Introduction

- **Economics**: science of household management
- Unlimited wants, limited means: scarcity
- Scarcity necessitates choice
- Every choice entails opportunity cost
- **Opportunity cost**
  - best alternative forgone
  - examples
• **Microeconomics and macroeconomics**
  
  • **Microeconomics:**
    - focus on detail
    - microscope
    - examples
  
  • **Macroeconomics:**
    - deals with whole economy
    - examples

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**Major flows in the economy**

• Production $\rightarrow$ income $\rightarrow$ spending/expenditure

*Production, income and spending*
• **Production:**
  – factors of production
    ▪ natural resources (land)
    ▪ labour
    ▪ capital
    ▪ entrepreneurship

• **Income:**
  – Flipside of production
  – Reward of the factors of production
    ▪ rent (natural resources)
    ▪ wages and salaries (labour)
    ▪ interest (capital)
    ▪ profit (entrepreneurship)
- **Spending**: expenditure by all sectors of the economy
  - consumption expenditure by households (C)
  - investment (capital) expenditure by firms (I)
  - government spending (G)
  - exports (X) minus imports (Z)
Circular flows

- **Goods market and factor market**

- **Circular flow of goods and services**

The circular flow of goods and services

- **Circular flow of income and spending**
  (opposite direction to goods and services)

The circular flow of income and spending
• **Injections into (or additions to) circular flow of income and spending**
  – investment spending/capital formation
  – government spending on goods and services
  – exports

• **Withdrawals or leakages from the circular flow**
  – saving
  – taxes
  – imports

• **Note that capital goods (capital as factor of production) are tangible**

• **Investment refers to purchase of capital goods**
The government in the circular flow of production, income and spending

The main elements of the circular flow of income and spending
Macroeconomic theory

Simplification, abstraction, model

Purposes

• explanation
• prediction
• policy

Macroeconomic policy

Objectives

• economic growth
• full employment/low unemployment
• price stability/low inflation
• balance of payments stability/external stability
• equitable/socially acceptable distribution of income
Instruments

- monetary policy
- fiscal policy
- other policies

Things to watch out for

*Fallacy of composition*

- whole is more than the sum of the parts
- what is true for single part not necessarily true for the whole
  > examples
Do not confuse correlation with causation
  ➢ examples

Do not confuse levels with rates of change
  ➢ examples