what is economics?

Economics as a subject deals with how people earn and spend their income to maximize their economic gains. It is concerned with the study of economic activities of various individuals and the society.

Economics deals with economic problems of the individuals business units, society and that of the globe.

An economic problem arises on account of the following reasons

1.Unlimited wants

2.Limited resources

3.Alternative use of resources

4.Problem of choices

Economics is a logic of choice. It teaches the art of rational decision making in economizing behavior to deal with the problem of scarcity.

Business Economics

Business Economics deals with the applications of economic laws to business problems to take sound business decisions.

Business Economics is a science which deals with the application of economic theories techniques principles and concepts to business management in order to solve business and managerial problems.

Definitions

Acc to Prof. Spencer and Seigelman “Managerial economics is the integration of economic theory with business practice for the purpose of facilitating decision making and forward planning”.

Characteristic features of business economics

- New discipline and of recent origin
- It is a highly specialized and separate branch of economics
- Micro in nature
- It is normative science which is goal oriented and prescriptive science
- It provides solutions to the problems
- It is a study of decision making
- It is a study of allocation of resources
- It deals with economic behavior of the firm
- It also studies various macro economic concepts like GNP,GDP,NNP,inflation etc
- It is conceptual.

Difference between economics and business economics

Economics	Business Economics
1. It is more comprehensive and wider in scope	1. It is too narrow and has limited scope
2. It is concerned with body of principles	2. It deals with the application of economic principles to the problems faced
3. It includes both micro and macro economics	3. It is micro in nature
4. It is based on no of assumption	4. The scope of assumptions are limited as it is concerned with application of theories
5. It is both positive and normative science	5. It is mainly a normative science
6. It discusses general economic problems	6. It deals with the problems of a firm only
7. Model building is the main function of the economist	7. Decision making and forward planning is the main function of the business economist

Scope of business economics

The term scope refers to the area of study boundaries width of the subject and subject .

Some of the important topics covered in this subject are

1.Objective of a firm

2.Consumption analysis with special emphasis on demand analysis and forecasting

3.Production and cost analysis

4.Pricing decision policies and practices

5.Profit Management

6.Capital Management

7.Market structure and conditions

Objectives of business economics

1.To integrate economic theory with business practice

2.To apply economic concepts and principles to solve business problems

3.To employ most modern instruments and tools to find solutions to business problems

4.To make optimum use of scarce resources of a firm

5.To help in making overall development of a firm

6.To help the manager to understand the intricacies of business problems and to make right decision at the right time

Role of a business economist

The term role refers to the behavior and action exhibited by a person in a given situation or environment.

1. To identify various business problems their causes and suggest remedial measures.
2. To provide a quantitative base for decision making and forward planning.
3. To act as a thinker.
4. To act as economic advisor to the firm.
5. To respond to the dynamic changes taking place in market situation.
6. To conduct various types of research studies.
7. To synthesize various policies.
8. To have complete information about the environment factors.

Functions of a business economist

Two important functions of a business economist are

1.Decision making

2.Forward Planning

Decision making is essentially a process of selecting the best out of many alternative opportunities that are open to management. It is a management function and part of business activity.

Forward planning refers to planning in advance for the future that is deciding future course of action of a firm.

A business economist must be sufficiently intelligent enough to think

In advance prepare a sound plan take all possible precautionary measures to meet all types of challenges of the future business.

Basic Concepts in Economics

Outline of the Session

- Nature of Economics
- Nature of Economic problem
- Nature of Human Wants
- Classification of wants
- Goods & Services
- Classification of goods
- Utility & Forms of Utility
- Value in use & Value in Exchange
- Wealth

Economy. . .

. . . The word *economy* comes from a Greek word for "one who manages a household."

A household and an economy face many economic decisions:

- Who will work?
- What goods and how many of them should be produced?
- What resources should be used in production?
- At what price should the goods be sold?
- Cond. .

Scarcity at the centre

Society and Scarce Resources:

- The management of society's resources is important because resources are scarce.
- *Scarcity*. . . means that society has limited resources and therefore cannot produce all the goods and services people wish to have.

Scarcity

- Scarcity - the fundemental economic problem facing ALL societies. Essentially it is how to satisfy *unlimited wants* with *limited resources*. This is the issue that plagues all societies.

Human Wants

- Human wants are unlimited
- Any particular want is satiable
- Wants are complementary
- Wants are competitive
- Wants have alternatives
- Wants vary with time, place and person

Human Wants

- Wants vary in urgency and intensity
- Wants multiply with civilisation
- Wants recur
- Wants change into habits
- Wants are influenced by income, salesmanship and advertisement
- Wants are the result of customs and conventions

Classification of Wants

- Necessaries

a) Necessaries of Existence: Food, clothing, shelter

b) Necessaries of Efficiency: Table & Chair for a student

c) Conventional Necessaries: Social customs, societal pressures, addictions

…Classification of Wants

- Comforts: For a better, fuller life.
- Luxuries: Something we could do without- costly furniture, cars, designer clothes etc.

Necessaries, Comforts and Luxuries are relative terms- luxuries of yesterday can become necessaries of today

Factors of Production

- Factors of Production/Resources - these are those elements that a nations has at its disposal to deal with the issue of scarcity. How efficiently these are used determines the measure of success a nation has. They are
- Land - natural resources, etc.
- Capital - investment monies.
- Labor - the work force; size, education, quality, work ethic.
- Entrepreneurs - inventive and risk taking spirit.

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How Does the Economic Problem Arise?

- Ends are unlimited, multiplicity of wants
- Wants are of different importance/urgency
- Means/resources are scarce in quantity
- Scarce means have alternative uses

These are the 4 conditions which cause the economic problem

The Economic Problem

- "Economics studies human behaviour as a relationship between ends and scarce means which have alternative uses"- Lionel Robbins
- This definition is based on 3 propositions:

a) Unlimited Ends

b) Limited Means

c) Alternative Uses of Means

Five Ws:

- What to produce
- How to produce
- How much to produce
- Where to produce
- For whom to Produce

- In other words, economics studies how the prices of labor, capital, and land are set in the economy, and how these prices are used to allocate resources.

Economics

Economics is the study of how individuals and society use, choose and manage their scarce resources(scarcity) optimally (efficiency) and distribute them among different people. Scarce resources refer to men, material, machines, money, time, energy, information etc.

Five Ws are at the center stage and alternative economic systems organizing the society.

The market economy, the command economy and the mixed economy.

What are Goods

- ‘Goods’ refer to those things (whether a commodity or a service) which possess utility, or are capable of satisfying human wants

Classification of Goods

- Free Goods: Exist in plenty, without payment, eg air, sunshine
- Economic Goods: Scarce goods, have a price
- Consumers' Goods: yield satisfaction directly, eg food, clothes
- Producers' Goods: yield satisfaction indirectly, help in producing other goods, eg machines, tools (Capital Goods)

…Classification of Goods

- Material Goods: tangible, land, buildings, furniture etc
- Non-material goods: Services, intangibles, eg. Goodwill of a business
- Transferable Goods: Change in ownership whether physical or non-physical is possible, eg. Car, land
- Non-transferable Goods: Personal qualities which cannot be transferred, eg. Skill, ability, intelligence

…Classification of Goods

- Personal Goods: Personal qualities of a person, non-material or internal goods, eg. Skill, ability
- Impersonal Goods: External, lie outside a person, eg. Land, houses
- Private Goods: Property of private individuals exclusively, not shared, eg. Buildings, land.
- Public Goods: Common to all, owned by society collectively, eg. Roads, parks, street lights

What is Value?

- Value in Economics is the 'Value-in-exchange' and <u>not 'Value in use'</u>
- This means the purchasing power of a commodity in terms of other commodities and services
- In order to have value, a commodity must be capable of being bought and sold

Value-in-use and Value-in-exchange

- Value-in-use is nothing but utility, want-satisfying power of a commodity, commodity may or may not have a value in the market
- A commodity or service having value-in-exchange other than having utility also has a price in the market
- Value of a commodity/service expressed in terms of money is nothing but the price

Attributes of Value in exchange

- Scarcity
- Utility
- Transferability

What is Wealth?

- Money in ordinary language
- In economics it has got a very wide meaning, anything which possesses value (value-in-exchange) is wealth
- Besides money, it can include furniture, land, buildings, goodwill etc.

Attributes of Wealth

- Utility
- Scarcity
- Transferability

Classification of Wealth

- Individual Wealth: Belongings of a person minus debts
- Social Wealth: Wealth of a society eg., roads, gardens, railways
- National Wealth: Wealth of the whole nation, individual wealth plus social wealth
- Cosmopolitan Wealth: Wealth of the whole world

Wealth cont..

- Wealth and capital
- Wealth and Income
- Wealth and Money

Wealth and Welfare

- Wealth is the means and welfare is the end
- Wealth/money not desired for its own sake but for the sake of commodities and services that it will buy
- Wealth refer to stock of goods whereas welfare refers to the state of the mind

…Wealth and Welfare

- Divergence between wealth and welfare: air/sunshine not regarded as wealth, joy, love, friendship, health, culture also not regarded as wealth
- Increase in wealth does not necessarily mean an increase in welfare

People Face Tradeoffs.

Basic principle of economics is that there is not free meal.

To get one thing, we usually have to give up another thing.

- Guns v. butter
- Food v. clothing
- Leisure time v. work
- Efficiency v. equity

Making decisions requires trading off one goal against another.

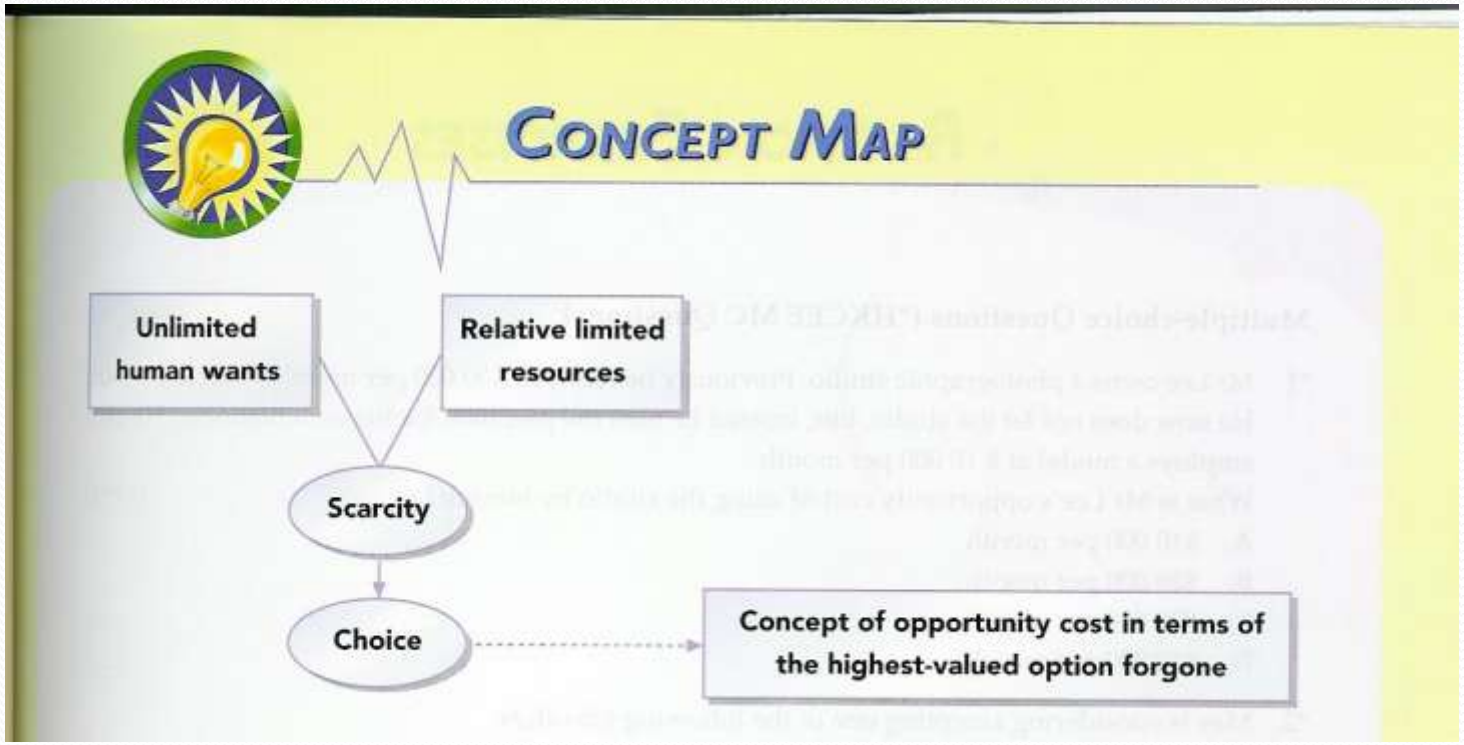
The Cost of Something Is What You Give Up to Get It.

- Decisions require comparing costs and benefits of alternatives.
  - Whether to go to college or to work?
  - Whether to study or go out on a date?
  - Whether to go to class or sleep in?
- The *opportunity cost* of an item is what you give up to obtain that item.

Opportunity cost

- Opportunity Cost - The cost of an economic decision. Opportunity cost is the highest-valued option forgone
- The classic example is "guns or butter." What should a nation produce; butter, or guns, a?
- If we choose the guns the cost is the butter & vice versa.
- It is a matter of choices. Resources are limited thus we cannot meet every need or want.

Opportunity cost cont…



Choice among options

- Rank options according to a person's preference order

- Option 1 going to cinema
- Option 2 going to sing karaoke
- Option 3 sleeping at home

What is the cost of going to the cinema?

- Going to sing karaoke (highest-valued option forgone)
- We cannot choose option 2 and option 3 at the same time, we only forgo option 2 when we select option 1

Complimentary tickets

- Going to Monsoon trek
- Ticket : Free of charge
- Money spent on food, transport..=Rs. 400
- Income forgone = Rs. 500

- Full cost of going of Trek = Rs. 900

Is Time a cost?

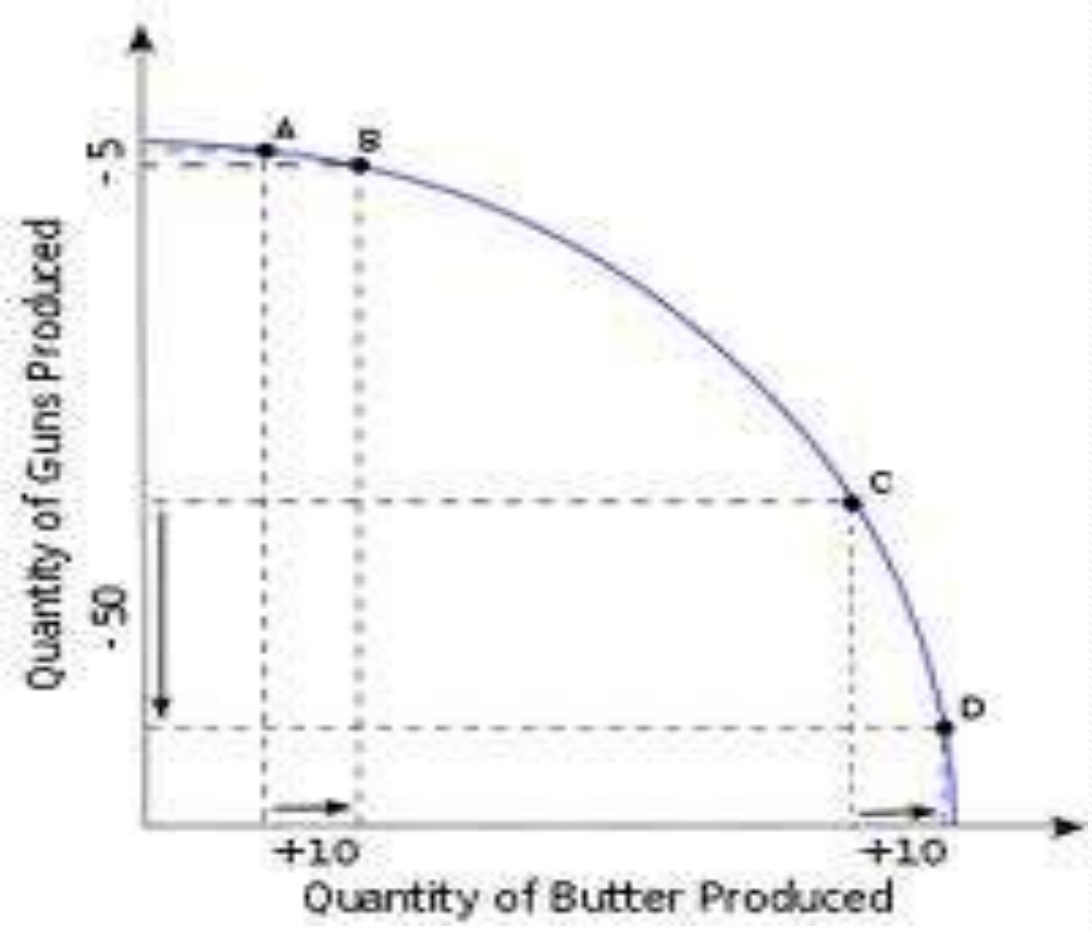
- Price of a mobile phone = Rs. 5,000
- Search = one evening
- Income forgone while searching = Rs. 200
- Opportunity cost of buying the mobile phone is Rs. 5,200

Production Possibility Frontier

- The production possibility frontier is a graph showing the various combinations of two goods that an economy is able to produce with fixed resources. PPF is drawn on the following assumptions.

- The economy produces only two goods.
- The amount of resources is fixed.
- Each of the goods can be produced using changing ratios of the factors of production

PPF


Quantity of Guns Produced
- 5
- 50
A
B
C
D
+10
+10
Quantity of Butter Produced

What is Utility?

- Usefulness in ordinary speech
- Want-satisfying power of a commodity in economics
- Utility refers to that quality of a commodity by which it is capable of satisfying human wants irrespective of its good or bad effects, eg alcohol, cigarettes
- Utility has no ethical or moral significance
- Utility is subjective- differs from individual to individual
- Utility is not the same thing as usefulness, satisfaction or pleasure

Forms of Utility

- Form Utility: a log of wood converted into furniture
- Place Utility: furniture transported to a market where it fetches a higher price
- Time Utility: Furniture kept in godown to sell at a higher price in the future

Micro & Macro Economics

- Micro studies individual behaviour of consumer, firm, market price, industry, etc.
- Macro studies overall performance of the economy. It is concerned with aggregate savings, agg consumption, total emp, interest, money supply, etc.

Positive verses Normative economics

- Positive eco emphasises on depicting the facts & reality. It relies on alysis & empirical evidence.
- Normative involves ethical precepts & norms of fairness.
- Economics deals with both normative as well as positive science.

Summary

- Economics is the scientific study of how man uses scarce resources to produce goods and services to satisfy his wants.
- The economy is the mechanism through which these scarce resources are organised for the production of goods and services.
- Economic activities are conducted in the economy. The main economic agents are households, firms and the government.

Summary

- Since resources are scarce and wants are unlimited, scarcity exists. It necessitates choice, and making a choice involves incurring an opportunity cost.
- Money cost is what is paid to produce a good or a service and is different from opportunity cost, which is the alternative forgone.
- To explain production in the economy, economists use the production possibility frontier. The PPF can be used to illustrate scarcity, choice and opportunity cost.