Introduction to Economics

Topic 1

Learning Objectives

- Define the discipline of economics
- Trace economics throughout history
- Analyze the importance of economics

What is Economics?

- ‘economics’ comes from the Greek word *oikonomia*
  - *oikos* (house)
  - *nomos* (law, rule)

- Economics tries to answer the question of how households manage their resources.
- The study of human decision-making.

What is Economics?

- Do you have everything you want?
- Why don’t you have everything you want?
- What are some scarce resources that you face?
- What does scarcity force us to do?
- What did you give up to be here today?

What is Economics? – Ctd.

- Scarcity
  - A universal phenomenon that arises because resources are limited.
- Trade-offs
  - Acquiring more of one thing can often only be done at the expense of getting by with less of something else.
- Opportunity Cost
  - The cost of a good in terms of another good that must be given up.

What is Economics? – Ctd.

- Economics is the Social Science that studies how people make decisions in the face of scarcity and the resulting impact of such decisions on both society as a whole and on the individual therein.
- How does Economics differ from other disciplines that also study human decision-making?
  - Methodology: Marginalism
  - Opportunity cost as measurement
  - Rational decision-maker

The Importance of Economics

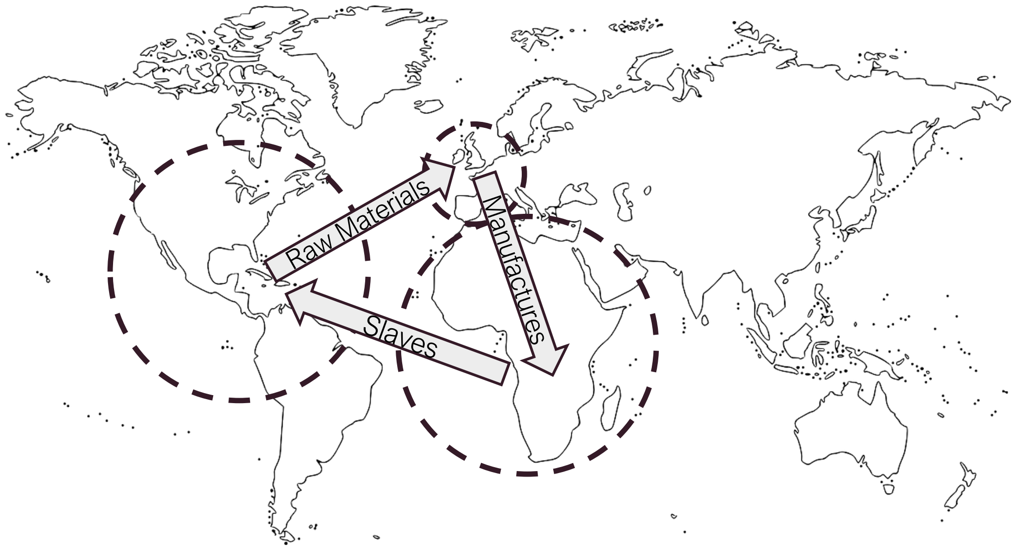
- Economists develop conceptual models of behavior to predict responses to changes in policy and market conditions.
- Economists use rigorous statistical analysis to investigate these changes (Econometrics).
- Thus, they contribute to the development of many public policies, including health care, welfare, and school reforms and efforts to reduce inequality, pollution, and crime.
- Whether you major in economics or not, economic fundamentals may help to better understand “what is going on in the news” and provide a tool for making decisions in everyday life.

A little History of Economics

- Mercantilism 16th – 18th Century
  - In essence, it is the economic paradigm of imperialism
  - Free trade was considered a zero-sum game; thus, development rests on trade surpluses meaning that exports are good, imports are bad
  - Bullionism (16th Century):
    - a state's wealth is measured by its amount of precious metals
  - Jean Baptiste Colbert (1619 - 1683):
    - Emphasized the importance of coerced trade, agricultural self-sufficiency, and strong military
  - Oliver Cromwell's Navigation Acts (1651 - 1660):
    - All value added associated with the transportation of goods and services needs to be secured by England
    - non-English "service providers" needed to be taxed

A little History of Economics – Ctd.

- Mercantilism 16th – 18th Century
  - – The Dutch-Anglo Wars
    - Were fought over the control over the trade routes between Europe and its colonies
  - – Slave Trade
    - the mercantilist business model



A little History of Economics – Ctd.

- The Boston Tea Party (1773) and US Independence (1776)
  - As a consequence of pursuing mercantilist policies, the prices for tea went up and up.
  - In order to bypass high prices, colonist wholesalers began to smuggle in tea from the Dutch.
  - Obviously, this was a threat to the East India Trading Company and England, who therefore allowed to dump cheap tea into the colonies.
  - North American Colonist, however, destroyed the English Tea shipment destined for the colonies.
  - As the US colonies gained economic power, they were no longer willing to share their increasing wealth with England, which ultimately led to the Independence of the United States.

A little History of Economics – Ctd.

- Enlightenment and industrial revolution (17^{th} – 18^{th} Century)
  - – Propagation of Protestantism
    - Medieval rule (subordination of the individual to the church) lost its credibility.
  - – David Hume's Price-Specie Flow Mechanism (1711 – 1776)
    - Constant trade surpluses lead to an inflow of money, which in turn causes prices to rise. As price levels increase, imports become cheaper.
  - – Adam Smith's Wealth of Nations (1723 – 1790)
    - Relationship between government and industry is harmful to the general population.
  - – The philosophical shift towards Enlightenment led to more political freedom and economic liberalism, which paved the way for the industrial revolution
    - Development of seeds, weaving machine, electricity and the light bulb, steam engine, steam train and boat, telegraph

A little History of Economics – Ctd.

- The first Globalization Wave (1870-1914)
  - The combination of the Industrial Revolution and the rise of the United States led to an unprecedented rise in global trade and migration.
  - The "North" quickly specialized in capital-intensive manufactures; the "South" specialized mostly in land-intensive agricultural production.
  - Hardship in Europe and migration to the former colonies made farmers and workers scarce, which raised their bargaining power in negotiating land reforms and workers' rights.

A little History of Economics – Ctd.

- The Interwar Period (1919-1945)
  - The Roaring 20ties
    - The end of World War I was characterized by producer and consumer confidence and optimism leading to a stock-market frenzy.
    - Soon, people started using their stocks as collateral to get loans and buy more stocks.
    - Firms, motivated by the investments, flooded to market with ever more innovations.
    - Yet, money supply was still bound to the gold standard. As more products entered the market, no money could be issued since it was difficult to obtain gold, and prices dropped.

A little History of Economics – Ctd.

- The Interwar Period (1919-1945)
  - The 1929 Stock Market Crash
    - When consumer saturation hit, the real sector's performance began to fell behind the stock market's expectations.
    - When these news spread everyone wanted to sell their stocks as quickly as possible, causing the stock market to crash
  - The Great Depression
    - Due to the excessive bank lending and deflation weakening demand, the 1929 stock market crash turned out to be especially severe, culminating in the great depression with unemployment rates as high as 25%.
    - Consequentially, tariffs were imposed on imports and the gold standard was abandoned.
    - John Maynard Keynes (1883-1946) identified fiscal and monetary policy as stabilization mechanisms for an economy.

Contemporary Applications

- The East Asian Crisis of 1997
- Free Trade Agreements
- Patient Protection and Affordable Health Care Act
- Inequality, especially in Latin America, but also in general