ECONOMICS 1

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The assumption in Economics:

- Producers will seek to ……………………………………………….
- Consumers will seek to ……………………………………………….
- Governments will seek to ………………………………………….

Choices in Economics

- What to produce?
- How to produce it?
- Who to produce it for?
- How to apportion it?

Economics is concerned with how choices are made about the use of resources: what should be produced and who should consume it. (what to produce?, how to produce it?, who to produce it for? and how to apportion it?)

Business economics is the analysis of business enterprises, the factors contributing to the relationships of firms with labour, capital and product markets and the factors influencing the variety of organisational structures

- **Microeconomics** is the study of

- **Macroeconomics** is the study of

Economic Systems

- Centrally Planned (or command) Economy –

- Free Market Economy –

- Mixed Economy –

GOVERNMENT INFLUENCES ECONOMIC ACTIVITIES

(a) Direct control over macroeconomic forces can be exercised through policy on tax, spending and interest rates.

(b) Taxes, subsidies and direct controls can affect the relative prices of goods and services.

(c) Government-owned institutions such as public health service, Free education, postal service can provide goods and services directly free or at low cost

(d) Regulation can be used to restrict or prevent the supply of goods and services.

(e) Incomes can be influenced through the tax and social security systems

Positive and Normative Economics

Positive Economics is objective and fact-based where the statements are precise, descriptive, and clearly measurable. These statements can be measured against tangible evidence or historical instances. The aim of positive economics is to determine relationships of cause and effect.

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- The rising price of crude oil on world markets will lead to an increase in cycling to work
- A rise in average temperatures will increase the demand for sun screen products.
- Cut-price alcohol has increased the demand for alcohol among teenagers
- Monopolies have proved to be inefficient

Normative Economics is based on the ideal and subjective in nature. The aim is to present collective desire towards an economic development by stating what 'should' happen.

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- Unemployment is more harmful than inflation
- The government is right to introduce a ban on smoking in public places.
- The retirement age should be raised to 70 to combat the effects of our ageing population.
- The government should implement strict wealth tax laws to decrease the uneven distribution of wealth

Most public policy is based on both positive and normative economics.

The factors of production

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(a) **Land** is rewarded with **rent**. Land consists not only of property (the land element only: buildings are 'capital') but also all the natural resources that grow on the land or that are extracted from it, such as timber and coal.

(b) **Labour** is rewarded with **wages** (including salaries). Labour consists of both the mental and the physical resources of human beings. Labour productivity can be improved through training, or by applying capital in the form of machinery.

(c) **Capital** is rewarded with **interest**. Capital in an economic sense is not 'money in the bank'. Rather, it refers to man-made items such as plant, machinery and tools which are used to aid the production of other goods and services. Buildings such as factories are capital items.

(d) **Enterprise, or entrepreneurship** is rewarded with **Profit**. An entrepreneur is someone who undertakes the risk and task of organising the other three factors of production in a business enterprise and, in doing so, bears the risk of the venture.

Normal and inferior goods

Normal Goods

A rise in household income may increase demand for a good. This is what we might normally expect to happen, and goods for which demand rises as household income increases are called **normal** goods.

Eg- televisions and cars

Income Demand

Inferior Goods

Demand may rise with income up to a certain point but then fall as income rises beyond that point. Goods whose demand eventually falls as income rises are called **inferior** goods:

Eg- Tripe and cheap wine. The reason for falling demand is that as incomes rise, demand switches to superior products, for example beef instead of tripe; better quality wines instead of a cheaper variety.

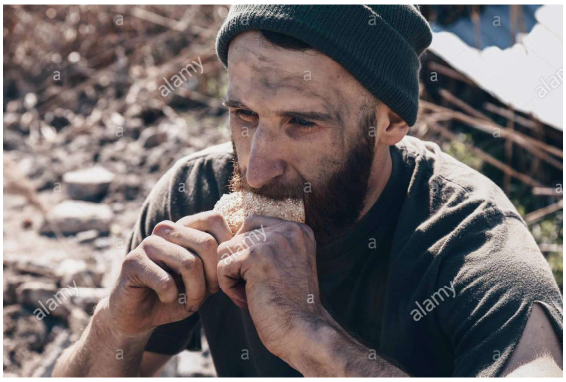
Income Demand

- **Giffen Goods**

When the price of a good rises, there will be a substitution effect: consumers will buy other goods instead, because they are now relatively cheaper. But there will also be an income effect in that the rise in price will reduce consumers' real incomes, and will therefore affect their ability to buy goods and services.

The 19th century economist Sir Robert Giffen observed that this income effect could be so great for certain goods called Giffen goods that the demand would increase as their price increased This could happen because the increase in price of a commodity which made up a high proportion of individuals' consumption could have a significant effect on real incomes.

Daily income	Bread unit price	Noodles Unit Price



Veblen goods

- A Veblen good, named after the economist Veblen, is a good or service whose demand increases when its price increases. These goods may be bought for purposes of status or ostentation (to display wealth or importance). Having a higher price tag makes the good more desirable to consumers, which increases demand.

Price Demand

Public goods

Public goods are goods which by their nature are <u>hard to exclude the general public from enjoying, regardless of whether those receiving the good or service have paid for it</u>.

Eg: lighthouse, National defense, Public roads, street lighting, the rule of law, fresh air, public gardens, police services

<u>2 conditions of Public Goods</u>

(a) Non-diminishable (or non-rivalrous):

(b) Non-exclusive:

The free-rider problem

Because the good is non-exclusive, individuals can benefit from the good without paying for it. This means that unless non-payers can be compelled to pay, or can be excluded from consuming the good, there would normally be no economic incentive for firms to make the good because they would get no revenue.

How to overcome free rider problem in Public Goods

- **Compulsory payment** - This includes licences to use roads, or compulsory payment through taxation for defence and police services.
- **Exclusion on non-payers** - The use of smart cards to allow decoding of satellite television broadcasts, or pay gates on websites.
- **Public provision** - The government may choose to provide the service directly and levy a charge from the population via taxation.

Scarcity is the excess of human wants over what can actually be produced. A scarce resource is a resource for which the quantity demanded at a nil price would exceed the available supply.

The producers and consumers have to make choices about what to produce or to buy. Since resources for production are scarce and there are not enough goods and services to satisfy the total potential demand, choices must be made. Choice is only necessary because resources are scarce.

(a) Consumers must choose what goods and services they will buy.

(b) Producers must choose how to use their available resources, and what to produce with them.

The nature of the choices:

(a)

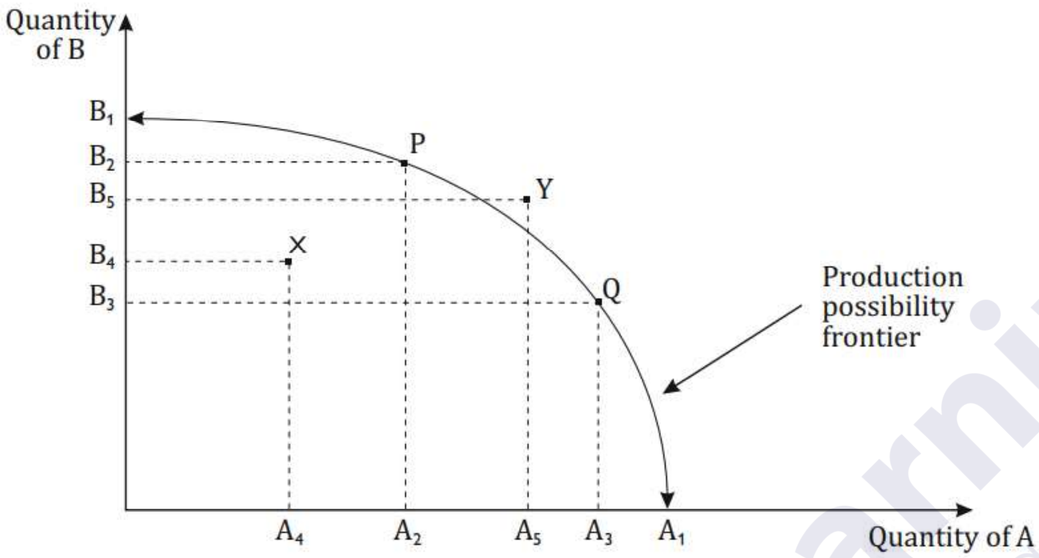
(b)

(c)

Making choices about how to use scarce resources is the **fundamental problem of economics**.

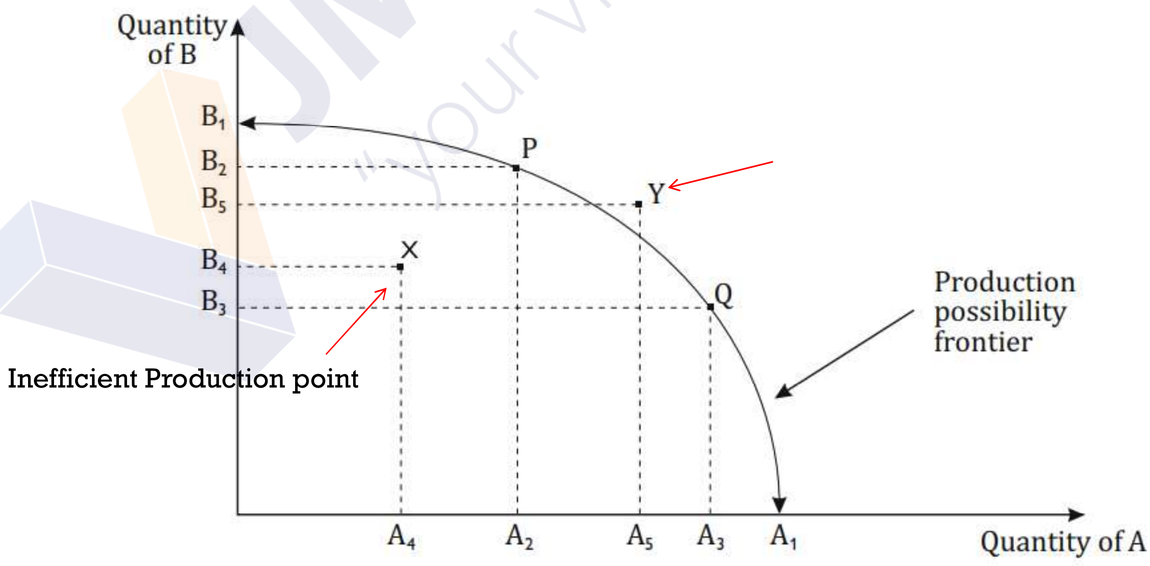
- Production is the process and method employed to transform tangible and intangible inputs into goods and services.
- Productivity is the measure of efficiency with which output has been produced.

Production Possibility Frontier (PPF)



the production possibility frontier (PPF) is a curve that illustrates the possible quantities that can be produced of two products, if both depend upon the same finite resource for their manufacture.

The cost of an item measured in terms of the next best alternative forgone is called its **Opportunity cost**



The shift of the PPF would be possible,

- A Change in Resources
- A Change in Technology

Accounting profits

For an accountant, costs can be divided into 'fixed costs' and 'variable' or 'marginal costs'. Total fixed costs per period are a given amount, regardless of the volume of production and sales. The variable cost per unit is a constant amount, so that the total variable cost of sales is directly proportional to the volume of sales.

Explicit costs Includes

Economic profits

Implicit costs are benefits forgone by not using the factors of production in their next most profitable way. (Opportunity Cost)