KEY ECONOMIC TERMINOLOGY

Timeframe:	Minimum of 8 hours
Learning outcome:	• Understand key economic terminologies and concepts.
Recommended reading:	• Chapters 1 and 2 in Parkin, M. 2013, *Economics: Global and Southern African Perspectives*, 2nd ed., Cape Town: Pearson Education. • Dolan, E.G. 2010, 'Chapter 5: The circular flow of income and expenditure, in Dolan, E.G., *Introduction to Macroeconomics*, 4th ed., BVT Publishing, pp. 123–148, http://www.bvtpublishing.com/files/BV11Chapter5.pdf (accessed 10 February 2014). • Evans, G. 1997a, *Chapter 1: Economic models*, HMC.edu, http://www2.hmc.edu/~evans/chap1.pdf (accessed 10 February 2014). • Investopedia. 2012d, *Economics basics: Introduction*, http://www.investopedia.com/university/economics/default.asp#axzz250jlVolG (accessed 10 February 2014).
Recommended multimedia:	• Learningeconomthego. 2012, 'Introduction to economics — 3: The production possibilities curve', [video online], http://www.youtube.com/watch?v=K4wv_3XL6io (accessed 10 February 2014). • Mr Sandberg. 2012, 'Market economy characteristics', [video online], http://www.youtube.com/watch?v=qybdb80t9fo (accessed 10 February 2014). • Bessey, L. 2012, 'Micro vs. macro economics', [video online], http://www.youtube.com/watch?v=DJG-liA19eY (accessed 10 February 2014). • The Khan Academy. 2012a, 'Circular flow of income and expenditure', [video online], http://www.youtube.com/watch?v=Hfz1bwK5C4o (accessed 10 February 2014).
Section overview:	The aim of this section is to provide an overview of the concept of economics and related terminology such as micro and macroeconomics, inflation, Gross Domestic Product (GDP), Gross National Product (GNP), economic growth rate, fiscal and financial policy, exchange policy and trade policy. We will explain these concepts with the aid of examples. We illustrate the central principles of economics (scarcity; choice and opportunity costs) using the production possibility curve. This section also provides an overview of the circular flow of goods and services in an economy; central economic questions; as well as the highlights of different economic systems.

Introduction

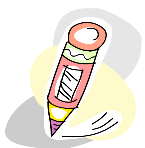
Mohr, Fourie and Associates (2011) state that economics is a social science and, like any other science, involves a systematic attempt to discover regular patterns of behaviour. These patterns are required to explain occurrences and make predictions that can assist policy makers and the overall economic decision-making process.

For example, economics assists us in explaining the level of the petrol price, what the price will be in future, or what will happen to the rest of the economy if the petrol price increases. Economics assists authorities who are responsible for devising a policy pertaining to the petrol price. Economics helps to explain the rise and fall of the petrol price and provides future predictions and policy adaptions that will minimise the effect of the petrol price on the overall economy.

At first, the study of economics may appear to include complicated tables and charts, statistics and numbers but, as you continue to study the science of economics, you will note that it constitutes a rationale for human behaviour in the endeavour to fulfil needs and wants. The aim of this first section is to introduce you to economics and related concepts. Please read through the section carefully and highlight, for yourself, the key concepts that you need to understand in order to continue with the rest of the module.

Defining Economics

Whatiseconomics.org (2012) defines economics as:



"The study of the production and consumption of goods and the transfer of wealth to produce and obtain those goods. Economics explain[s] how people interact within markets to get what they want or accomplish certain goals. Since economics is a driving force of human interaction, studying it often reveals why people and governments behave in particular ways."

According to the American Economic Association (AEA) (2012), economics is the study of how people choose to use resources. Such resources include time, people talent, land, buildings, equipment and other tools on hand, as well as the knowledge of how to combine them to create useful products and services. Economics includes the study of labour, land, investments of money, income and production, taxes and government expenditure. Economics seek to measure wellbeing and to learn how wellbeing may be increased.

Based on this definition, we can surmise that economics is the study of how scarce resources are allocated for alternative uses to satisfy unlimited human wants/ needs. Human wants are the material and non-material goods, services and circumstances that people desire. Resources are the inputs used to produce whatever satisfies human wants.

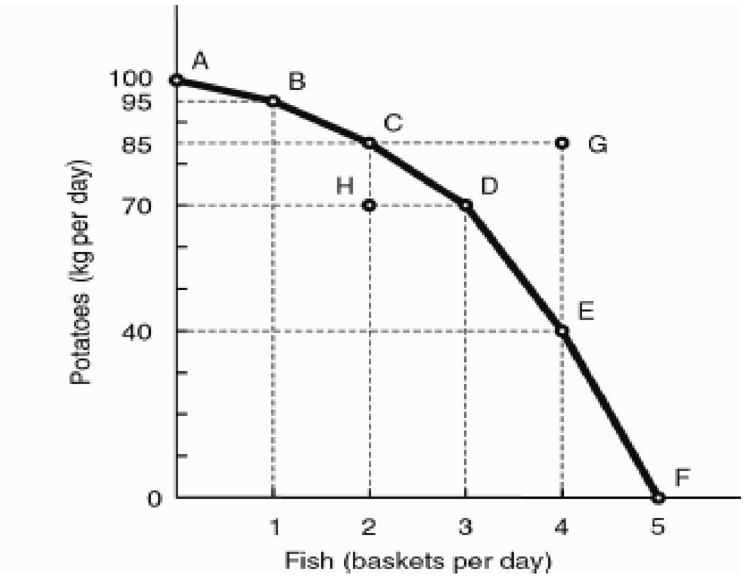
The foundation of economic thought is the concept of scarcity — that there is not enough to satisfy all wants for all people. This comes from our assumption that human wants are infinite, while the resources to fulfil those wants are limited. Even the richest country, with the most advanced technology, is not able to produce everything that everybody wants. This naturally leads to an allocation problem that forces us to choose what to produce (and, by implication, what *not* to produce). Whenever we choose one option, we have sacrificed all the alternatives we could have had instead.

If you choose to buy one DVD as opposed to two CDs you must give up owning two music CDs in exchange for one high-quality DVD.

The above example explains the concept of opportunity costs (what you forego when choosing one option over another). Opportunity cost is one of the defining principles of economics, which is what differentiates economics from accounting and traditional finance.

The concepts of scarcity, choice, and opportunity costs can be illustrated using the production possibility curve as shown below in **Figure 1**:

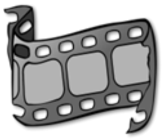
FIGURE 1: THE PRODUCTION POSSIBILITIES CURVE



(Mohr, Fourie and Associates, 2011:8)

The production possibilities curve indicates the combinations of any two goods or services that are attainable when the available resources in a country are fully and efficiently employed (Mohr, Fourie and Associates, 2011:8). On the above diagram, movement to the right from A to F implies the production of fish increasing while the production of potatoes decreases. There is a trade-off between fish and potatoes. This implies that the country can produce 95 units of potatoes and one unit of fish at Point B, but it can produce 40 units of potatoes and four units of fish at Point E. Point G is unattainable and Point H shows that the economy is not at full capacity.

Consult the following source to obtain a better understanding of production possibility curves:



- Learningecon완thego. 2012, 'Introduction to economics — 3: The production possibilities curve', [video online], http://www.youtube.com/watch?v=K4wv_3XL6io (accessed 10 February 2014).

There are three central types of economic questions that underpin economic theory and applications (Mohr, Fourie and Associates, 2011:22):

- **What goods and services will be produced? (Output questions)**

  Goods are tangible objects such as houses, cars, food, etc.; and services are intangible and can include legal services, financial services, medical services etc. Goods can be categorised into consumer goods or capital goods, final goods or intermediate goods, private goods or public goods, economic goods or free goods, and homogeneous or heterogeneous goods (Parkin, Kohler, Lakay, Rhodes, Saayman, Schöer, Scholtz and Thompson, 2010). Goods and services are produced to satisfy human wants.

- **How will each of the goods and services be produced? (Input questions)**

  The production of goods and services needs resources. These resources (factors of production) can be grouped into four categories namely, natural resources, labour, capital, entrepreneurship and technology. The **natural resources** consist of the free gifts of nature such as water, land, minerals, vegetation, etc. **Labour** is the human effort in the production of goods and services. **Capital** refers to all the man-made resources that are used in the production of other goods and services such as machines, tools, buildings, etc. Entrepreneurship involves the identification of opportunities and the combination of labour, capital and natural resources to produce the desired goods and services. The person who drives the process of entrepreneurship is called an entrepreneur. Technological advancement improves the process of entrepreneurship.

- **For whom will the various goods and services be produced? (Distribution questions)**

  Goods and services are produced mainly for those who have the means to demand them. They are distributed to various sectors and participants in the economy. The distribution issue is a highly emotional question, especially in societies where the distribution is unequal.

Macro and Microeconomics

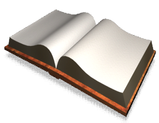
Macro and microeconomics are the two vantage points from which an economy is observed. When we study microeconomics, it is primarily individual human beings and individual firms that we study. Microeconomics tends to study the separate parts of human behaviour and shows us how individuals and firms respond to changes in price and why they demand what they do at particular price levels (Investopedia, 2012e).

Macroeconomics, by contrast, studies whole economies and bigger issues such as unemployment and inflation (Ahlersten, 2008). Macroeconomics looks at the total output of a nation and the way the nation allocates its limited resources, land, labour, and capital in an attempt to maximise production levels and promote trade and growth for future generations (Investopedia, 2012e).

Task Questions

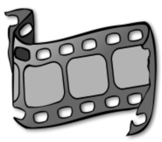
1. In your own words, explain the interaction between micro and macroeconomics.
2. Assume that a colleague has a limited understanding of economics. Explain to this person how gaining an understanding of micro and macroeconomics can benefit her/ him and your organisation.

Read more about micro and macroeconomics by consulting the following source:



- Investopedia. 2012d, *Economics basics: Introduction*, http://www.investopedia.com/university/economics/default.asp#axzz250jlVolG (accessed 10 February 2014).

You can also view the following clip on micro vs. macroeconomics:



- Bessey, L. 2012, 'Micro vs. macro economics', [video online], http://www.youtube.com/watch?v=DJG-liA19eY (accessed 10 February 2014).

Key Concepts Related to Economics

In addition to understanding the concept of micro and macroeconomics, you need to have knowledge of a number of other key terminologies in order to thoroughly grasp the content of this module. A brief definition of key economic concepts will be provided in this section. More detail on how these concepts link to economic development and progress will be provided throughout the study guide.

Key concepts that you should take cognisance of are listed and described in **Table 1**.

TABLE 1: KEY ECONOMIC TERMINOLOGY

Factors of production	Land (earns rent), labour (earns wages), capital (earns interest) and entrepreneurship (earns profit). (Parkin, 2013:3–4)
Choice	A choice is in your self-interest if you think the choice is the best available for you, whereas a choice is in the social interest if it leads to an outcome that is the best for society. A choice is a trade-off giving up one thing to get something else. Rational choice is one that compares costs and benefits and achieves the greatest benefit over cost for the person making the choice. (Parkin, 2013:5–6)
Gross Domestic Product (GDP)	The market value of the final goods and services produced within a country in a given time period. GDP has four parts — market value, final goods and services, produced within a country, in a given time period. (Parkin, 2013:457)
Economic growth	The expansion of production possibilities is called economic growth. Economic growth increases our standard of living, but it does not overcome scarcity and avoid opportunity cost. To make our economy grow, we face a trade-off: The faster we make production grow, the greater the opportunity cost of economic growth. (Parkin, 2013:34)
Market failure	A market does not always produce an efficient outcome — market failure occurs because too little of an item is produced (underproduction) or too much is produced (overproduction). Some of the obstacles to efficiency that bring about market failure include price and quantity regulations, taxes and subsidies, high transaction costs. (Parkin, 2013:108)
Monetary Policy	The control over money supply. A nation's monetary policy objectives and the framework for setting and achieving those objectives stem from the relationship between the central bank and the government. The primary objective is to maintain price stability in order for the economy to achieve balanced and sustainable economic growth. (Parkin, 2013:691)
Fallacy of composition	The false statement that what is true of the parts is true of the whole or that what is true of the whole is true of the parts. For example, a firm retrenches some workers to cut costs and improve its profits. If all firms take similar actions, income falls and so does spending. The firm sells less, and its profits do not improve. (Parkin, 2013:9)
Unemployment rate	The proportion of people in the labour force who do not have jobs. Unemployment is expected to fall during a boom and increase during a recession. However, it should be considered within the contexts of 'frictional' and 'structural' unemployment (frictional refers to the unending flow of people in and out of the labour force as people move through the stages in their lives, whereas structural arises when changes in technology or international competition changes the skills and location needed to perform jobs). (Parkin, 2013:481–484)

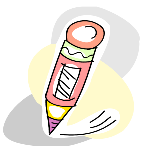
Task — Tip

Refer to the terminology and concepts in **Table 1**. This represents a sample of economic terms and concepts. As you progress through this study guide and your recommended reading (your recommended textbook, in particular), you will accumulate a vast array of economics terminology and concepts. It is important to be conversant in these and be able to use them to assist in economic analysis. Consider using the list of 'Key Terms' at the end of the chapters in your recommended textbook to evaluate your learning.

Example: Refer to Parkin, M. 2013, *Economics: Global and Southern African Perspectives*, 2nd ed., Cape Town: Pearson Education, p. 71.

Economic Models

The foundation of economics rests in the development of theoretical models, which are often tested empirically with the use of different types of statistical and economic analysis. Determining the relation between different variables, understanding the impact of shocks to an economic system, or predicting future economic trends requires that economists objectively examine reality through the development and use of models.



"An **economic model** is a stripped-down, simplified description of an economy or of a component of an economy such as a business or a household. It consists of statements about economic behaviour that can be expressed as equations or as curves in a graph. Economists use models to explore the effects of different policies or other influences on the economy."

(Parkin, 2013:15)