Unit V 1: Introduction to economics

1. Summary

Economic issues affect us all, either directly or indirectly. In economics, a distinction is made between macroeconomics and microeconomics: the former deals with overarching economic issues of an entire society, while microeconomics deals with individual, single markets. Macroeconomics has four main objectives: Economic growth, employment, price stability, and external balance. Central to macroeconomics are the circulation of goods and the circulation of money. To satisfy needs, there are free goods, which are available to all and do not have to be purchased. In addition, there are public goods that are paid for by the general public and used by all. However, most goods are products or services that are sold and bought through the market. They are produced using factors of production that determine how expensive a product or service is. The economy is generally divided into three sectors: a primary sector, a secondary sector and a tertiary sector, depending on the type of goods and services produced.

2. What does economics deal with?

Matthias Wühle (2015:11) has pointed out that the focus of economic considerations is welfare, which is the goal of all economic activity: "Business administration initially interprets this goal as profit maximization for one's own company, whereas economics examines welfare for society as a whole.

"View of the economists and the business economists.
A man is sitting in a hot air balloon and has completely lost his orientation because of the strong wind. He is floating five meters above a field and sees a man below him. "Excuse me, can you tell me where I am?" he calls down.
The man in the field replies, "You are in a red hot air balloon five meters above the surface of the earth."
Then the balloonist says, "You must be an economist."
"That's right," replies the man in the field. "How do you know?"
"It's obvious - your answer, while technically absolutely correct, is still completely worthless."
"Then you must be a top manager," exclaims the man in the field.
"Correct," replies the balloonist. "How did you figure that out?"
"That wasn't particularly difficult either. From your position you actually have an excellent view, but you still don't know where you are or where you are going. Besides, your position hasn't changed since we met. But now I am suddenly responsible for your problem."
Source: Bofinger 2007:32/33.

The American economist Hazel Henderson wrote (1985:42) polemically: "... economic policy measures are too important today to be left to economists". Undoubtedly, many people today think that economic issues are extremely complicated and that they do not understand anything about them. However, economic policy and economic decisions are so important and affect us all so much - directly or indirectly - that they are definitely worth dealing with. Everyone should have at least a basic knowledge of economics.

But what is economics all about? Peter Bofinger (2007:34 as well as 2015:3) stated that economics is mainly about markets: These include

- Goods markets,
- labor markets,
- services markets,
- financial markets and
- Real Estate Markets.

The field of activity of economics can be divided into two major main areas: On the one hand, microeconomics, which deals with individual markets, and on the other hand, macroeconomics, which deals with issues of economic growth, unemployment and overall price developments. There is a close affinity between the microeconomic perspective and business administration, which focuses on the interests of the individual firm in the market and, above all, on issues of corporate governance (management).

The economic behavior of individuals or groups, but also of companies, often leads to macroeconomic developments that were not intended at all. Behavior that is perfectly rational on an individual basis leads to economic results that are completely undesirable. For example, saving in crisis situations makes perfect sense for individuals, but if a large proportion of the people in an economy in crisis put large parts of their income aside, this behavior can deepen the crisis because the demand for goods decreases accordingly.

The different perspectives of macroeconomics and microeconomics, but also of economics and business administration, often lead to a so-called rationality trap. This can be seen, for example, in the theater: If a person stands up to get a better view of what is happening on stage, this may well expand his or her field of vision. But if everyone else stands up as well, the view of the stage is just as bad as before.

The German economist Wolfgang Stützel has called this phenomenon the "competition paradox" (Bofinger 2007:38/39.).

In macroeconomics, four central goals - the so-called magic quadrilateral (see Bofinger 2015:252) - are sought, namely.

- Steady and adequate economic growth,
- high level of employment,
- stable price level, and
- external balance.

2.1 Circulation of goods and money

Any economic system can be represented in terms of the double and opposite cycles of money and goods.

The business cycle model shows the interdependence of the financial and real economies:

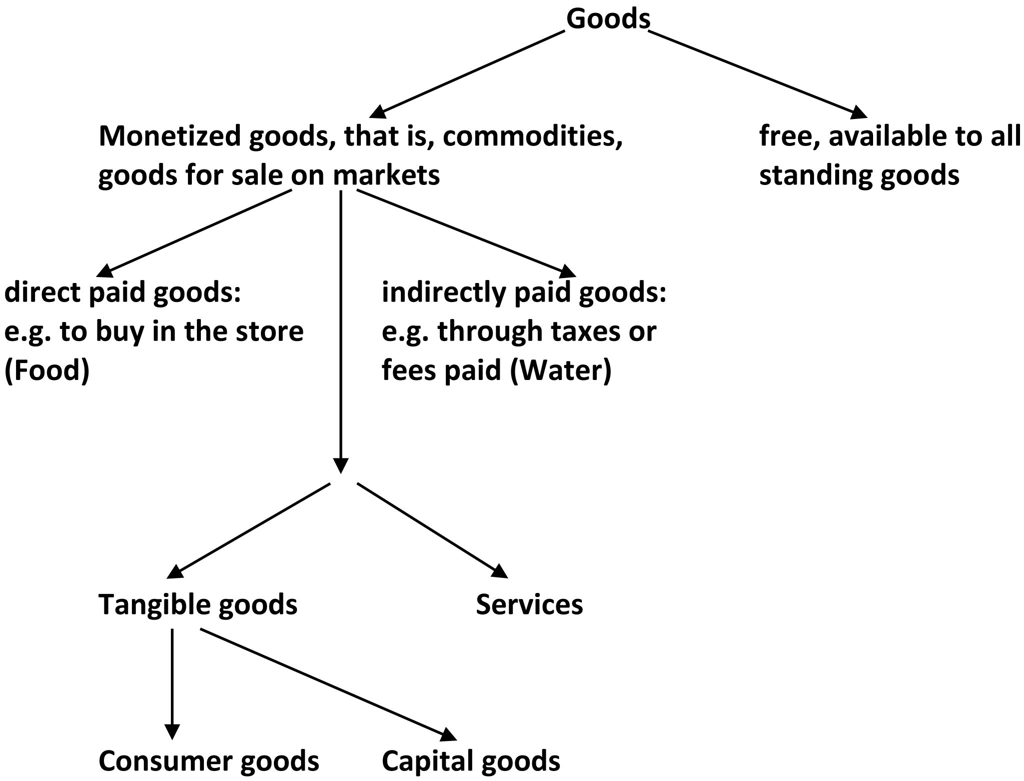
"In the simple business cycle, households own and control resources such as labor, capital and knowledge. These resources are the inputs to the production process. The financial income from the sale of these resources is used to satisfy households' consumption demands for goods and services. Firms respond to this demand by offering appropriate goods and services to generate profits. Both household resources and firms' products are traded in markets (factor and money markets). The interaction of supply and demand thus regulates quantity and price" (Bloss et al 2009:26).

Shortages of essential products - such as food - can occur for very different reasons. For example, when production is too low, when there are supply problems, or when people no longer have the money to buy food. Sen (2003:200) wrote in this regard: "In an economic crisis, some production sectors are sometimes more severely affected than others. For example, in the Bengal famine (1943), the exchange rates of food and certain products changed radically. Huge shifts took place in the relative prices of fish and grains regardless of the price relationship between wages and food. Bengali fishermen were among the worst hit occupational groups in the 1943 famine. Of course, fish is also a food, but it is among the highest quality foods, and poor fishermen must sell fish to buy cheaper calorie donors in the form of staples (in Bengal, this is usually rice) in order to get enough nutritional value to survive. The balance of survival is based on this exchange, and a sudden drop in the relative price of fish to rice can destroy this balance" (cf. in detail Jäggi 2018a:21ff.).

In reality, the goods and money cycle is more complicated. Not only households and businesses, but also the government and foreign countries in the form of trade play an important role.

2.2 The Production of Goods and Services

To satisfy the needs of people, goods and services are produced. There are different types of goods:



Quelle: Eisenhut 2006:20, Eisenhut 2010:16, edited and completed by CJ.

Free goods are goods that are available to everyone in unlimited quantities and for which nothing has to be paid. These include air, in some countries drinking water from rivers, but also love. There is no market for free goods because there is neither scarcity nor are people willing to pay for them.

A special form of economic goods are public goods - also called collective goods: Public goods are goods which are produced in the form of a production process, but which are not brought to the (individual) demanders via the market. Public goods are, for example, public security, national defense, city parks or street lighting. However, strictly speaking, there is also a market for public goods on the supply side. This can be seen, for example, in the fact that public goods can also be provided by private service providers, who certainly also compete with each other (e.g. construction of private prisons in the USA alongside state prisons, private-public partnerships for the generation of electricity or for water supply, etc.).

A characteristic of public goods is that consumers do not compete for these goods - they behave as "free riders," so to speak (Eisenhut 2012:55): they benefit from the public goods, but there is no limited allocation to individual consumers. Classic public goods are usually financed indirectly - e.g., through taxes or fees, although fees never cover the entire cost (e.g., public education, state television, etc.).

While tangible goods are sensually tangible and thus material, services have an intangible character. Capital goods are products that are needed to produce other goods - such as consumer goods - e.g. machinery.

Tangible goods and services are the result of production processes. Factors of production are needed to produce goods. In the past, economics assumed three factors of production: labor, land and capital. Modern economics lists four factors of production. These are partly named differently:

Factors of production:				**Source**
Labor	**Natural** resources: soil and raw material	**Real capital:** Machinery, equipment, buildings	**Knowledge:** Experience, skills, abilities	Eisenhut 2006:21 und 2012:17
Labor	**Materials:** Raw materials and supplies that have to be procured on a regular basis.	**Resources:** machines, tools, land, buildings, money	**Know how:** Technical and specialized knowledge	Brauchle/Pifko 2006:17

Three principles are important for the production of goods and services:

- **The minimum principle**: producing the good or service with the least possible input. The satisfaction of needs with as little input as possible.
- **The maximum principle**: as many tangible goods or services as possible are produced with a given input or fixed resources. The given input leads to the greatest possible satisfaction of needs or to the greatest possible output.
- **The optimum principle**: With the smallest possible input of means or production factors, the greatest possible output or a good output is achieved: With as little input

as possible, the greatest possible output is achieved (cf. Eisenhut 2006:23 and Brauchle/Pifko 2006:17).

These three principles show the dilemma of the national economy: On the one hand, the needs of as many people as possible should be satisfied; on the other hand, this should be done as efficiently as possible - i.e. at low cost - and without serious damage to nature and people. This means that a further principle would have to be added to these three principles:

- **The sustainability principle**: Economic processes are to be designed in such a way that they neither damage people's habitat - even locally - nor affect people themselves in terms of health, social well-being and quality of life - both those living today and future generations.

In connection with the maximum principle, the so-called Pareto criterion should be mentioned. It is named after the sociologist Vilfredo Pareto, who dealt with questions of economics at the end of the 19th century.

"The Pareto criterion ... is the answer of recent welfare theory to the 'communist fiction' of the utilitarian principle and the idea of a 'national economic maximum' based on it. According to the Pareto criterion, only those social changes are to be recognized as collective (economic) welfare improvements which improve the (subjectively assessed) situation of at least one individual without worsening the situation of any other individual. Thus, any social (political) reform proposal is considered to be pareto-efficient if all participants agree to it solely because it is the most advantageous alternative available in real terms for each of them and thus 'to the advantage of all concerned'. Conversely, any proposal for changing social rules of the game that provokes rejection (lack of 'acceptance') among individually affected persons because the change violates their vested interests according to their subjective perception is considered pareto-inefficient."
Source: Ulrich 2016:2003.

According to Ulrich (2016:204), the Pareto criterion is actually an "individualistic concept of the common good". Therefore, if it serves the private benefit of each individual, it also serves the general good. However, one would have to restrict here that the benefit or the damage must also be recognized as such by the individual. Thus, environmental regulations, whose effect can often only be recognized in the long term, are only perceived as costs in the short term for the individual or the individual company, which if not invalidates the Pareto criterion, at least puts it into perspective. This is precisely why, for example, the

Trump administration withdrew from the climate agreement. Another example is the nuclear power plants, which are far too expensive to operate and, in particular, too risky to dispose of, but which continue to be connected to the grid because a few people - namely the operators and their shareholders - earn money from them.

Peter Ulrich (2016:205) criticized the Pareto criterion - or more precisely, its application as an ethical legitimization of economic decisions - for reducing every economic decision to a question of general acceptance: "If Pareto efficiency is regarded as a sufficient legitimation criterion, then ... ethical legitimation (justification) is legitimized to strategic acceptance (enforceability)" (Ulrich 2016:205). At the same time, any market can be understood as Pareto-compliant and thus ultimately ethically just from a limited perspective: "Since in a 'free' market all exchange transactions that come about are formally entered into voluntarily, i.e. everyone always acts to his or her advantage, the market is by definition and quite independently of the initial distribution of resources efficient for all participants and thus overall Pareto-efficient" (Ulrich 2016:208).

2.3 Development phases of the market economy

According to Jürg Huffschmid (2002:17), the market economy - or capitalism - has undergone various changes since World War II. Today, it is in its third phase. In the period after 1945 until about the mid-1970s - as the first phase - the social market economy developed, or as Huffschmid (2002:17) says, reform capitalism. This was strongly influenced by the labor and trade union movement and provided for a whole range of social safeguards, including employee co-determination. From the mid-1970s, this form of market economy was overlaid by another model of market economy, namely the neoliberal market economy or neo-liberalism. In it, financial markets played a decisive and increasingly important role. Neo-liberalism lasted until 2007 at the latest, i.e. until the beginning of the financial crisis. According to Huffschmid (2002:17), a third pattern of market economy began to emerge from the 1990s, or at the latest from the turn of the millennium, in which "open, state and non-state power overlapped the law of markets." These three forms overlapped to some extent, and in all three manifestations the three elements of reform, counter-reform and violence occurred to a greater or lesser extent. One could also say that today, as a result of globalization, anarchic forms of market economy dominate in many places due to the absence or weakness of nation-state monopolies of violence and in the form of many local markets of violence.

According to the goods produced, a distinction is made in economics between the following economic sectors:

	Areas	**Type of production**
Primary sector	Mining, agriculture, forestry	Extraction of raw materials
Secondary sector	Industry, commerce	Manufacturing sector
Tertiary sector	Trade, banking, insurance, social sector, education	Services

The development of the national economies is also reflected in the shift of the individual economic sectors. Whereas at the beginning of industrialization practically all countries had a population of about 80% working in agriculture, the share of farmers in the highly industrialized countries fell to less than 5%. Temporarily, the industrial sector increased strongly. Later, the service sector dominated.

In recent years, the industrial sector has continued to decline, at least in terms of the number of people employed in it. This is largely due to the strong increase in productivity in industry. Despite globalization, competition from China and emerging states such as Mexico, the USA, for example, is producing more and more goods, but with fewer and fewer workers. At the industrial peak in mid-1979, there were 19.5 million people working in industry in the U.S.; by early 1987, there were still 17.5 million (see Lanz in Neue Zürcher Zeitung, Dec. 3, 2016:29). Between the turn of the millennium and the severe recession following the financial crisis, around 6 million jobs were lost in industry. In 2016, only just under 9 million Americans were still employed in industry in the narrow sense (see Lanz in Neue Zürcher Zeitung of 3.12.2016:29). However, one cannot speak of de-industrialization here, because output has not become smaller, but larger.

In Switzerland, the three economic sectors have developed over time as follows:

Sectors	Percentage distribution of the workforce					
	1950	1960	1970	1980	1990	2011
Agriculture	21,7%	13,7%	8,2%	6,9%	4,3%	3,5%
Industry	41,5%	45,8%	45,4%	39,7%	32,2%	22,8%
Services	36,8%	40,5%	46,4%	53,4%	63,5%	73,7%

Source: Eisenhut 2012:142.

In terms of tendency, this also applies to most other countries - albeit to varying degrees and with a time lag.

3. Control Questions

1. What are the five types of markets that economics deals with?
2. What does microeconomics deal with?
3. Explain the rationality trap.
4. What is meant by the competition paradox?
5. What are the four central goals of macroeconomics?
6. Outline the extended goods and money cycle.
7. What are the types of goods?
8. What are free goods?
9. What are public goods?
10. Name the four factors of production and explain them.
11. Which three principles are important in a market economy?
12. Which fourth principle should be added?
13. Name and explain the three sectors of an economy.

4. Links

Produktionsfaktoren
http://www.betriebswirtschaft-lernen.net/erklaerung/produktionsfaktoren-vwl/

Güter und Arten von Gütern
http://www.rechnungswesen-verstehen.de/bwl-vwl/bwl/gueter.php

Begeisterung für Wirtschaft, Finanzen und ökonomisches Handeln - das ist Oeconomix!
http://www.oeconomix.de/oeconomix-startseite/

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