

Crash Course in Economics

(Alma Mater Studiorum – Università di Bologna – Rimini Campus)

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- Materials and link to the recorded lessons:

Microsoft Teams platform:

[***https://teams.microsoft.com/meet/338216212406989?p=DV9LIwHsm4RQqWuy7N***](https://teams.microsoft.com/meet/338216212406989?p=DV9LIwHsm4RQqWuy7N)

Lesson 1

Principles of Economics

What is Economics?

Economics is a social science and study how people satisfy their unlimited wants and needs with limited resources.

- What makes economics a *social science*?

Economics is a study of human behavior because it looks at the decisions we make and how we react to those decisions.

- People have to make *choices*.



Economic Science

- *Two closely related branches of the economics:*

Microeconomics *studies individual decision-making processes and their interaction in markets.*

Macroeconomics *analyses the functioning of the economic system as a whole.*

- The fundamental concepts of *microeconomics*: *individuals, choices, interests, well-being, prices, markets.*
- The fundamental concepts of *macroeconomics*: *economic growth, productivity, money, inflation, unemployment.*

Economics and economic systems

Economy: *a set of individuals and firms in a particular geographical region.*

Economic activity: *complex interactions between households and firms (total purchases and total sales).*

Economic system: *complex production and exchange activities.*

- Economic science studies the *relationships between individuals and firms* in relation to the *exchange of goods and services*.

The Economic System

The Economic System describes how resources are allocated among individuals.

Capitalist Economic System is based on:

- *private ownership of inputs.*
- *production of goods and services with the ultimate profit.*
- *trade through the pricing mechanism.*



The Economic Problem

The *decisions* that each firms must take are about:

- *What to produce* (such as goods and services)?
- *How to produce* (using what resources)?
- *For who to produce* (who should receive the goods/services produced)?



The Economic Principles

To try to *solve the previous economic problems* there are **12 basic principles**:

- 4 principles about *individual choices*
- 5 principles about *interactions* between *individual choices*
- 3 principles on *economic system interactions*



Individual Choice

1. Choices are necessary because resources are scarce.

Choices are a result of unlimited wants in a world of limited resources (scarcity).

- *Spending and production decisions involve choices.*
- *Choices compete with each other.*

Resources and Scarcity

- *Resource: anything that can be used to produce something else (labour, capital, land).*

A resource is scarce when there is not enough of the resource available to satisfy all the various ways a society wants to use it.

- People *compete* for *limited resources*.



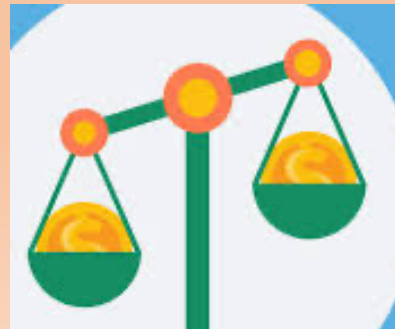
Production Factors

- Responding to the economic problem by *using resources to produce something else (production factors)*:
 - **Land**: set of *natural resources* (mineral reserves, marine, natural gas. etc.)
 - **Labour**: set of *individuals' physical/mental resources* (any work activity useful for the production of goods and services)
 - **Capital**: *equipment and structures* useful for producing (factories, buildings, computers, ovens)
- The available amount of resources is not large enough to satisfy all production uses.

Individual Choice

2. The true cost of something is its opportunity cost.

Opportunity cost: *what you must give up in order to get something.*



Opportunity Cost

Opportunity Cost: *measure alternatives that you have to give up when making a decision, value the benefits you give up.*

- *Comparison of costs and benefits of alternative choices.*
- Individuals consider the *cost of what you have to give up* to get something else.
 - The opportunity cost of choosing to attend university is the salary of the work that has been given up.
 - The cost-opportunity of choosing to work is the training and cultural enrichment of the university study that has been renounced.

Practical Application

You win 10,000 dollars in the lottery.

You can deposit the money in the bank with a 5% annual interest or you can spend it entirely right away.

What is the opportunity cost to spend the amount of money won right away?

The interest of 5% per annum is the opportunity cost to spend the amount of money won immediately, rather than depositing it in the bank.

Individual Choice

3. “How much” is a decision at the margin.

Trade-off: comparison of the costs and the benefits between two choices

- ***Economic agents:*** individuals who have an *active* role within an economic system (*households and firms*).
- They *make choices (decisions)* based on the *benefits* that come with them.



Marginal Concept

- *Marginal analysis*: the study of *marginal decisions*.
- *Marginal decision*: decision made at the margin of an activity about whether to do a bit more or a bit less of that activity.

Marginal change: modest incremental changes in costs and benefits.

- The choices of economic agents are aimed at *maximizing or minimizing certain results*.
- Individuals evaluate *incremental changes* resulting from a *possible decision*.
- The correct choice is one that leads to *marginal benefits greater than marginal costs*.

Individual Choice

4. People usually respond to incentives, exploiting opportunities to make themselves better off.



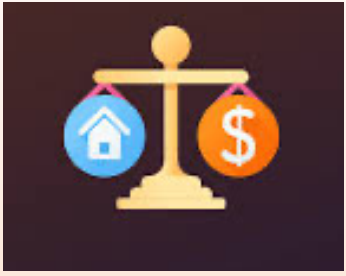
- ***Incentive***: anything that offers *rewards to people who change their behavior, it is an opportunity*
 - *In the United States, restaurant customers have the option of adding a tip to the restaurant bill. In much of Europe a tip is added automatically.*
 - *Where would you expect waiters to be more attentive?*



Interaction and Individual Choice

5. There are gains from trade.

- *Trade* allows us all to *consume more than we otherwise could*.
- Economic agents *operate through trade*: they provide goods and services to others and receive goods and services in return.
- *Benefits from trade*: it ensures that you get more than self-sufficiency.
- The *Invisible Hand* (Adam Smith, "The Wealth of Nations," 1776) drives private interest in promoting the well-being of the community.



Interaction and Individual Choice

6. Markets move toward equilibrium.

Equilibrium: an economic situation in which no individual would be better off doing something different.

- Achieved because individuals *take advantage of every opportunity to improve their condition.*
- Market equilibrium: *no economic agent improves its position by changing its choices.*
- Whenever there is a *change*, the economy moves towards a *new equilibrium*.
- ***Price changes:*** increase or fall until there is no longer any opportunity to exploit.

Interaction and Individual Choice

7. Resources should be used efficiently to achieve society's goals.

Efficient: *taking all opportunities to make some people better off without making other people worse off.*



Interaction and Individual Choice



- *Equity*: a condition in which everyone gets his or her “fair share.”

- There are many definitions of equity.
- *Equity* and *efficiency* are often at odds.



Interaction and Individual Choice

8. Markets usually lead to efficiency.

- People normally *take opportunities* for *mutual gain*.
- *Interaction* lead to efficiency.
- Generally there is *no possibility to further improve individual well-being* (without worsening that of others).

Interaction and Individual Choice

9. When markets don't achieve efficiency, government intervention can improve society's welfare.

- Sometimes *markets fail* and need *correction*.
- The *allocation of resources* by the market is *not always efficient*.
- Market failures:
 - *Externality* (e.g. pollution)
 - *Market power* (e.g. monopoly)
 - *Government intervention* can improve inefficiencies



Economy-Wide Interactions

10. One person's spending is another person's income.

- **Income = Production**
 - **GDP:** *The value of the final goods and services produced in a year within an economy.*
 - **Production** represents the **supply** and becomes the *income of producers* (from the *sale of goods and services*).
- **Spending = Consumption**
 - *Individuals buy (consume) final goods and services.*
 - It represents **demand** within an economy.



Economy-Wide Interactions

During *recessions*, a *drop in business spending* leads to:

- *Less income,*
- *less spending...*
- ...and further drops in business spending, layoffs, and rising *unemployment* → *Labour Market*



Economy-Wide Interactions

11. Overall spending sometimes gets out of line with the economy's productive capacity.

- ***Balanced: Demand and Supply***
 - *Everything that is produced* (offered) within an economy, is *consumed* (asked)

Sometimes there may be ***imbalances***:

- Excess of Demand: $Demand > Supply$
- Excess of Supply: $Supply > Demand$



Economy-Wide Interactions

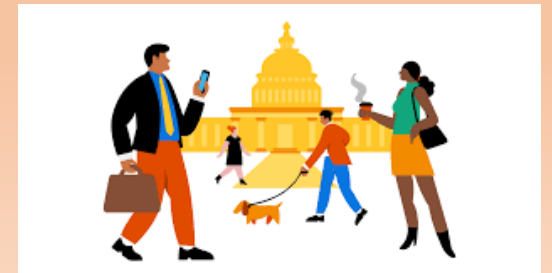
12. Government policies can change spending.



- The U.S. government funded the WPA and provided almost 8 million jobs between 1935 and 1943.

Public Policies

- In macroeconomics, market models provides for the *presence of the Government*.
- Not only private consumption (individuals, households) but also *public expenditure (G)*.
- The Government can implement *fiscal policies* to increase or decrease demand:
- *Expansionary fiscal policy*: increase public spending (or decrease taxation, T) $\rightarrow$ increase demand.
- *Restrictive fiscal policy*: decreases public spending (or increases taxation, T) $\rightarrow$ decreases demand.



Practice Learning

1. What is the fundamental reason why economic choices must be made?
 - a) *Prices are constantly increasing in all economic systems.*
 - b) *Unlimited wants and needs conflict with limited resources (scarcity).*
 - c) *Governments strictly regulate all consumer spending decisions.*
 - d) *Private firms choose not to optimize their production.*

Practice Learning

2. Which of the following is considered a primary factor of production representing physical or mental work?

- a) *Capital*
- b) *Land*
- c) *Labour*
- d) *Technology*

Practice Learning

3. In economics, how is the "opportunity cost" of a decision defined?

- a) *The monetary price paid for a good or service.*
- b) *What you must give up in order to get something else.*
- c) *The extra cost added when buying goods during high inflation.*
- d) *The tax percentage imposed by public policies.*

Practice Learning

4. Suppose you win \$10,000 and choose to spend it all immediately instead of depositing it into a bank account with a 5% annual interest rate. What is the opportunity cost?

- a) *The \$10,000 spent.*
- b) *The 5% annual interest lost by not depositing the money.*
- c) *Zero, because the money was won for free.*
- d) *The sales tax paid on purchases.*

Practice Learning

5. A marginal decision involves evaluating:

- a) Modest incremental changes in costs and benefits to do a bit more or less of an activity.*
- b) Long-term macro-level trends in GDP growth.*
- c) Total overall revenues versus fixed operational costs.*
- d) Decisions dictated strictly by government intervention.*

Practice Learning

6. What concept describes a situation in an economic system where no individual would be better off doing something different?

- a) Trade-off*
- b) Opportunity Cost*
- c) Equilibrium*
- d) Equity*

Practice Learning

7. An economy achieves efficiency when:

- a) Everyone in society receives an equal share of resources regardless of effort.*
- b) All opportunities are taken to make some people better off without making others worse off.*
- c) The government eliminates all forms of taxation.*
- d) Goods are distributed strictly based on needs rather than market prices.*

Practice Learning

8. Which of the following scenarios represents a market failure?

- a) Prices adjusting until supply equals demand.*
- b) Individuals engaging in voluntary trade to gain mutual benefits.*
- c) Pollution generated by a factory affecting the local community (externality).*
- d) Consumer choosing to save money in a bank account.*

Practice Learning

9. In macroeconomics, GDP is defined as:

- a) The total amount of money saved by households annually.*
- b) The value of the final goods and services produced within a year in an economy.*
- c) The maximum production capacity of public sector facilities.*
- d) The total tax revenues collected by the government in a fiscal year.*

Practice Learning

10. To stimulate demand during an economic downturn, a government implementing an expansionary fiscal policy would:

- a) Decrease public spending and increase taxation.*
- b) Increase public spending or decrease taxation.*
- c) Limit private firm ownership and set price ceilings.*
- d) Restrict international imports and exports.*