

Unit 1: Introduction to Economics

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Assessment Objectives

SL/HL Content: Learning Objectives

AO2	Explain the social nature of economics
AO2	Distinguish between microeconomics and macroeconomics
AO2	Introduction to the nine central concepts: scarcity, choice, efficiency, equity, economic well-being, sustainability, change, interdependence, intervention
AO2	Explain the meaning of scarcity. – as unlimited human needs and wants met by limited resources – in relation to sustainability
AO2	Identify and explain the four factors of production
AO2	Explain the meaning of opportunity cost and its relationship to choice and free goods

What is economics?

- The economic problem is that of having unlimited wants but a limited supply of economic resources with which to satisfy them.
- **Economics** is the study of choices leading to the best possible use of scarce resources in order to best satisfy unlimited human needs and wants.
 - ▶ It is a social science because it deals with human society and behaviour
 - ▶ The economics approach is based on the scientific method
- There are two central questions that will be used to explore and motivate our discussion throughout the course.
 1. How do people and firms respond to incentives?
 2. How do we allocate scarce resources with alternative uses?

Branches of economics

- Economics can be divided into two main branches.
1. **Microeconomics** is the branch of economics that examines the behaviour of individual decision-making units, consumers and firms.
 - ▶ It is concerned with consumer and firm behaviour and how their interactions in markets determine prices in goods markets and resource markets.
 2. **Macroeconomics** is the branch of economics that examines the economy as a whole by use of aggregates, which are wholes or collections of many individual units such as output of the entire economy as well as total employment and the general price level.
 - ▶ It is concerned with economy-wide issues such as unemployment, inflation, and growth. [[Website of macroeconomic indicators](#)]

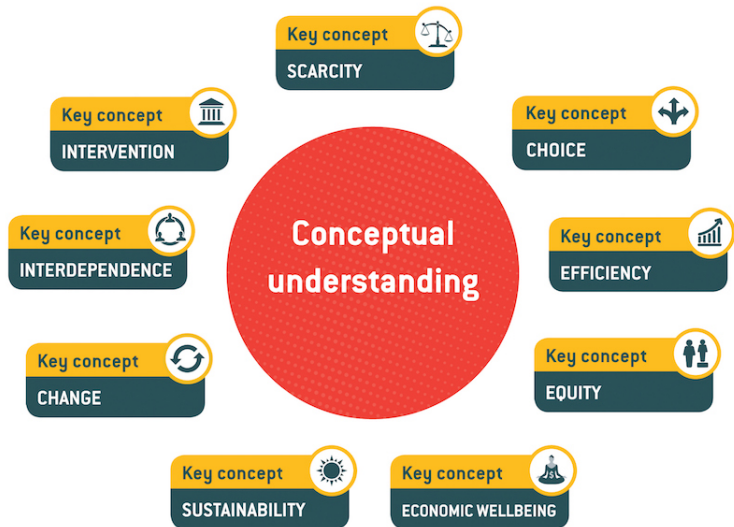
Central concepts

- There are nine central concepts that guide the field of economics and that you will encounter throughout the course.
1. **Scarcity** refers to the idea that resources are insufficient to satisfy unlimited human wants and needs.
 2. **Choice** refers to the fact that since resources are scarce, choices must be made about what will be produced and what will be forgone.
 - ▶ Choices must be made between competing alternative options
 3. **Efficiency** refers to making the best possible use of scarce resources to avoid resource waste.
 - ▶ **Productive efficiency** means using the fewest resources possible to produce goods and services.
 - ▶ **Allocative efficiency** means producing the goods and services that most satisfy society's needs and wants.

4. **Equity** refers to the idea of being fair or just.
 - ▶ Fairness is a normative concept because ideas of what is fair vary according to beliefs, value judgements and ideologies.
 - ▶ Governments face a trade-off between equity and efficiency when intervening in markets.
5. **Economic well-being** refers to levels of prosperity, satisfaction and standards of living among members of society.
6. **Sustainability** refers to the long-term maintenance or viability of any particular activity or policy.
 - ▶ Ability of the present generation to satisfy its needs by the use of resources without limiting future generations' ability to satisfy their own needs.

7. **Change** refers to the dynamism in economic theory and in real-world events.
 - ▶ Real-world phenomena is characterized by continuous change in the institutional, technological, social, political and cultural environments in which economic events occur.
8. **Interdependence** refers to the idea that economic decision-makers interact with and depend on each other.
9. **Intervention** refers to government involvement with the workings of markets.
 - ▶ Market failure provides a justification for government intervention into free markets.
 - ▶ Free markets on their own often fail to achieve equity, sustainability, economic well-being or efficiency

Central concepts



Scarcity and choice

- **Scarcity** is the situation in which available resources, or factors of production, are finite, whereas wants are infinite. There are not enough resources to produce everything that human beings need and wants.
 - ▶ The fundamental problem of economics is having unlimited needs and wants but limited resources with which to satisfy them.
 - ▶ Wants and needs are satisfied by physical objects called **goods** (food, clothing, housing, television, car etc.) and non-physical activities called **services** (education, health care, entertainment, banking, travel etc.)
 - ▶ Due to limited resources, economic agents must continually make choices.
 - ▶ Since resources are scarce, it is important to avoid waste in how they are used.

Test your understanding

Question: Explain why diamonds are far more expensive than water, even though diamonds are a luxury while water is a necessity without which we cannot live.

Paradox of value



Economic choice

- Economic choices are made according to the following four principles.
1. **Self-interest motive** refers to the assumption that individuals are rational and pursue their own self-interest and are primarily concerned with their own welfare.
 - ▶ Economic agents will continually compare the costs and benefits of their actions when making choices.
 2. **Utility maximization** refers to maximizing the satisfaction that one expects to receive from owning and using an economic good or service.
 - ▶ Economists assume that whenever you make an economic choice that you are trying to maximize your own utility.

3. **Opportunity cost** refers to the cost of any activity measured in terms of the best alternative activity that is forgone.
 - ▶ Economic agents must keep in mind the opportunity cost of each alternative when making decisions
4. **Profit maximization** refers to the assumption that firms supply consumers to maximize their own profit.
 - ▶ Firms may pursue alternative objectives, but the primary objective of the firm is to maximize profits

Scarcity and sustainability

- **Sustainability** refers to maintaining the ability of the environment and the economy to continue to produce and satisfy needs and wants into the future.
 - ▶ Economic activities in many countries are often achieved at the expense of the natural environment and natural resources.
 - ▶ Sustainability depends on **sustainable resource use** referring to the preservation of the environment over time.
 - ▶ The problem of sustainability arises because resources are scarce.
 - ▶ **Sustainable development** involves meeting the needs of the present without compromising the ability of future generations to meet their own needs.

Resources as factors of production

- **Economic resources** are the scarce resources that are used to produce economic goods and are called factors of production. These fit into one of four categories.
1. **Land** refers to any factor of production that is provided by nature.
 - ▶ Consists of all natural resources as well as everything that is under or above the land.
 - ▶ **Example(s):** Minerals, oil reserves, forests and lakes
 2. **Labour** refers to the human input into the production process
 - ▶ Includes the physical and mental effort that people contribute to the production of goods and services.
 - ▶ **Example(s):** Efforts of a doctor, taxi driver, and construction worker

Resources as factors of production

3. **Capital**, also known as physical capital, is the man-made factor of production used to produce goods and services.
 - ▶ Physical capital is also referred to as a capital good or investment good
 - ▶ **Example(s):** Machinery, tools, factories, road systems and harbours
4. **Entrepreneurship (Management)** refers to the resource that organizes the other three factors of production and takes on the risks of success or failure of a business.
 - ▶ It is the human skill involving the ability to innovate, to take business risks and seeks new opportunities for opening and running a business
 - ▶ **Example(s):**
Elon Musk (CEO of Tesla) and Jeff Bezos (CEO Amazon)

Other types of capital

- Capital, in the most general sense, refers to resources that can produce a future stream of benefits.
- **Physical capital** refers one of the factors of production consisting of man-made inputs that provide future benefits in the form of the ability to produce greater quantities of output.
- **Human capital** refers to the skills, abilities and knowledge acquired by people, as well as good levels of health, all of which make them more productive.
- **Financial capital** refers to investments in financial instruments, like stocks and bonds, or the funds that are used to buy financial instruments.
- **Natural capital** refers to an expanded meaning of land resources and includes additional natural resources such as the global climate.

Opportunity Cost

- **Opportunity cost** is the value of the next best alternative that must be sacrificed to obtain something else.
 - ▶ Every time we choose to do something, we give up something else we could have done instead
 - ▶ Opportunity cost is central to the economic perspective of the world and results from the scarcity that forces choices to be made.
 - ▶ **Example(s):** The opportunity cost of university is the sum of your university expenses plus the money you could have earned had you chosen to work

Test your understanding

Question: Think of three choices that you have made during the past week and describe the opportunity cost of each one.

Free and economic goods

- **Free good** is any good that is not scarce, and therefore has a zero opportunity cost.
 - ▶ Since it is not limited by scarcity, it includes anything that can be obtained without sacrificing something else.
- **Economic good** is any good that is scarce, either because it is a naturally occurring scarce resource, or because it is produced by scarce resources.
 - ▶ Sometimes a good can be a free good in certain situations and an economic good in others
 - ▶ **Public goods** and **common pool resources** are two categories of goods that are available free of charge, but which do have opportunity costs and are therefore economic goods.

Test your understanding

Question: Identify which of the following goods are “free goods” and explain why:

1. Public parks
2. Sand in the Sahara desert
3. Garbage collection
4. Free health care services
5. Wildlife