

Economic Concepts and Systems in the Business Environment

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01. Introduction to Economics (AAT)

1. What Economics Means

- **Definition of Economics:** The social science that explains the relationship between **unlimited wants** of humans and the **limited resources** that have alternative uses.
- It studies how people fulfill their wants with limited resources.
- Economics analyses the economic behavior of humans and how human behavior changes according to time, environment, and society.
- It utilizes a **scientific method** (observing, experimenting, testing theories).

1.1 Economics as a Social Science

- Economics is categorized as a **Social Science** because it analyzes and studies human behavior.
- It studies how humans behave in society and how they make decisions under social science.

1.2 Benefits of Studying Economics

Studying economics allows individuals to:

- Be able to **understand economic phenomena** better.
- Apply knowledge in **governance**.
- Make **effective decisions** as producers, consumers, and investors.
- Act as a **rational consumer**.
- Be an **informed voter**.

2. Microeconomics vs. Macroeconomics

2.1 Microeconomics

- **Definition:** A branch of economics that studies the **behavior of individual entities** (e.g., households, firms).
- Focuses on how small units make decisions when allocating **limited resources**.
- *Key Entities/Areas Studied:*

1. Consumers or Households.
2. Producers or Business Firms.
3. Markets.

2.2 Macroeconomics

- **Definition:** A branch of economics that looks at the economy from a **broader perspective**; it is the "bird's eye view of the economy".
 - It studies the structure, behavior, and performance of the **entire economic system**.
 - *Key Areas Covered:*
 1. Aggregate output and income and expenditure.
 2. Inflation, price level, and money supply.
 3. Exchange rate, foreign trade, and balance of payments.
 4. Employment, unemployment, and economic growth.
 5. Economic boom, recession, and decline.
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3. Economic Analysis

3.1 Positive Economic Analysis

- **Definition:** study of economics that is concerned with **facts and objective statements**, explaining **what actually is happening in the economy**.
- This statement can be true or untrue.
- Aims at answering questions like: What is? What has happened? What will happen?.
- *Example:* There is an inverse relationship between the price and the quantity demanded of that product.

The inflation rate of the country is 5%.

3.2 Normative Economic Analysis

- **Definition:** statements in economics that are based on **opinions, value judgments, and beliefs**, expressing **what ought to be** rather than what is, and **cannot be tested or proven** using facts alone.
- These statements cannot be examined through facts and figures.
- *Example:* The government should take steps to protect the environment.

The tax rates imposed on income are unfair.

4. Needs, Wants, and Resources

4.1 Needs and Wants

Feature	Needs	Wants
Definition	Essential for human survival (e.g., food, clothing, shelter).	Ways and means of satisfying one's needs.
Availability	Limited.	Unlimited.
Priority	Primary (a must that these are fulfilled).	Secondary (not a must to fulfill them).
Influence	Cannot be influenced through advertising.	Can be influenced through advertising.

4.2 Economic Resources vs. Non-Economic Resources

- **Resources:** Anything with productivity that can be utilized in producing goods and services.

Feature	Economic Resources	Non-Economic Resources
Supply	Limited in supply and scarce compared to unlimited wants.	No scarcity; unlimited supply.
Cost	Utilization results in opportunity cost .	Utilization results in no opportunity cost .
Examples	Buildings, machinery, Labour, raw materials.	Sun light, rain water, fresh air.

4.3 Factors of Production

Resources used in production are broadly divided into four categories, known as factor production inputs.

1. **Land:** Resources provided by nature (forests, rivers, mineral deposits).
 - It is a natural factor and generally has an inelastic supply.
 - Income generated: **Rent**.
 - *Renewable Resources:* Can be replenished (e.g., Forest Cover).
 - *Non-Renewable Resources:* Exhausted when used and cannot be replaced easily (e.g., Petroleum/Oil, Coal).

2. **Labour:** Physical and mental effort of human beings in the production of goods and services.
 - It is a live production factor.
 - Productivity can be enhanced through education and training.
 - Income generated: **Wages**.
 3. **Capital:** Man-made things that aid production (e.g., tools, equipment, machinery).
 - It is subjected to **depreciation** when being used.
 - Payment made for capital: **Interest**.
 4. **Entrepreneurship:** The ability and talent to organize and conduct production (combining Land, Labour, and Capital).
 - Entrepreneurs are **innovators and risk takers**.
 - Return on entrepreneurship: **Profit**.
 - *Functions:* Making policy decisions, risk taking, introduction of novel products.
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5. Scarcity, Choice, and Opportunity Cost

5.1 Scarcity

- **Scarcity** is the **central and fundamental problem of economics**.
- It is the imbalance between **limited resource base** and **unlimited wants and desires** of humans.
- It is the limited availability of resources relative to unlimited wants.
- Scarcity is **not** a condition similar to poverty or deficiency.

5.2 Choice

- Limited resources relative to unlimited wants force humans to **choose** the best option out of the available alternatives.
- This is necessary because economic resources have **alternative uses**.
- **Basic Economic Questions (Choices):**
 1. **What to produce, in what quantities?**
 2. **How to produce?**
 3. **To whom to produce?**

5.3 Opportunity Cost

- **Definition:** The cost of **sacrificing the next best alternative** when choosing to utilize resources for one purpose.
 - It is not the cost of *all* alternatives, but only the cost of the **next best alternative**.
 - It is a real concept that can be measured in real or monetary units.
 - **Instances where Opportunity Cost is Zero:**
 - When there is no scarcity of resources.
 - When resources have no alternative uses.
 - When unemployed resources are used in economic activities.
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6. Goods and Services

6.1 Economic Goods (Scarce Goods)

- Any good or service for which there is a **limitation/scarcity in supply** and therefore requires scarce resources for production.
- *Characteristics:*
 - Existence of limitation/scarcity in supply.
 - Existence of cost of resources.
 - Existence of **opportunity cost**.
 - Having a price.

Ex : Machinery, Books, Food, Clothing

6.2 Non-Economic Goods (Free Goods)

- Goods available **without any limitation at zero price**.
- These are gifts of nature.
- *Characteristics:*
 - No limitation/scarcity in supply.
 - No resource cost.
 - **Zero opportunity cost**.
 - Not having a price.
- *Examples:* The Sun Light, Fresh Air, Water.

7. Production Possibility Curve (PPC)

- **Definition:** A curve that shows a **feasible combination of two goods** that can be produced at any given point in time, when all available resources are used to the **maximum efficiency**.
- **Assumptions of the PPC Model:**
 1. Only two goods can be produced.
 2. Amount of available resources is fixed.
 3. Technology is constant.
 4. All available resources are used in full and to the maximum efficiency.
- **Concepts Explained by the PPC:**
 1. Scarcity of resources and their alternative uses.
 2. Efficient and inefficient allocation of resources.
 3. Employment and unemployment.
 4. The opportunity cost.

Basic Economic Problems

1. What to produce and in what quantities?
2. How to produce?
3. To whom to produce?

8. Economic Systems

- **Economic System:** The mechanism developed by people in a society to solve the basic economic problems (What, How, To Whom to produce).

8.1 Market/Liberal Economic System

- Solves fundamental problems through the **price mechanism**.
- **Key Feature:** Existence of **private ownership of property**.
- *Main Characteristics:*
 - Properties are owned by the private sector.

- Minimal interference of the government.
- Existence of consumer sovereignty.
- Existence of competition and freedom of choice.
- *Functions of Price Mechanism: **Signaling, Incentive, and Rationing.***
- *What to Produce:* Determined by the relative price of goods and services (Profitability)
- *How to Produce:* Based on the profitability and the cost of the method, which ever the method is the cheapest will be used..
- *To Whom to Produce:* Determined by the consumer's purchasing power.

8.2 Command/Planned Economic System

- Solves problems according to the commands given by a **central planning authority**.
- **Key Feature:** Resources are owned by the **state**.
- *Main Characteristics:*
 - Property ownership/means of production lie with the government.
 - Guiding factor is **social welfare**.
 - Absence of consumer sovereignty and freedom of choice.
 - Existence of fair income distribution.
- *What to Produce:* Determined by the requirements of the society, not price
- *How to produce :* solved by central planning committee based on requirement of the society and to maximize social welfare.
- *To Whom to Produce:* Guided by maximizing the welfare of the people.

8.3 Mixed Economic System

- An economic system that has features found in both market and command/planned systems.
- It employs **both the price mechanism and planned mechanism**.
- **Key Feature:** Property ownership lies with **both the state and private sectors**.
- *Main Characteristics:*
 - Resource ownership lies with both private and state sectors.
 - Private sector is driven by the **profit motive**; public sector is driven by providing **social welfare**.

- *What to Produce:* The private sector produces for profit, and the public sector provides goods and services for social welfare. The government influences the market via **taxes and subsidies**.

9. Role of Economics in Business

Economic knowledge helps business organizations make effective decisions, including:

- Whether to produce an item itself or purchase it from another firm.
- Choosing the most profitable production technique.
- Deciding the quantity and price of the item to be produced.
- Determining technical methods of recruiting and training workers.
- Generating necessary funds and investing surplus funds.
- Selecting the appropriate media channel for advertising.

