

Lecture -1

**Subject and
methods of**

Economic Theory

Lecture outline.

- 1. The subject of Economic Theory.
Three basic problems of daily living
- 2. Methods of Economic Theory

3. Positive and normative
Economics

4. Microeconomics and
Macroeconomics

- **Economics is the study of how society decides what, how, and for whom to produce.**

- **Economy** - is a special sphere of social life with its own laws, problems and contradictions. In this area, the economic potential of a society is formed, producing different goods for satisfaction the physiological and spiritual needs of people.
- **Economics** - efficient management of limited productive resources for the purpose of attaining the maximum satisfaction of human material needs.
- **Economics** is concerned with the efficient use of scarce resources for the production of goods and services to satisfy material needs.
- **Economics** - how to use scarce resources efficiently

- **Economic theory** is a science which studies production relations between economic agents in the process of production, exchange, distribution and consumption of goods and services

Thinking Like an Economist

- Every field of study has its own terminology
 - Mathematics
 - integrals ❖ axioms ❖ vector spaces
 - Psychology
 - ego ❖ id ❖ cognitive dissonance
 - Law
 - promissory ❖ estoppel ❖ torts ❖ venues
 - Economics
 - supply ❖ opportunity cost ❖ elasticity ❖ consumer surplus ❖ demand ❖ comparative advantage ❖ deadweight loss

Thinking Like an Economist

- Economics trains you to. . . .
 - Think in terms of alternatives.
 - Evaluate the cost of individual and social choices.
 - Examine and understand how certain events and issues are related.

The subject of Economics is

- human behaviour in the production, distribution, exchange and use of goods and services.**

Three basic problems of Economics

- 1. What goods and services to produce**
- 2. How to produce these goods and services**
- 3. For whom to produce these goods and services**

Trends and schools of economic theory

- Neoclassical school (since the end of XIX century until the 1930s): era of free entrepreneurship.
 - Alfred Marshall (1842-1924) to meet human needs. The key idea was problems of supply and demand as the forces that determine the processes occurring in the market. Neoclassical approach - the price of a commodity is determined by two factors: marginal utility (the buyer) and cost of production (by the seller); quantitative analysis and mathematics
- Keynesian school (since 1930s)
- John Maynard Keynes (1883-1946): theory of effective demand, which offered their prescriptions regulating the economy. His idea was to apply the methods of activation and stimulate aggregate demand (general purchasing power) and thus affect the expansion of the production and supply of goods.

Trends and schools of economic theory

- 1970-1980 - excessive state intervention in the economy stops the development of social production — back to neoclassical doctrine
- Monetarism - a theory of economic stabilization, leading role - monetary factors."back to Smith," abandonment of active methods of state regulation.
- Neoliberalism - another trend in economic theory and practice of economic management. Private enterprise itself can bring the economy out of the crisis and ensure its recovery and prosperity. The State must ensure the conditions for competition and away from excessive regulation of the market.

Positive economics

- The aim of positive economics is to explain how society makes decisions about consumption, production, and exchange of goods

Normative economics

- It offers recommendations based on value judgements.

- *Positive statements* are statements that attempt to describe the world as it is.
 - Called descriptive analysis
- *Normative statements* are statements about how the world should be.
 - Called prescriptive analysis

- Microeconomics - is concerned with the specific economic units and detailed consideration of the behavior of those individuals (we examine the trees, not the forest)
- Macroeconomics - is concerned with the economy as a whole or with the basic subdivisions or aggregates (government, household, business sectors), (total output, total income, total level of employment)

The main key words of microeconomics

- **Product**
- **Price**
- **Income**
- **Revenue**
- **Costs**
- **Profit**
- **Company**
- **Firm**
- **Factory**
- **Consumer**
- **Market**
- **Demand**
- **Supply**

The main key words of macroeconomics

- GNP
- GDP
- Unemployment
- Inflation
- Consumer goods
- Budget
- Export
- Import
- Trade balance
- Payment balance
- Taxes

Methods of economic theory

- - *methods of a scientific abstraction* - is based on abstraction of secondary phenomena, separation and study the most important, typical things in economic processes that allow to formulate typical of the notions, categories, economic laws;
- *a method of the system analysis or system approach* is means the studying an internal structured-functional, causal direct and feedback relationship. Their cognition enables to reveal the complex processes of the development of the production relations, investigate the point of the many economic phenomena and processes;
- *a method of the analysis and syntheses*. The Analysis - is a process of the dismemberment integer on a component parts; the syntheses - is an integration process or phenomena's different element, into united integer.

Methods of economic theory

- Induction - the movement from the particular facts to the general; from the facts to the theory (gathering, accumulation of facts — analysis—theory)
- Deduction - from observation, logic, insight, intuition to the tentative principle or hypothesis; goes from the general to the particular, from the theory to facts.
- Observation
- Macro- and microlevels of analysis
- Generalizations
- Ceteris paribus/other thing equal