

2 Nature and context of economics

2.1 Economics is the study of the factors that influence income, wealth and well-being. From this it seeks to inform the design and implementation of economic policy. Its aim is to analyse and understand the allocation, distribution and utilisation of resources and their consequences for economic and social well-being. Economics is concerned with such phenomena in the past and present and how they may evolve in the future.

2.2 Studying economics requires an understanding of how resources are used and how economic entities, such as households, firms and governments, behave and interact. This understanding is required at both the individual (micro) and the aggregate (macro) level. The analysis is both static (dealing with, for example, levels of output, employment, income, trade and finance) and dynamic (concerned with, for example, innovation, technical progress, economic growth, business cycles, sustainable development and its resource base). The study of economics requires an understanding of resources, agents, sectors, institutions and mechanisms and how they interact. Moreover, since virtually no economy operates in isolation, it is important that these phenomena are studied in an international context.

2.3 Economics is a major part of social science. It also engages with a wide range of other subject areas such as psychology, history, finance, politics, international relations, law, ethics and philosophy. It uses mathematics and statistics and also incorporates findings from sciences such as environmental science, biology and medicine. As economics is also integral to understanding business behaviour, strategy and corporate performance, it is also one of the core disciplines informing the study of business and management and related areas.

2.4 Recognition of these interrelationships and the increasing number of students who are choosing to study economics jointly with other subjects have led to new and imaginative degree programmes. Their design has been influenced by the appreciation that a training that includes economics provides significant employment opportunities in a variety of careers in addition to working as a professional economist.

2.5 This points to certain key intellectual features that characterise the economist's approach. First there is the ability to abstract and simplify in order to identify and model the essence of a problem. Second is the ability to analyse and reason - both deductively and inductively. Third is the ability to gather evidence and to assimilate, structure, analyse and evaluate qualitative and quantitative data. Fourth is the ability to communicate results concisely to a variety of audiences, including those with no training in economics. Fifth is the ability to think critically about the limits of one's analysis in a broader socio-economic context. Sixth is the ability to draw economic policy inferences, to recognise the potential constraints in their implementation and to evaluate the efficacy of policy outcomes in the light of stated policy objectives.

From learning economic principles, the typical student acquires a facility with some key concepts that are present in most of the decision problems that they are likely to face subsequently in their careers. These include:

- **opportunity cost** - a problem solver or decision-maker must routinely ask 'what would have to be given up if...', where the answer does not always involve a simply calculated financial cost. It is often the case that actions are proposed that fail to recognise forgone alternatives. Opportunity cost allows the economist to think about the costs in terms of all resources. Also, there are many examples of economic policies which enhance efficiency yet reduce equity and vice-versa. There are also many examples where gains in one time period involve costs in other time periods. All of these examples encourage an appreciation of inevitable trade-offs
- **incentives** - economists are trained to recognise and evaluate the incentives implied by particular rules, and how to establish sets of rules that actually lead people to react in ways that give rise to some intended outcome. The ability to think logically about these issues is essential in the effective design of both policy and strategy
- **equilibrium, disequilibrium and stability** - these are concepts that economists make heavy use of and the typical graduate will have seen these deployed in economic argument with great regularity. The concept of equilibrium is a state where no participant has any incentive to change behaviour. The ability to recognise disequilibria and appreciate their stability properties, and to think coherently about reactions to this, are essential ingredients of good decision-making
- **strategic thinking** - economists learn the importance of strategic thinking, and the roles of opportunities, strategies, outcomes, information and motivation in the analysis of strategic actions, including conflict, bargaining and negotiation
- **expectations and surprises** - economists learn that behaviour partly depends on experience and partly on peoples' perceptions of what is expected to happen. Thus behaviour may change when unanticipated events occur. Effective decision-making requires the skill of reacting in a context where people's behaviour is based on expectations that may be confounded by subsequent surprises. Students in economics will have been exposed to these issues and this will enhance their potential effectiveness as decision-makers
- **the relevance of marginal considerations** - economists are trained to recognise that important decisions often relate to small variations in key variables and parameters. An action is worth undertaking if the additional benefit that accrues is greater than the additional cost incurred. The typical student in economics will be fully aware of the importance of the margin relative to the average
- **the possible gains from voluntary exchange** - economists study and measure the net gains that people, institutions and countries can obtain from economic interaction in the form of specialisation, employment, exchange and trade. The identification and measurement of gains relative to costs and the barriers to maximising net gains are important in devising appropriate policies to optimise the use of scarce resources with respect to various individual, institutional, political, social and environmental objectives
- **systems and dynamics** - many economic decisions or events can start a complex chain of events. Economists gain an understanding of the interrelationships between economic phenomena and how effects can accumulate or die away. The ability to see beyond the direct or short-term effects is a crucial insight that economists can bring to analysing the effects of both deliberate decisions and external shocks.