


# Business Economics 1

## Introduction & Overview

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## What is Economics?

- *Economy* comes from the Greek word *oikonomia* which means “management of a household or state ...”

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## What is Economics?

- Economics is the study of how scarce resources are allocated amongst competing alternative uses.
- The allocation problem faced by any economy has two different aspects: the allocation of
  - productive resources: what, how and how much to produce?
  - final goods and services: who gets what and how much?

Note: There would be no allocation problem if resources were unlimited!

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## What Economics is NOT about

Economics is NOT about

- how to get rich, like making money in the stock market or the real estate market
- becoming a better manager
- balancing your checkbook

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## Why study economics?

- A good understanding of some basic economic concepts is essential for us to understand the world we are living in.
- We will look at some examples in the next few slides.
- Government policies (or the lack of) directly or indirectly affect our daily life and economic well-being.

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## Examples of Economic Issues

### On Minimum Wage

- Does Hong Kong need a minimum wage law?
- What will be the impact of a minimum wage on unemployment?
- Who would benefit / be hurt the most by a minimum wage?

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## Examples of Economic Issues

### On Housing Problem

- Should the government resumes building public housing under the Home Ownership Scheme (居者有其屋計劃) or the Sandwich Class Housing Scheme (夾心階層住屋計劃), or both?
- Will the Home Ownership Scheme, if revived, drag down property prices?

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## Economic Issues (Cont./)

- Should the Cross Harbour Tunnel (紅磡海底隧道) be privatized?
- Can the Western Harbour Tunnel Co. (香港西區隧道有限公司) increase its revenue by raising its toll (fee) recently?
- Should HK maintain the pegged exchange rate system?
- Is the economic growth of China sustainable without political reform?

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## To address these issues

We need:

- to know some basic economic **concepts** and **principles**
- to have a general understand of how the **economic system** works

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## Economic Concepts & Principles

- Some important **concepts**:
  - Law of Demand & Supply
  - Opportunity Cost
  - Cost and Benefit Analysis
  - The Marginal Concept
- Some important **Principles**
  - Mankiw's 10 Principles (discussed below)

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## Economic System

- We will focus on Market (vs. Command or centralized) Economies and how they operate.
- Two levels:
  - Micro: studies how individuals, households and firms make decisions to allocate limited resources
  - Macro: studies the aggregates (sum totals of economic activities) and focuses on issues such as growth, inflation and unemployment

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## Ten Principles

- Professor Mankiw (the author of our textbook) listed 10 Economic Principles you are expected to learn.
  - The first 7 are micro principles
    - How people make decisions
    - How people interact with each other
  - The last 3 are macro principles
    - Forces that affect the economy as a whole

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# Ten Principles

## 1. **People face trade-off**

Making decisions often requires trading off one goal against another. To get more of one thing, you have to give up something else.

- To have more time studying you have to give up time for some other activities: leisure, sleep
- To have more economic growth we may have more environmental pollution
- “There is no such thing as a free lunch”

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# Ten Principles

## 2. **The cost of something is what you give up to get it**

Decision-makers have to consider **both** the explicit and implicit costs of their actions.

- Explicit costs are financial expenditures (or out-of-pocket expenses)
- Implicit costs are opportunity costs (e.g. time costs)

If someone gives you a free ticket to a concert, does it mean your cost of attending the concert is zero?

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## Ten Principles

### 3. **Rational people think at the margin**

This basically means rational people weight the marginal cost and the marginal benefit of an action when they make decisions.

- Example: You are supposed to meet a client to sign a multi-million dollar contract at 3pm. It's 2:50pm now and you have circled around for 10 minutes already but cannot find a parking space. The penalty for illegal parking in HK is about \$300. What would you do?

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## Ten Principles

### 4. **People response to incentives**

Behavior changes when costs or benefits change.

- Suppose the fine of a parking violation is only \$20. Do you expect to see more or less drivers park illegally on the street?
- If your professor announces on the first day of class that everyone will get an A automatically. There will be no exams and you don't even have to show up for class. How would you choose to spend your time for the rest of the term?

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## Ten Principles

### 5. **Trade can make everyone better off**

- Trade allows countries to specialize in activities that they do best and become more efficient
- Trade between two countries (firms, families, or individuals) can make both better off
- By trading with others, people can buy a greater variety of goods or services.

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## Ten Principles

### 6. **Markets are usually a good way to organize economic activity**

- Market mechanism (vs. central planning) is usually the best way to allocate resources efficiently.
- Market participants (households and firms) acting on their self-interest tend to generate and use information more efficiently, as if they are guided by an "invisible hand".

(We will examine different forms of market structure and the notion of “market efficiency” in this class.)

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## Ten Principles

### 7. **Government can sometimes improve market outcomes**

- In some situations the market mechanism may fail to allocate resources efficiently.
- The government can change the outcome through public policy.
- Examples are regulations against monopolies and pollution.

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## Ten Principles (Macro)

### 8. **A country's standard of living depends on its ability to produce goods and services**

- Countries whose workers produce a large quantity of goods and services per unit of time enjoy a high standard of living.
- Similarly, as a nation's productivity grows, so does its average income.

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## Ten Principles (Macro)

9. **Prices rise when the government prints too much money**

When a government creates large quantities of the nation's money, the value of the money falls and prices will increase as a result.

10. **Society faces a short-run trade-off between inflation and unemployment**

Reducing inflation often causes a temporary rise in unemployment. This tradeoff is crucial for understanding the short-run effects of changes in taxes, government spending and monetary policy.

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## Summary

- When individuals make decisions, they face tradeoffs among alternative goals.
- The cost of any action is measured in terms of foregone opportunities.
- Rational people make decisions by comparing marginal costs and marginal benefits.
- People change their behavior in response to the incentives they face.

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## Summary

- Trade can be mutually beneficial.
- Markets are usually a good way of coordinating trade among people.
- Government can potentially improve market outcomes if there is some market failure or if the market outcome is inequitable.

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## Summary

- Productivity is the ultimate source of living standards.
- Money growth is the ultimate source of inflation.
- Society faces a short-run tradeoff between inflation and unemployment.

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## Positive Vs. Normative Statement

- When we analyze an issue and make certain statements about the issue, one important thing to keep in mind is the distinction between
  - a **positive** statement (what is) and
  - a **normative** statement (what “should be”)

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## Positive Vs. Normative Statement

- A “positive” statement is about WHAT IS
  - A positive statement is objective
  - has a definite yes / no (true / false) answer.
- A “normative” statement is about the desirability of something and involves value judgment.
  - A normative statement is subjective
  - i.e. what an observer thinks it OUGHT TO BE.

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## Positive or Normative?

### ■ Positive or Normative Statements?

- An increase in the minimum wage will cause a decrease in employment among the least-skilled.

POSITIVE

- Higher federal budget deficits will cause interest rates to increase.

POSITIVE

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## Positive or Normative?

### ■ Positive or Normative Statements?

- The income gains from a higher minimum wage are worth more than any slight reductions in employment.

NORMATIVE

- State governments should be allowed to collect from tobacco companies the costs of treating smoking-related illnesses among the poor.

NORMATIVE

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## How To Study Economics

- Read and Understand
  - Have to put in the time
  - What is the concept saying?
- Think and Apply
  - Does it make sense (to you)?
  - Can you explain the concept to someone?
  - Learn *when* and *how* to use the tools properly

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**\*\* End of Introduction \*\***

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