Introduction to Economics

Economics is the social science studying the production, distribution and consumption of goods and services. It is a complex social science that spans from mathematics to psychology. At its most basic, however, economics considers how a society provides for its needs. Its most basic need is survival; which requires food, clothing and shelter. Once those are covered, it can then look at more sophisticated commodities such as services, personal transport, entertainment, the list goes on. Today, this social science known as "Economics" tends to refer only to the type of economic thought which political economists refer to as *Neoclassical Economics*. It developed in the 18th century based on the idea that Economics can be analysed mathematically and scientifically.

Contents

What is Value?

A generally accepted notion of Value is the worth of goods and services as determined by markets. Thus an important part of Economics is the study of policies and activities for the generation and transfer of Value within markets in the form of goods and services. Often a measure for the worth of goods and services is units of currency such as the US Dollar, peso, etc... But, unlike the units of measurements in Physics such as Seconds for Time, there exists no absolute basis for standardizing the units for Value. Usually the value of a currency is related to the value of Gold, which in turn is valued by amount or number of goods and services that it can be exchanged for. Because the rate of production of gold in the world is slower than the rate of creation of goods and services, the relation between gold and currencies is not as strict as it used to be.

Thus, one of the most complicated and most often misunderstood parts of economy is the concept of *value*. One of the big problems is the large number of different types of values that seem to exist, such as *exchange-value*, *surplus-value*, *use-value*

The discussion of values all start with one simple question: **What is something worth?**

Today's most common answer is one of those answers that are so deceptively simple that it seems obvious when you know it. But then remember that it took economists more than a hundred years to figure it out: *Something is worth whatever you think it is worth*. In 1st century BC, Publilius Syrus wrote: "Something is only worth what someone is willing to pay for it".

This statement needs some explanation. Take as an example two companies that are thinking of buying a new copying machine. One company does not think they will use a copying machine that much, but the other knows it will copy a lot of papers. This second company will be prepared to pay more for a copying machine than the first one. They find different *utility* in the object.

The companies also have a choice of models. The first company knows that many of the papers will need to be copied on both sides. The second company knows that very few of the papers it copies will need double sided copying. Of course, the second company will not pay much more for this, while the first company will. In this example, we see that a buyer will be prepared to pay more for the increase in utility compared to alternative products.

But how does the seller value things? Well, in pretty much the same way. Of course, most sellers today do not intend to use the object he sells himself. The utility for the seller is not as an object of usage, but as a source of income. And here again it is marginal utility that comes in. For which price can you sell the object? If you put in some more work, can you get a higher price?

Here we also get into the resellers utility. Somebody who deals in trading will look at an object, and the utility for him is to be able to sell it again. How much work will it take, and what margins are possible?

So not only do the two different buyers have a different value on an object, the salesman puts his value on it, and the original manufacturer may have put yet another value on it. The value depends on the person who does the valuation, it is subjective.

So, how do all these subjective values turn into the price? To understand that, we must take a look at the place where things are bought and sold: The market.

The Market

The market is the place/system or arrangement where buyers and sellers of goods and services come into close contact with each other for the purpose of business transactions. Not only can you have electronic marketplaces such as eBay, markets are also seen as the congregation of all people buying and selling things everywhere. This is usually named *"the market"* and referenced to as it is a thing with a will and a power of it's own. But of course, it is just the average will and opinion of all the buyers and sellers, the *actors*, on the market that shows itself by prices rising and falling and money moving around.

Setting a price

An object's Value, worth and utility is not something fixed, but instead a subjective property of the object. This subjectivity may be a bit surprising, it is easy to imagine that something must have an objective worth being bought and sold. However this is not the case, in fact, it's the opposite.

When somebody has an item to sell, he puts a value on this item, and will not sell under that value. Likewise, when somebody wants to buy something, he will put a value on the object, and will not pay more than this. If these valuations overlap, so that the buyer's valuation is higher than the seller's valuation, the object will be sold. If the seller's valuation is higher than the buyer's, the buyer will simply say "it's not worth it" or the seller will say "it's worth more than that" and no deal will be made.

Of course, you don't haggle about price every time you buy a candy bar, but you still agree on a price. It's just that the store owner has put up a sign with a price, and you can either accept it or reject it. Neither you nor him want to haggle about something that just costs eighty cents, because it's simply not worth the effort. So even though haggling is not a necessary part of the pricing, both the buyer and seller agrees on the price, and both think they are better off after the exchange. Think about this: If you would think you would be worse off after buying something, would you buy it? Of course not, so buying and selling is an act done by free will. (Unless of course somebody is pointing a gun at you, but then it's not buying and selling, but stealing.)

Now, we know that the price ends up somewhere between the seller's valuation of the item and the buyer's valuation of the item. The question of what the price of an item will be, therefore depends on these valuations. What, then will these valuations depend on?

If an object had an intrinsic, objective worth, and both seller and buyer were aware of it, the buyer's and seller's valuation of the object would never overlap, and no deal would ever be cut, because the seller would never be willing to sell it at a price less than the objective worth [or else he would be in loss] and the buyer would never be willing to buy it at a cost higher than the objective worth [why would he?], and hence, nobody would ever sell or buy anything. The subjectiveness of value is necessary for things to be sold and bought at all.

Free and Regulated markets

The description above is of a free market, where anyone can buy and sell, and where price is set by buyer and seller alone. This is not always the case. Instead many markets are *regulated*.

While the national government may hold the ultimate control over national affairs, at least to some degree, depending on its level of political/economical independency, often it will delegate the power to private or non-governmental public authorities, even to supra national or international institutions to oversee the regulatory needs, internationally there may be also be other regulations due to treaties and accords.

A form of sanctioned bureaucratic approval is often necessary to limit either the people involved or the prices or both, or to make sure the action/function is not a danger to others. For example, not everyone is allowed to sell medicine, claim to be a doctor or drive a taxi. But it goes beyond public security, it can be generalized primarily as a way to protect special interest groups, more than the good of the general public. Regulated markets include for instance valuable metals, currency, weapons, technical functions (practice of medicine, drug production, prescription, sale) and even educational accreditation and technology. This regulations can take many shapes, for example the control of prices, movement/transfer, establishing of quality and quantity gradients and the freedom and requirements to practice a job/function.

Of course, it can be said today that all markets are regulated in some way. When the state sets up the rules for making the market function smoothly is not usually seen as making the market non-free, at best it is to exert control (protect, manage), preserve market (social-economic) stability and increase national competitiveness.

Money

Money is such an obvious and integral part of today's society, that it is sometimes difficult to imagine society without it. It's also a very abstract concept, and can be hard to grasp. It comes in many forms, from special types of sea-shells, to pigs, and via the paper and coin system to digital blips in a computer. But what is money, really?

As we have seen, people value things differently. But communicating this value to somebody else is a problem. The only way you can communicate this value is by comparing it with other things. But since all others, just like you, have subjective values, it becomes complex and confusing. This gets evident if we look at how value impacts on barter

The complexities of barter

When exchanging goods by barter, you need to find something you want more than something you have, while the person you barter with has to value the thing you have more than the thing you want. There are four individual valuations that must match.

An example might clear things up: If what you really want is some shoes, and the thing you have that you want to get rid of is a chair, you have to find a shoemaker that needs a chair, or you will not get any shoes. Say that the shoemaker instead needs a lamp. Then you can find somebody else that needs a chair, and has a lamp, barter that, and then go to the shoemaker.

Now, the big problem here is that when you are to value the lamp, it is no longer what you think of the lamp that is important. It's what the shoemaker thinks of the lamp. You need to guess its average value, so that you can be reasonably sure that the shoemaker will want it. The effect of this is that you pretty much need to know how people value almost everything, since you'll be forced into bartering almost everything.

This type of direct barter system may seem to some as not very efficient, but in fact may be extremely efficient if done in the proper context and with the needed infrastructures, especially in today technological world. The reason we don't do it like that ? Well, we can only state that it is not the general norm. There are plenty of communities that still use barter systems. Bartering is also the system that is adopted as soon as any other more complex system fails or loses trust. But due to the way trade evolved with the appearance of larger markets and adoption of currency the need of an increased level of economic control and taxation become evident to ruling classes and inevitable beyond the level of city states.

The essence of money

So in essence, money is a common value system. It quantifies the value of an object in a way that everyone understands, and it makes communicating with others simpler. Instead of weighing the values of the shoes against the lamp against the chair, you can set a number on it. You can say that your chair is worth five units, the lamp maker can value his lamp to three units and the shoemaker thinks his shoes are worth four units. We can now instantly and easily compare values. Trading suddenly got much easier.

But that's not all. With a common value system that is based on exchangeable entities, we can exchange these entities as payment. You can now go down with your chair to the market, sell the chair to the highest bidder, and then go with your money to the shoemaker, and buy a couple of shoes. The shoemaker in turn takes the money and goes to the lamp maker. No longer do you need to evaluate the average market value of the lamp, or cut three-way deals. All you need to do is find somebody that is willing to pay what you think your chair is worth, and find a pair of shoes that is cheap enough for you.

And it doesn't even end there! Money can be stored because it does not rot like wood or rust like steel. If you have a source of income that is seasonal you can keep the money you make during high-season and buy food with it during low season.

So money is simply a common value system based on exchangeable entities. But this simple concept makes life much less complicated in so many ways.

Supply and Demand

The principle of *supply and demand* is one of the best-known principles of economic theory. It was first posited by Jean-Baptiste Say, an 18th-century Classical Political Economist who suggested that demand and supply are interrelated. His theory was that the more people want something, the higher the demand is for it and the more they will value it. So if something is in low supply but in high demand the value is increased, as it will decrease if there is an abundance or a low demand for the that item. For example: There are 100 dolls and 400 people that want those dolls. Since there are more people than there are dolls, people will pay more money for them.

Alfred Marshall, a famous neoclassical economist, went further in the mid-20th century and developed a mathematical model of supply and demand. The two variables in this theory are price and quantity. The forces of demand and supply are prominent in determining the price of a commodity.

Capital

Capitalism, as its name suggests, is based on the ownership of capital. What is capital? Basically, capital is anything that can be traded for something else. Any amount of money is capital, as it can be traded for a huge variety of things. Personal items are also capital because they can be sold; houses, cars, and other bizarre items fall under this category. The ability to work can also be considered capital, or labour-power.

Karl Marx first posited that perhaps there was something that separated capital into two broad categories. Some capital is bought, and then the value is fixed; this applies for an item of clothing or food, for instance. Some may lose value and depreciate; cars fall into this category. Some capital, however, can actually produce more capital which can then be sold; this, he argued, is *real* capital. For example, if you have a cookie-stamper and a van, some flour, butter, and other cookie ingredients, with that capital, you could produce cookies and ship them around in the van selling them for a profit, albeit small.