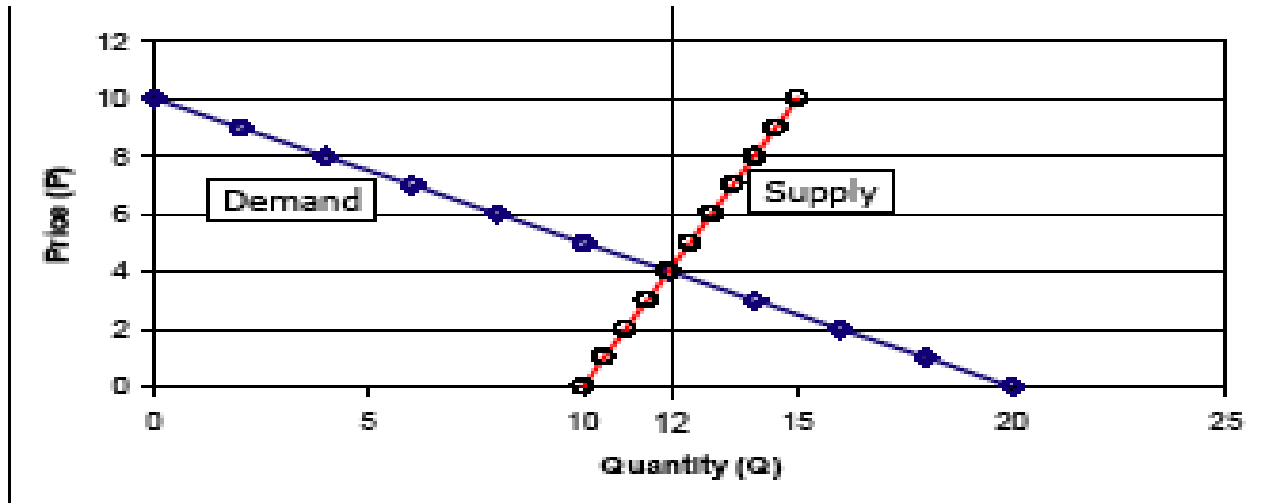
- DEMAND
 - Schedule
 - Curve
 - Equation

Supply
schedule
curve
equation



+ Solving sets of equations

- It is often useful to depict a competitive market by using specific functions to represent the respective demand and supply for a good.
- For example, consider the Demand and Supply of apples:
- Demand: $Q_D = 20 - 2P$
- Supply: $Q_S = 10 + 0.5P$
- We need to solve for the Price and Quantity of apples by setting $Q_D = Q_S$. This is the competitive outcome and will ensure that there are no shortages or surpluses of apples in this market.



We need two points to plot a line:

■ Demand: $Q_D = 20 - 2P$

$P = 0, Q_D = 20; Q_D = 0, P = 10$

■ Supply: $Q_S = 10 + 0.5P$

$P = 0, Q_S = 10; P = 4, Q_S = 12$

+ Solving for P and Q



- QD = QS implies

$$20 - 2P = 10 + 0.5P$$

$$20 - 10 = 2P + 0.5P$$

$$10 = 2.5P$$

$$P = 10 / 2.5$$

$$= 4$$

- With $P = 4$, QD = QS = 12



Movement along the same curve for both D & S is caused by PRICE



- Shifting of the Demand Curve
 - Income
 - Population
 - Change in taste, preferences, expectations
 - Price of related goods
 - Substitutes or complements



- Shifting of the Supply Curve
 - No. of Producers
 - Price of Inputs
 - Technology
 - Price of related products
 - Production substitutes or complements



- Income Effect
 - Normal good
 - Inferior good
 - Superior good

- Substitution Effect
 - Necessities and Luxuries

