FINANCIAL LITERACY
FOR YOUTHS

Introductory Economics

Fundamentals of Economics

Before we make any decisions, we do a simple cost benefit analysis will illustrate this principle by describing to you how a person would start up a lemonade stand. At the start, you would have to get a supply of lemons, build the stand and probably equipment to serve it with. All of this factors would contribute a cost in terms of money. Subsequently you will factor in the benefits that come along with having the stand. These data are needed to make a well informed decision. To start up the business the benefits must be greater than the costs.

You may wonder what motivates the entrepreneur to start the lemonade stand. It can be said that incentives are what drives individuals into starting the business. The primary incentive would be the financial benefits such as additional disposable income. Other benefits such as the satisfaction that comes with working hard to earn a living or the putting all the free time to good use may play a role as well.

Another term that is commonly used in economics is the opportunity cost. It is the value of the next best alternative use of that resource [1]. In our example, a resource that is used is the entrepreneurs time and effort. For the entrepreneurs, if he or she were to spend time and effort to start the lemonade stand, the he would not have the time to spend with his family. So his opportunity cost would be what he had to let go, in this case it is spending time with family.
International Economics

Trading is an important aspect of economics. Trade is the exchange of goods with money or other goods. A customer buying lemonade in exchange for money would be a good example of trade.

Among important aspects of international economics is balance of payment. The balance of payment is the difference between imports and exports of a country. If we were to use the lemon example. Let’s assume that the lemons are transported in and out of the country and the country only trades one type of good, if the cost of lemons is less than the value of lemonade exported it is said that the country has a trade surplus. If the cost of lemons is higher than the value of lemonade, then the country is said to have a trade deficit.

Then there are the barriers to trade. These are government imposed restraints on the flow of international exchange of goods. For an example, the government may impose an import tariff (tax on imports) on lemons in order to protect local lemon industry. This can be classified as a protectionist measure.

Another concept that is often taken into account is comparative advantage. A country is said to have comparative advantage if it can produce something at a cost lesser than everyone else. In situations like this it is better to leave the production of that good to the country with comparative advantage and other countries can trade with the that country to obtain the good rather than trying to produce it at a higher cost.

Something that we should always take into account when it comes to international trade is the exchange rate. It is the price of a currency expressed in terms of another currency. Appreciation of a currency can cause goods to be relatively more expensive in other countries while depreciation would have a reverse effect.

Microeconomics

It is the study of the behaviour and decisions of individuals and businesses in markets in the economy and is concerned with how resources are used to produce goods and services to meet the needs and wants of individuals.

In microeconomics scarcity plays an important role. Everything in this world exists in a limited amount and we as humans want many things, but the limitation of things confines us to the notion of trade. In the modern context, people obtain these goods in exchange for cash. A decision then represents itself; would you purchase lemonade in exchange for cash or use it for the attainment of other things. This idea of choice is an economic one. Should you decide to purchase lemonade and quench your thirst, you'd lose out on, say that apple pie you were starving for. This forfeiture is an opportunity cost. This problem of 'scarcity' then requires us to make a choice regarding what, how and for whom to produce (resource allocation).

Another aspect of microeconomics is the pricing of goods; the general assumption is that the prices of things are determined to reflect the use of it to the consumer. The diamond water paradox contradicts this. We know diamonds are priced explicitly higher than water. You would suggest that diamonds are costlier because it takes considerably more effort to procure and produce. But consider this, if you were in a dessert, there would be no doubt that water is more valuable. The price of a good is dependent on the collective perceived value of the good. This assumption of worth represents the demand of an item and provision of it is the supply.
In conclusion, the price of goods a determined by the law of demand and supply.

Since scarcity requires us to make choices, the choices an economy makes would then depend on the economic system it adopts, i.e. market economy (Free Market/ Free Enterprise Economy) whereby consumer sovereignty exists in other words there are multiple brands of lemon to pick from, planned economy (Command Economy) in which the government plays a central role in all decisions that are being made. For example, there would likely be only one brand of lemon available for the consumer to pick from as the government tries to allocate the resources elsewhere. Mixed economy is where public and private sectors work together.

Macroeconomics

Macroeconomics deals with the aggregate economy. Two of the common economic problems that plague the society we live in are Inflation and Unemployment. Inflation is the general increase in prices which occur over each year. In the lemonade example, If the cost of each of your lemons experience a 5% increase in price then from the initial cost of RM1 would rise to RM 1.05. Why inflation is a problem would be, because it decreases the value of money you have, so for that amount of cash you afford less. Another problem that arises due to an economic shortcoming would be unemployment. This refers to category of people who are willing and able to work but for reasons are unable to enter the workforce. These problems give rise to policies to circumvent these social ills.

Fiscal policy is the use of taxation and government spending to influence economic activity. For an example, expenditure can be governments giving tax breaks to lemonade vendors for the first 5 years to help them establish themselves.

Monetary policy consists of the actions of a central bank, currency board or other regulatory committee that determine the size and rate of growth of the money supply, which in turn affects interest rates which then would affect decisions to save and decisions to invest. A high interest rate may cause the lemonade vendor to store money in the bank instead of investing in expanding his business.

Reference:

1. Henderson, D. (2008). The concise encyclopaedia of economics. Indianapolis, Ind.: Liberty Fund.
2. Econlib.org. (2016). The 51 Key Economics Concepts | Library of Economics and Liberty. [online] Available at: http://www.econlib.org/library/Topics/HighSchool/KeyConcepts.html