INTRODUCTION OF ECONOMICS

# THE SCOPE AND METHOD OF ECONOMIC

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# 2 SESSIONS

- 28/3/09 ( 10 00 -12 00 ) :
  SUPPLY, DEMAND, PRICE SYSTEM :
  THE LAW OF DEMAND
  THE LAW OF SUPPLY
  PRICE & ALOCATION RESOURCE

- 7/3/09 (10 00 – 12 00 ) :
  MARKET STRUCTURE :
  PERFECT COMPETITION
  MONOPOLY
  MONOPOLISTIC COMPETITION & OLIGOPOLY

# DEMAND, SUPPLY, PRICE, AND MARKET EQUILIBRIUM

# WHY STUDY ECONOMICS?

- To learn a way of global thinking, opportunity cost, marginalism and sunk cost, efficient market

Opportunity cost: the best alternative that we forgo, or give up, when we make a choice or a decision

Marginalism : the process of analyzing the additional or incremental costs or benefits arising from a choice or decision.

Sunk Costs: costs that cannot be avoided, regardless of what is done in the future, because they have already been incurred.

Efficien Market : a market in which profit opportunities are eliminated almost instantaneously

- To understand society, past and present economic decisions have an enormous influence on the character of life in a society.

- To understand the global affairs, the destruction of the World Trade Center towers in New York City and the subsequent war on terror in Afghanistan and elsewhere led to a huge decline in both tourism and business travel.

- To be an informed voter, as we approach the election of 2008, the important issues will be determined to a large extent by the performance of the economy during the years prior the election. Will the economy continue to grow or will it still slip into recession? Will unemployment rise or fall?

# THE SCOPE OF ECONOMICS

- Microeconomics, the branch of economics that examines the functioning of individual industries and the behavior of individual decision making units-that is, business firms and households.

- Macroeconomics, the branch of economics that examines the economic behavior of aggregates-income,employment, output,and so on- on a national scope.

# THE METHOD OF ECONOMICS

- Positive economics, an approach to economics that seeks to understand behavior and the operation of systems without making judgments. It describes what exists and how it works.

- Normative economics, an approach to economics that analyzes outcome of economic behavior, evaluates them as good or bad, or may prescribe courses of action. Also called policy economics.

- Descriptive economics, the compilation of data that describe phenomena and facts.

- Economics theory, a statement or set of related statements about cause and effect, action and reaction

# ECONOMIC POLICY

- Efficiency, an efficient economy is one that produces what people want at the least possible cost.
- Equity, fairness
- Economic Growth, an increase in the total output of an economy.
- Stability, a condition in which national ouput is growing steadily, with low inflation and full employment of resources.

# FIRM AND HOUSEHOLDS : THE BASIC DECISION-MAKING UNITS

- Firm, an organization that transforms resources (inputs) into products (outputs).Firms are the primary producing units in a market economy.

Household, the consuming units in an economy

- Enterpreuner, a person who organizes, manages, and assumes the risks of a firm, taking a new product and turning it into a successful business.

# INPUT MARKETS AND OUTPUT MARKETS : THE CIRCULAR FLOW

- Product or output market, the markets in which goods and services are exchanged
- Input or factor markets, the market in which the resources used to produce products are exchanged
- Labor market, the input/factor market in which households supply work for wages to firms that demand labor.
- Capital market, the Input / factor market in which households supply land or other real property in exchange for rent.
- Land market, the input/ factor market in which households supply land or other real property in exchange for rent
- Factor of production, the inputs into the production process. Land, labor, and capital are three key factor of production.

# DEMAND IN PRODUCT

- Quantity demanded, the amount of a product that a household would buy in a given period if it could buy all it wanted at the current market price.
- Demand schedule, a table showing how much of a given product a household would be willing to buy at different price.
- Demand curve, a graph illustrating how much of a given product a household would be willing to buy at different prices.
- Law of demand, the negative relationship between price and quantity demanded : As price rises, quantity demanded decreases. As price falls, quantity demanded increases.

# OTHER DETERMINANTS OF HOUSE HOLD DEMAND

- Income, the total value of what a hof all a household's wages, salaries, profits, interest payments, rents, and other forms of earnings in a given period of time.
- Welth or net worth, the total value of what a household owns minus what it owes.
- Normal goods, goods for which demand goes up when income is higher and for which demand goes down when income is lower.(movie,meals, calls, shirt)
- Inferior goods, goods for which demand tends to fall when income rises. (bus)
- Substitutes, goods that can serve as replacements for one another, when the price of one increase, demand for the other goes up.

# FROM HOUSEHOLD DEMAND TO MARKET DEMAND

Market demand, the sum of all the quantities of a good or service demanded per period by all the households buying in the market for that good or service.

Profit, the differece between revenues and cost.

# PRICE AND QUANTITY SUPPLIED : THE LAW OF SUPPLY

- Quantity supplied, the amount of a particular product that a firm would be willing and able to offer for sale at aparticular price during a given time period.

- Supply schedule, a table showing how much of a product firms will sell at different prices.

- Law of supply, the positive relationship between price and quantity of a good supplied: an increase in market price will lead to an increase in quantity supplied, and decrease in market price will lead to a decrease in quantity supplied.

# MARKET EQUILIRIUM & EXESS DEMAND

- Market equilibrium, the condition that exists when quantity supplied and quantity demanded are equal. At equilibrium, there is no tendency for price to change.

- Excess demand or shortage, the condition that exist when quantity demanded exeeds quantity supplied at the current price.

# EXESS SUPPLY

- Exess supply, or a surplus, the condition that exists when quantity supplied exceeds quantity demanded at the current price.

# DEMAND AND SUPPLY APPLICATION

- Price rationing, the process by which the market system alocated goods and services to consumers when quantity demanded exeeds quantity supplied

- Price ceiling, a maximum price that sellers may charge for a good, usually set by government

# PRICES AND THE ALLOCATION OF RESOURCES

- Price floor, a minimum price below which exchange is not permitted
- Minimum wage, a price floor set under the price labor.

# SUPPLY AND DEMAND AND MARKET EFFICIENCY

- Consumer surplus, the difference between the maximum amount a person is willing to pay for a good and its current market price. (5$ vs 2.5$)

- Cost benefit of analysis, the formal teqnique by which the benefits of a public project are weighted against its costs.

- Producer surplus, the difference between the current market price and the full cost of production for the firm.(0.75$ vs 2.5$)

# ELASTICITY

- Elasticity, a general concept used to quantify the response in one variable when another variable changes.

- Price elasticity of demand, the ratio of the precentage of change in quantity demanded to the precentage of change in price; measures the responsiveness of quantity demanded to changes in price.

# HOUSEHOLD BEHAVIOR AND CONSUMER CHOICE

- Perfect competition, an industry structure in which there are many firms, each small relative to the industry and producing virtually identical products, and in which no firm is large enough to have any control over prices.

- In a perfectly competitive industry, no single firm has any control over prices. That is no single firm firm is large enough to affect the market price of its product.

- The key assumption is that all market are perfectly competitive.

# HOUSEHOLD CHOICE IN OUTPUT MARKET

- Budget constraint, the limit imposed on household choices by income.
- Real income, set of opprtunities to purchase real goods and services available to a household as determined by prices and money income.
- Determinant of household demand, price,income, accumulated wealth, price of other product, taste and preference, expectation about future income/wealth/prices.

# THE BASIS OF CHOICE: UTILITY

- Utility, the satisfaction,or reward, a product yields relative to its alternative.The basis of choice.

- Total utility, the total amount of satisfaction obtained from consumption or use of one or more unit of something.

# HOUSEHOLD CHOICE IN INPUT MARKET

- Labor supply decision, households face constrained choices in input market. They must decide whether to work, how much to work, what kind of job to work at.

- The price of leisure, households must choose among goods, services, and leisure.

- Household may also decide to save and borrow.

  Save: using current income to finance future spending.
  Borrow : it finances current purchases with future income.

# THE PRODUCTION PROCESS : THE BEHAVIOR OF PROFIT MAXIMIZING FIRMS

- The behavior of profit-maximizing firms : profits and economic costs.
- Normal rate of return, a rate of return on capital that is just sufficient to keep owners and investors satisfied.
- Short run, the period of time for which two conditions hold : The firm is operating under a fixed scale of production and firms can neither enter nor exit an industry.
- Long run, that period of time for which there are no fixed factor of production : Firms can increase or decrease the scale of operation and new firms can enter and existing firms can exit the industry.

# SHORT-RUN COST AND OUTPUT DECISION

- Fixed cost, any cost that does not depend on the firm's level of output. These costs are incurred even if the firm is producing nothing.
- Variable cost, a cost that depends on the level of production chosen.
- Total cost, fixed costs + variable costs
- In the short run, a firm's decision about how much to produce depends on the market price of its product and the shapes of its costs curve.
- Short run cost curves shows costs that are determined by the currents scale of plant.
- Total Revenue, the total amount that a firm takes in from the sale of its product: the price per unit times the quantity of output the firm decides to produce

# LONG-RUN COST AND OUTPUT DECISION

- The long run decisions of individual firms depend on what their costs are likely to be at different scale of operation.
- They must compare their costs at different scales of plan to arrive at long run costs.
- Breaking event, the situation in which a firm is earning exactly a normal rate of return.
- Long run costs : economies and diseconomies of scale.

# INPUT DEMAND : THE LABOR AND LAND MARKET

- Because land is fixed, its price is demand determined.

- Demand determined price, the price of a good that is in fixed supply, it is determined exclusively by what firms and households are willing to pay for the good.

- The price of labor, is the wage determined in the labor market.

# INPUT DEMAND : THE CAPITAL MARKET AND THE INVESMENT DECISION

- Capital, those goods produced by the economic system that are used as inputs to produce other goods and services in the future.

- Capital market, the market in which households supply their savings to firms that demand funds to buy capital goods.

- Bond, a contract between a borrower and a lender, in which the borrower agrees to pay the loan at some time in the future, along with interest payments along the way.

- Expected rate of return, the annual rate of return that a firm expects to obtain through a capital investment.

# GENERAL EQUILIBRIUM AND THE EFFICIENCY OF THE PERFECT COMPETITION

- Partial equilibrium analysis, the process of examining the equilibrium conditions in individual markets and for households and firms separately.

- General equilibrium, the condition that exists when all markets in an economy are in simultaneous equilibrium.

- Efficiency, the condition in which the economy is producing what people want at least possible cost