

The Economic Way of Thinking

Economics is a branch of social science. Its focus is on the behaviour of households, enterprises, and government agencies. In the complex society of today, economic problems and issues arise all the time. Those trained in economics will have the necessary tools to investigate into the social and economic phenomena. The toolkit of economists is far from being a black box. It is comprehensible to a person of average intelligence, as long as one masters the basic principles and theories. A few examples can illustrate. One key concept in economics is incentives, which motivate people to act in particular ways. This idea stems from the hypothesis of "the rational man." Thus, if the government raises the tax on cigarettes, the demand for cigarettes will decline. If university rankings take class sizes in excess of 50 to be a negative factor, universities will try to limit class sizes to no more than 50. Incentives are very important as drivers of society. Yet they are not well understood and sometimes even ignored altogether. During the time of central planning on the mainland, state enterprises do not maximize profit and do not care about the satisfaction of the consumers of their products. They care, instead, only whether or not they meet the target given by the planners. For example, a state enterprise that produces iron nails will try to produce the required number without caring the weight. If the planners require the nails to be weighty, the enterprise will produce such accordingly. But each time the nails may not meet the real needs of consumers.

A policy maker that fails to consider the responses of people to their policies, certain incentives intended to work in one way could turn out working in other ways--even in contrary to what is intended. There is a well known story in colonial India. At that time, there were many cobra that pose a threat to the people. The government, intent on killing the cobra, declared it would give rewards to those who would present a dead cobra. But this policy, while apparently successful in the beginning, failed to curb the number of cobra. The reason is that some farmers were incentivized to raise cobra. The government then withdrew the policy. The result was disastrous. The farmers readily let go the cobra that they were raising into the wild.

Economics requires model building or theorizing. The models are often represented by graphs or mathematical equations, and they can be highly abstract. A physicist studying a falling object would assume away the friction with the air molecules. This simplifies their analysis, but may not agree with

the world as we know. However, once the underlying laws are well understood, physicists can always take the effects of friction into consideration. Similarly, economists often start with a two country model trading two goods without any trade barriers. When the effects of free trade are well understood, then it is possible to introduce trade barriers. The free trade scenario will then become a benchmark against which we can study the effects of trade barriers. Students of economics often are first introduced to the model of perfect competition, and general equilibrium is taken to be the norm. Economists studying the role of transaction costs often start with zero transaction costs--which is assumed under the Coase Theorem. But this scenario serves as a benchmark only, and is not intended to be a description of reality.

To check if a particular theoretical model is valid, economists need to take their models out to the world for a test. For physical science, it is possible to conduct experiments in a laboratory, and they can do various tests according to their needs. In social science, it is often not possible to do experiments they way scientists do. Macroeconomists, for example, take the data available as they are to do statistical analysis. The relationship between money supply and inflation is not found out in a laboratory, but through studies of the experiences in various countries. The effects of the money supply on inflation can be crystallized through controlling the effects of other variables in a multivariate regression.

The Economics Department of Lingnan University is a department under the Faculty of Social Sciences. It offers a full range of well structured courses spanning many areas and at different levels. Apart from laying out solid foundations of economics through microeconomics and macroeconomics courses, our courses include finance, international economics, labour economics, industrial economics, game theory, public economics, development economics, environmental economics, urban economics, etc.

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Sources:

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