

The Current Economic Theory and Principles Affecting the Daily Lives of Individuals

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Introduction

Economics is an indispensable part of human civilization that affects the choices made at individual and state levels. The following report deals with the current economic theory and principles affecting the daily lives of individuals and conditions in a state.

What is economy:

Economics is a science that studies the production, distribution, and consumption of services and goods. This study of how and why people make choices is analyzed at two levels. Microeconomics, where individual or business-level economics is studied, how these entities behave in the milieu of scarcity and under government interventions, and what factors control the supply and demand of goods and services. In contrast, Macroeconomics deals with the structure and functioning of a whole economic setup, such as at the state level, where concepts like inflation, unemployment, international trade, and national production and consumption are studied. Thus, an economist works like a scientist by developing models, making assumptions about economic activities, and formulating policies for the economic development of a country (Mankiw, 2016).

On what principles a society Allocates its limited resources:

Resources in an economy are scarce, and they must be utilized to maximize output for the benefit of society. Thus, people use tradeoffs between alternatives to obtain certain goods and services, which vary depending on their abilities, desires, and efforts. This is reflected at macro scale when a country allocates its budget for defense, and infrastructure and human development, the more is allocated for one sector cuts the share of other. A similar tradeoff is made between the efficiency of economic activity and equality in society, which is decided at the policy level to incentivize one group at the expense of another's efforts (Rajewski, 2016).

The flow of Goods and Money in an economy:

Money in an economy follows a circular path. In an economy, consisting of firms and households, money from firms finds its way to the household when the firm pays workers in the form of wages. This money is spent by the household members to buy goods and services offered by the firms. The governments on the other hand levy taxes on these exchanges between firms and households and provides certain benefits to everyone.

Economy coordinates independent economic actors in a society:

Households, firms, governments, and individuals act independently, and their actions are coordinated by the economy through markets. Households supply labor, capital, and resources to the market and create demand for goods and services, which are, in return, satisfied by the firms. The economy provides a platform for the coordination between households and individuals through market power, which determines prices and the supply of goods and services depending on the demand. How the economy coordinates independent economic actors in a society is determined by the gross domestic product of that country.

Gross Domestic Product:

The gross domestic product, commonly known as GDP, is described as “the market value of all the final services and goods produced in a given country during a specific time period.” GDP gives a holistic picture of the overall performance of a country’s economy by measuring the total income earned by everyone in that country and the total expenses on the production of goods and services in the economy. GDP measures all the money, goods, and services that find their way into the market where the exchange takes place. Thus, it excludes all the things and services manufactured or generated in a household that never made their way to the market, illegal goods and services, and purchases of goods and services in foreign countries (Rajewski, 2016). The following simple formula is used to calculate the GDP of a given country:

$$\text{GDP} = \text{private consumption} + \text{gross investment} + \text{govt investment} + \text{govt spending} + (\text{export} - \text{imports}).$$

Consumer Price Index:

The price of goods and services never remains stagnant; various factors and market forces bring about changes in the prices. The gain in prices also termed inflation, leads to various socio-economic problems that governments tend to control. To identify the inflation/deflation trends in the economy

and their effects on people, the consumer price index (CPI) is used. It evaluates the mean level of prices of goods and services expended by a city-dwelling family, where the price level is the mean price level obtained from a price index. CPI, in addition to indicating the inflation trend, also serves as a key to determining the effectiveness of government economic policies. It informs governments, individuals, and businesses about the general price trends in the economy and assists in informed decision-making regarding the economy. It is a statistical tool to measure the weighted mean of values in monetary terms of a basket of consumer merchandise and services such as housing, education, apparel, medical care, transport, food items, etc. (Investopedia, 2015).

CPI is constructed in three stages: selecting the CPI basket, conducting a month-based price survey, and utilizing the price and the basket to evaluate the CPI. This may lead to biased CPI calculations due to inherent shortcomings in the method. New goods, not accounted for in the base year, which may be expensive or cheaper than the goods they replace, substitution of goods and outlets on behalf of the consumers, leading to understating or overstating the actual figures.

Conclusion

From the above discussion, it is concluded that people face tradeoffs in making economic decisions, which are determined by various factors. The economy interconnects various actors via market and trade activities that benefit all, which, with the help of proper government intervention, lead to healthy competition and efficient utilization of limited resources. Thus overall, the wellbeing of a country depends on its ability to produce goods and services and balancing various developmental and non-developmental needs of the nation.

References

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