**IBP2205: Microeconomics**

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**CHAPTER 1: Introduction to Economics**

Why study economic?

* make money
* understand the law of supply and demand (mechanism of pricing)
* how recession or rising oil price will affect their future
* use economic lesson in your life
  + ex. Choosing your occupation
    - elaborate on this, wages, labor, production, demand

What is economic?

* The effect of government budget deficit, the rich and the poor, socialism, domestic worker vs. immigrants, how much does it really cost to go to college?
* Adam Smith – classical economic, political economic
  + Analyze the way that markets organized economic life and produced rapid economic growth.
  + The systems of prices and markets are able to coordinate people and businesses without any central direction.
* Karl Marx proclaimed that capitalism was doomed and would soon be followed by business depressions, revolutionary upheavals and socialism
* John Maynard Keynes, The general theory of employment, interest and money. This is about government policies and how gov’t can regulate business cycle
* The power of the market , capitalism Vs. Socialism

Definition of Economics

* Economics asks what goods are produced, how these goods are produced and for whom they are produced
* Economic analyzes movements in the overall economy – trend in price, output, unemployment, foreign trade, and government policies
* Study of commerce among nations, analyze and explain why some nations import goods and export others.
* Science of choice, how people choose to use scarce or limited productive resources (labor, equipment, technical, knowledge) to produce various commodities (such as wheat, overcoats, concerts, and missiles) and the distribution of these goods
* Economics is the study of money, banking, capital and wealth
* Economics is the study of how societies use scarce resources to produce valuable commodities and distribute them among different people.
  + Macroeconomics: the study of functioning of economy as a whole
  + Microeconomics: analyze the behavior of individual components like industries, firms, and households+

Scientific Approach

Why japan has grown so rapidly in 1960s and currently it is stagnant, compare with Russia and china

Explain the economic class

Economists and other scientists have developed techniques – sometimes called the scientific approach

* Observation: we people learn a lot by observing
  + Example inflation, how do we come to understand it
    - History of inflation in 1920 Germany has inflation rate of 100000% in 2 yrs
* Economic analysis: this is an approach that starts with a set of assumptions and then deduces logically certain predictions about the economic behavior of people, firm or overall economic
  + Ex. Attempt to restrict the import of foreign goods in order to protect domestic workers and forms from foreign competition
  + Cause of effect of an incident
* Statistical analyses: a complete understanding of economic activity relies upon the use of economic data and statistical analysis.
  + Who is richer, male or female and explain why?
    - On average women earn only 60% as much as men in United states in 1990s
      * some concrete evidence and some discrimination
* Experiments: controlled experiments, a scientist sets up a controlled experiment by dividing a population into 2 or more group. They are being treated the same way except for the impact factor.
  + It is difficult to perform experiment in economics than in laboratory science
  + Economist measured people’s reactions to different kinds of government programs to raise the incomes of the poor.
    - This showed how changes in gov’t programs might affect people’s work habits and saving behavior.

These four techniques form the approach by which economic science progresses. Economists test new ideas and reject old ones, and economics evolves and changes.

Pitfall in economic reasoning

* Falling to keep “other things equal”
  + Eg. The number of cars bought in a given year is determined by the price of cars, consumer incomes, gasoline prices and so on
    - How can we isolate the impact on car sales of a single variable??
    - Eg. Persian Gulf war cause the price of gasoline to increase
      * Cause and effect to other factor?
* The post hoc fallacy
  + The fact that event A takes place before event B does not prove that event A caused event B. To conclude that “after the event” implies “because of the event” is to commit to post hoc fallacy
    - Eg. After the gov’t has cut tax rates, the gov’t‘s total tax revenues began to rise.
* The whole is not always the sum of the parts: fallacy of composition
  + Fallacy of composition is the misconception that what is true for a part is therefore true for the whole
    - Eg. If all farmers produce a big crop, total farm income will probably fall…..
    - Eg. When you stand up in the stadium, the view would be better, but when everybody stand up, the view is not good.
* Subjectivity
  + This is probably the greatest obstacle to learning,
  + When we are young, our minds open to the new ideas, then we begin to organize our ideas and to learn about the world from our family, friends and teacher, but no sooner do we begin to understand our world than we become captive of our own knowledge.
    - Eg. Scientists used to understand the universe revolve around earth.
    - Unlearning is more difficult than learning.

The law of scarcity

* Economists study the way goods are produced and consumed because people want to consume far more than economy can produce.
  + If human desires were fully satisfied, people would not worry about the efficient use of scarce resources.
    - All goods will be free, like sand in Saudi desert and salt water at the beach
* Economic goods: goods those are scarce or limited in supply.
* Goods are limited while wants seem infinite
  + If you add up all the wants, you quickly find that there are simple not enough goods and services to satisfy even a small fraction of everyone’s consumption desires.
    - Imaging the children in very poor country and compare to your life.
* Law of scarcity, which states that goods are scarce because there are not enough resources to produce all the goods that people want to consume. All economics flows from this central fact.

The uses of economics

* Description and policy in economics
  + Help people cope with their personal concerns, economics improves knowledge of crucial national issues
    - It helps us understand our society
      * Eg. Explain and predict the cause of poverty
      * Eg. People use economic knowledge to help design policies that will build a better society.
* Normative Vs. Positive economics
  + Positive economics: describe the facts and behavior in the economy.
    - Eg. What are the causes of poverty in Thailand?
    - Eg. What is the effect of higher cigarette taxes on the number of smokers?
    - These questions can be resolved only by reference to facts
  + Normative economics: involves ethical precepts and value judgments
    - Eg. Should gov’t have handouts to the poor?
    - Should the socialist countries introduce private property and stock markets?
    - There are no right or wrong for these question, they involve ethics and values rather than facts
    - These questions ae resolved by political decisions, not b economic science.
  + Economics in government
    - The political agenda is full of economic issues
      * Eg. Should the minimum wage be raised?
    - Head of government must constantly make vial decisions that involve economics
      * No need to be expert, but the need to know and understand
    - Your view of the world will never be the same after a single semester of economic

Exercise

1. Give five definitions of economics. Which is the most comprehensive one to you?
2. Define Normative and positive economics?
3. Define economic goods and free goods? Give some example for each, think of examples of goods that used to be free goods, but now are economic goods?
4. Identify which of the following are normative/positive statement
   1. The deserving poor should pay no taxes
   2. Rising food prices contributed to the French revolution
   3. The Malaysian economy has grown more rapidly than Laos’ economy

**CHAPTER 2: Basic problems of economic organization**

“Every gun that is made, every warship launched, every rocket fired signifies, in the final sense, a theft from those who hunger and are not fed”. By former American president, Dwight D. Eisenhower

An economy’s production is limited by the amount of inputs available and by its technological knowledge, society must choose between necessities and luxuries, between public and private goods, and between consumption and investment. This insight leads to the important concept of opportunity cost.

The three problems of economic organization

Every human society must face these questions

* What commodities are to be produced and in what quantities, when will it be produced and so on.
* How shall goods be produced? By whom and with what resource and in what technological manner are they to be produced?
* For whom shall goods be produced? Who gets to eat the fruit of the economy’s efforts? Or, to put it formally, how is the national product to be divided among different households?

These three basic problems are common to all economies. But, as we will see later, different societies take different approaches in solving them

Inputs and outputs

The three central economic tasks of every society are really about choices among an economy’s inputs outputs

* Inputs are commodities or services used by firms in their production processes. An economy uses its existing technology to combine inputs to produce outputs.
* Outputs are the various useful goods or services that are either consumed or employed in further production.

Factor of production

We classify inputs, also called factors of production, into three broad categories: land, labor, and capital

* Land or natural resources- represents the gift of nature to our productive processes. Natural resource: the air we breathe and the water we drink and so on
* Labor consists of the human time spent in production
  + Ex. Working hours for the employee in terms of production and so on.
* Capital resources form the durable goods of an economy, produced in order to produce yet other goods.
  + Ex. Capital goods include machines, roads, computers,
  + The accumulation of specialized capital goods is essential to the task of economic development

Market, command, and mixed economies

* Command economy is the one in which the government makes all decisions about production and distribution
  + In command economy, the government answers the major economic questions through its ownership of resources and its power to enforce decisions.
* Market economy is one in which individuals and private firms make the major decisions about production and consumption.
  + What, how and for whom decision
* Mixed economies: No contemporary society falls completely into either of these polar categories. Rather, all societies are mixed economies, with elements of market and command.
  + There has never been a 100 percent market economy

Society’s technological possibilities

* The Production-Possibility Frontier (PPF)
  + Ex. Gun and butter
    - Butter is transformed into guns, not physically but by the alchemy of diverting the economy’s resources from one use to the other
  + The production-possibility frontier shows the maximum amounts of production that can be obtained by an economy, given the technological knowledge and quantity of inputs available
  + The PFF represents the menu of choices available to society
  + Efficiency means absence of waste, or using the economy’s resources as effectively as possible to satisfy people’s needs and desires.
    - Productive efficiency occurs when society cannot increase the output of one good without cutting back on another good. An efficient economy is on its production-possibility frontier
  + Unemployed resources and inefficiency

Opportunity cost

* Scarcity??
* Making a choice in a world of scarcity requires us to give up something else, in effect costing us the opportunity to do something else. The alternative forgone is called opportunity cost
* Opportunity cost of a decision arises because choosing one thing in a world of scarcity means giving up something else. The opportunity cost is the value of the good or service forgone

The law of diminishing returns

* This law concerns the relationship between inputs and outputs in the productive process.
* The law of diminishing returns holds that an increase in some input, with other inputs held constant, will increase total output. But after some point, the extra output resulting from additional doses of input will tend to become smaller and smaller
  + Ex. 100 acres with no labor = 0 production, 1 labor 50 kg of corn, 2 labor 100 kg of corn, 3 labor 120kg of corn, 4 labor 135kg of corn, 5 labor 145kg of corn, 6+ labor 150kg of corn.
  + The law of diminishing returns is an important and widely observed economic relationship. However, that it is not universally valid for all technologies.

Trade, Money and capital

The major differences between a modern economy and that of frontier days is found in the extensive network of trade and specialization of individuals and firms

Trade: specialization and division of labor

* Specialization occurs when people concentrate their efforts on a particular set of tasks. It permits each person and country to use best advantage any peculiar skills and resources
* Division of labor dividing production into a number of small specialized steps or tasks.
  + Ex. A division of labor permits slow people to fish and swift people to hunt, all exchanging what they make for what they need
  + Ex. Pin making working by Adam Smith
* In exchange for this specialized labor, we will receive an income adequate to buy goods from all over the world.
* The law of comparative advantage states that individuals or nations should specialize in producing and selling those commodities which they can produce at relatively low cost.
* Advanced economies engage in specialization and division of labor, which increases the productivity of their resources. Individuals and countries then voluntarily trade goods they specialize in for others’ products, vastly increasing the range and quantity of consumption and raising everyone’s living standards

Money: the lubricant of exchange

* Money then allows people to trade their specialized outputs for the vast array of goods produced by others
  + Money is the mean for payment or the medium of exchange; in our economy money consists of currency and checking accounts with which households and businesses pay for things.
    - Imaging a state of barter….
    - Ex. Primitive economies food might be traded for clothing….
  + The problem of managing money – one of the most important tasks of gov’t today
    - Imaging what will happen to the concept of money…

Capital

* Major factor of production: land, labor and capital
  + Capital (or capital goods) is a produced factor of production, a durable input which is itself an output of the economy
    - Ex. We build textile factory and the factory is use to produce shirt…..
* Capital and time
  + Direct method of production:
    - Direct methods of production are often less efficient than indirect or roundabout techniques
    - Ex. Catching fish in the river
  + Almost everyone is doing work of a preparatory and roundabout nature, with the final consumption a distant future goal.
* Growth from the sacrifice of current consumption
  + The advantage of using roundabout processes is offset by the initial disadvantage of having to forgo present consumption goods by diverting current consumption to investment in roundabout processes
    - * Ex. Upgrading your factory or building roads/railroads
* Capital and private property
  + Property rights bestow on their owners the ability to use exchange, paint, dig, drill or exploit their capital goods.
    - Socialism and capitalism
  + The ability of individuals to own and profit from capital is what gives capitalism its name
    - But society determines how much the owners of public utilities, such as electric and gas companies can earn and how much pollution your car can emit…
    - The abolition of slavery, it is against the law to treat human earning power like other capital assets. You must rent yourself at a wage, not sell but rent.

Assignment

1. Define each of the following terms carefully and give example:

PPF, efficiency, inputs, outputs, opportunity cost

2. Assume econoland produces haircuts and shirts with inputs of labor. Econoland has 1000 hours of labor available. A haircut requires ½ hour of labor, while a shirt requires 5 hours of labor. Construct econoland’s production-possibility frontier

3. Many scientists believe that we are rapidly depleting our natural resources. Assume that there are only two inputs (labor and natural resources) producing two goods (haircut and gasoline) with no improvement in society’s technology over time. Show what would happen to PPF over time as natural resources are exhausted. How would invention and technological improvement modify your answer? On the basis of this example, explain why it is said that “economic growth is a race between depletion and invention”

**CHAPTER 3 Market and government in modern society**

Market and command economies

* + Example of each
* The age of laissez-faire: this doctrine, which translate as “leave as alone”, holds that government should interfere as little as possible in economic affairs and leave economic decisions to the marketplace
  + Timeline from 1900s
    - Great depression
    - World wars
    - Cold wars
    - Recent days
* The invisible hand of markets

*Review*

* *3 problems of economic*
  + What commodities are to be produced and in what quantities, when will it be produced and so on.
  + How shall goods be produced? By whom and with what resource and in what technological manner are they to be produced?
  + For whom shall goods be produced? Who gets to eat the fruit of the economy’s efforts? Or, to put it formally, how is the national product to be divided among different households?
* *Market and command economic*
  + Opportunity cost
* *Trade, money and capital*

How the market solves the economic problems

Who’s responsible for solving economic problems? You may be surprised to learn that no one individual or organization is responsible for solving the economic problems in a market economy, instead, millions of businesses and consumers engage in voluntary trade. Their actions and proposes are invisibly coordinated by a system of prices and markets.

* + Eg. Bangkok and our 10 million people, imagine bkk without the flow of goods in and out of bkk
  + How much government does to control economic activities, what about the ones that the gov’t did not…..
* Economic order, not chaos
  + How you ever wonder why….
    - Eg. How it is that food is produced in suitable amounts, gets transported to the right place and arrives in a palatable form at the dinner plate. (market system)
    - Market system solve one of the most difficult question, nobody designs it, but yet it functions remarkably well
      * Eg. west Germany after WWII in 1947
        + Market systems from the past
        + Paralysis of the market mechanism, price controls and overarching gov’t regulation hobbled markets. Money was worthless; factories closed down for lack of materials; trains could not run for lack of coal; coal could not be mined because miners were hungry; miners were hungry because peasants would not sell food for money and no goods were available for them to purchase.
        + In 1948, after the war, the gov’t freed prices from controls and introduced a new currency, quickly putting the market mechanism back to effective operation.
  + During the cold war, the socialist economies, having seen their living standards decline relative to their western neighbors.
* The market mechanism
  + What is market?
    - Originally, a place where goods were bought and sold
    - Nowadays, SET, NYSE….
    - Mechanism by which buyers and sellers meet to exchange things
      * Centralized (stocks, bonds) and decentralized (houses, used cars) or even online
  + Market is a mechanism by which buyers and sellers of commodity interact to determine its price and quantity
    - Price represent the terms on which people and firms voluntarily exchange different commodities
    - Price serve as signals to producers and consumers
      * Up or down, what does it mean??
      * Situation, out of stock? Overstock?
  + Prices coordinate the decisions of producers and consumers in a market. Higher prices tend to reduce consumer purchases and encourage production. Lower prices encourage consumption and discourage production. Prices are the balance wheel in the market mechanism
    - Prices help balance consumption and production in an individual market.
  + Market equilibrium: they balance all the forces operating on the economy; markets are finding equilibrium of supply and demand.
    - It represents a balance among all the different buyers and sellers
    - Ex. Situation where firm produce and set a price that is either too high or too low
* How a market solves the three economic problems: in different market all together.
  + What?
    - The dollar votes of consumers, limited money in many different markets.
    - Concept of profit
    - Relative cost,
      * Ex. Japan’s electronic and Thailand’s fruit.
      * Who made this decision? It is the price system, land is plentiful in Thailand, and engineering talent is plentiful in Japan.
  + How?
    - How things are produced is determined by the competition among different producers, with the goal to maximize the profit
      * Keep the cost down by adopting the most efficient method of production
        + Ex. Steam engine v horses
        + Electricity v coal
        + Fiber optic v copper telephone line
  + For whom?
    - Supply and demand in the markets for factors of production
      * Wage, rent interest, profit,
      * The distribution of income among the population
      * Etc….
* Who governs the market?
  + Consumer: consumers direct by their innate or acquired tastes
    - Ex. I want corn, what will you produce??
  + Technology: the available resources place a fundamental constraint on consumers
    - Eg. You can fly to London, but there is no flight to Mars
  + Profit induces firms to enter areas where consumers want more goods, to leave areas where consumers want fewer goods, and to use the most efficient techniques of production.
* A picture of prices and markets
  + Product market: Prices on good market
  + Factor market: Prices on factor markets (wage, rent, interest)
  + Household buy goods and sell factors of production; biz sell goods and buy factor of production
  + Web of interdependent supplies and demands interconnect through a market mechanism, Figure3.1 pg 39.
* perfect competition
  + perfect competition
    - ex. squeezing the juice out to the last drops
  + imperfect competition
    - ex. Oil industry…..
  + Under perfect competition and with no market failures, markets will squeeze as many useful goods and services out of the available resources as are possible. But where monopolies or pollution or similar market failures become pervasive, the remarkable efficiency properties may be destroyed.

The economic Role of government

* The three functions of government: promote fair competitions and give everyone the chance to succeed. – perfect competition
  + Efficiency
    - Imperfect competition
      * Monopolist – a single supplier who alone determines the price of particular good.
        + Ex. Local utilities, gov’t antitrust laws, price fixing, dividing up the market, decline sale
    - Externalities: (or spilled over effects) occur when firms or people impose costs or benefits on others outside the marketplace.
      * Ex. Firm A has used the scarce, clean water without paying people whose water is fouled.
      * Ex. Firm B provided its employee free vaccination, people outside the firm also benefit from reduced danger of contracting the disease.
      * There is an economic transaction without an economic payment.
      * Gov’t regulations are designed to control externalities like air and water pollution, strip mining, hazardous wastes, unsafe drugs and foods, and radioactive materials.
    - Public goods: economic activity that conveys large or small benefit to the community
      * Ex. Building railroads, building highways.
    - Taxes: taxes are not voluntary. Everyone is subject to the tax law; we all have to pay for a share of the cost of public goods.
      * Ex. Income tax, VAT, duties, highway tolls and etc.
  + Equity: Market does not necessarily produce a distribution of income that is regarded as socially fair or equitable. A true market economy may produce unacceptably high levels of inequality of income and consumption.
    - Goods follow the money vote, not the greatest need
    - Ex. Should robot be invented and replace 80% of workforce?
    - Tax, progressive taxation, transfer payment (can’t help the poor by lower tax, therefore we will pay for you’re……….)
    - Social waste: Does handout encourage social waste?
    - Should we give out cash or product to the poor?
  + Macroeconomic growth and stability
    - Fiscal policies (taxing)
    - monetary policies (interest rate and credit conditions)
    - since 1930s, gov’t have succeeded in curbing the worst excesses of inflation (rising of prices) and depression (unemployment)