THE NEO CLASSICAL ECONOMICS

- Also called marginalist economics
- Formed in 1870
- Popularized the term "economics" as a substitute for "political economy"
- Systematized supply and demand as joint determinants of price and quantity in market equilibrium, affecting both the allocation of output and the distribution of income

ALFRED MARSHALL

- Dominant figure in British economics from 1890 – 1924.
- Specialty: microeconomics
- Most important book: Principles of Economics
- Emphasized that price and output of goods are determined by both supply & demand: the two curves are like scissor blades that intersect at equilibrium
- Credited for the concept of
  - Price-elasticity of demand, which quantifies buyers' sensitivity to price
  - Consumer Surplus
    - Noted that the price is typically the same for each unit of a commodity that consumer buys, but the value to the consumer of each additional unit declines. A consumer will buy units up to the point where the marginal value equals the price. Therefore, on all units previous to the last one, the consumer reaps the benefit by paying less than the value of the good to himself. The size of the benefit equals the difference between the consumer's value of all these units and the amount paid for the units.
    - This difference is called the consumer surplus.
  - Producer Surplus
    - The amount the producer is actually paid minus the amount that he would willingly accept.
  - *Marshall used Consumer Surplus and Producer Surplus to measure the changes in well-being from government policies.*

Marshall introduced the idea of three periods.

First – market period, amount of time for which the stock of a commodity is fixed

Second – short period, the time in which the supply can be increased by adding labor and other inputs but not by adding capital

Third – long period, the amount of time taken for capital to be increased

"The Mecca of the economist lies in economic biology rather than in economic dynamics."

This means, that the economy was an evolutionary process in which technology, market institutions, and people's preferences evolve along with people's behavior.

THE KEYNESIAN ECONOMICS

John Maynard Keynes

Published "The General Theory of Employment, Interest, and Money" in (1936)*

Note: His work was inspired and published during the Great Depression.

The Depression had been sparked by the Wall Street Crash of 1929, leading to massive rises in unemployment in the US, leading to debts being recalled from European borrowers, and an economic domino effect across the world.

Table 1.1 Economists Solution to the Depression

Orthodox Economists	**Keynes**
tightening of spending, until business confidence and profit levels could be restored	In his book, "A Tract on Monetary Reform" (1923), stated that a variety of factors determined economic activity, nad that it was not enough to wait for the long run market equilibrium to restore itself.

He famously remarked, **"…this long run is a misleading guide to current affairs. In the long run we are all dead. Economist set themselves too easy, too useless a task if in tempestuous seasons they can only tell us that when the storm is long past the ocean is flat again."**

He identified that the following as variables which determine the level of the economy's output:

- Propensity to consume
- Inducement to invest
- The marginal efficiency of capital
- Liquidity preference
- Multiplier effect
- Employment
- Level of Prices

General Theory – Keyne's book wherein he invented much of this esoteric terminology

He argued that if savings were being kept away from investment through financial markets, total spending falls. Falling spending leads to reduced incomes and unemployment, which reduces savings again. This will continues until the desire to save becomes equal to the desire to invest, which means a new "equilibrium" is reached and the spending decline halts. This new "equilibrium" is a depression, where people are investing less, have less to save and less to spend.

THE ECONOMIC ENVIRONMENT AND ITS PROCESSES

DIVISION OF ECONOMICS

Economics is divided into two branches:

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

It looks at the economy as a whole. Instead of trying to understand what determines the output of a single firm or industry or what the consumption patterns are of a single household or group of households, macroeconomics examines the factors that determine national output, or national product.

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

Firms' choices about what to produce and how much to charge and households' choices about what and how much to buy help to explain why the economy produces the goods and services it does. Another big question addressed by microeconomics is who gets the goods and services that are produced. Wealthy households get more than poor households, and the foces that determine this distribution of output are the province of microeconomics.

Table 1.2 Examples of Microeconomic and Macroeconomic Concerns

DIVISION OF ECONOMICS	PRODUCTION	PRICES	INCOME	EMPLOYMENT
Microeconomics	Production/output in individual industries and business How much steel How much office space How many cars	Prices of individual goods and services Price of medical care Price of gasoline Food prices Apartment rents	Distribution of income and wealth Wages in the auto industry Minimum wage Executive salaries Poverty	Employment by individual businesses and industries Jobs in the steel industry Number of employees in a firm Number of accountants
Macroeconomics	National production/output Total industrial output Gross domestic product Growth of output	Aggregate price level Consumer prices Producer prices Rate of inflation	National income Total wages and salaries Total corporate profits	Employment and unemployment in the economy Total number of jobs Unemployment rate

DIVERSE FIELDS OF ECONOMICS

A good way to convey the diversity of economics is to describe some of its major fields of study and the issues that economists address.

- **Industrial organization** looks carefully at the structure and performance of industries and firms within an economy. How do businesses compete? Who gains and who loses?
- **Urban and regional economics** studies the spatial arrangement of economic activity. Why do we have cities? Why are manufacturing firms locating farther and farther form the center of urban areas?
- **Econometrics** applies statistical techniques and data to economic problems in an effort to test hypotheses and theories. Most schools require economics majors to take at least one course in statistics or econometrics.
- **Comparative economic systems** examine the ways alternative economic systems function. What are the advantages and disadvantages of different systems? What is the best way to convert the planned economies of the former Soviet Union to market systems?
- **Economic development** focuses on the problems of poor countries. What can be done to promote development in these nations? Important concerns of development economists include population growth and control, provision for basic needs, and strategies for international trade.
- **Labor economics** deals with the factors that determine wage rates, employment, and unemployment. How do people decide whether to work, how much to work, and at what kind of job? How have the roles of unions and management changed in recent years?
- **Finance** examines the ways in which households and firms actually pay for, or finance, their purchases. It involves the study of capital markets (including the stock and bond markets), futures and options, capital budgeting, and asset valuation.
- **International economics** studies trade flows among countries and international financial institutions. What are the advantages and disadvantages for a country that allows its citizens to buy and sell freely in world markets? Why is the dollar strong or weak?
- **Public economics** examines the role of government in the economy. What are the economic functions of government, and what should they be? How should the government finance the services that it provides? What kinds of government programs should confront the problems of poverty, unemployment and pollution? What problems does government involvement create?
- **Economic history** traces the development of the modern economy. What economic and political events and scientific advances caused the Industrial Revolution? What explains the tremendous growth and progress of post-World War II Japan? What caused the Great Depression of the 1930s?
- **Law and economics** analyzes the economic function of legal rules and institution. How does the law change the behavior of individuals and businesses? Do different liability rules make accidents and injuries more or less likely? What are the economic costs of crime?
- **The history of economic thought**, which is grounded in philosophy, studies the development of economic ideas and theories over time, from Adam Smith in the eighteenth century to the works of economists such as Thomas Malthus, Karl Marx, and John Maynard Keynes. Because economic theory is constantly developing and changing, studying the history of ideas helps give meaning to modern theory and puts it in perspective.

THE INPUTS TO PRODUCTION

THE ECONOMICS RESOURCES

Our economic resources are also known as factors of production or inputs. There are five major factors of production, which are utilized in our economy. These are:

- **Land** – These resources consists of free gifts of nature which includes all natural resources above, on, and below the ground such. Land is considered economic resources because it has a price attached to it. One cannot utilize this natural resource without paying for it usually in the form of rent or lease.
- **Labor** – This is also termed as human resources. Labor refers to all human efforts, be it mental or physical, that help to produce want satisfying goods and services. Labor is an indispensable factor in the production of goods and services. In return, he earns an income in the form of wages and/ or salaries.
- **Capital** – It is a finished product, which is used to produce goods. It consists of all man-made aids to further the production process such as tools, machinery and buildings. Capital also serves as an investment. Income derived from capital is interest.
- **Entrepreneur** – This is a French word meaning enterpriser. An entrepreneur is the organizer and coordinator of the other factors of production: land, labor, and capital. An entrepreneur is one who is engaged in economic undertakings and provides society with goods and services it needs. He utilizes his initiative, talent and resourcefulness in the creation of economic goods. He is able to compensate himself through the acquisition of profits.
- **Foreign Exchange** – This refers to the dollar and dollar reserves that the economy has.