

The Central Concepts

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An Introduction

- Economics is the art of making the most of life
- Economics is a social science, since it deals with the society as a whole and human behaviour in particular, and studies the production, distribution and consumption of goods and services.
- Economics is the study of that process and its outcomes
- Study about how much they work, what they buy, how much they save, how they invest their savings.

Cont...

- Science of Wealth- Adam Smith, the father of modern economics defines economics as “An inquiry into the nature and causes of the wealth of the nations”.
- Science of material well-being- According to Alfred Marshall "Economics is a study of mankind in the ordinary business of life.
- Science of choice making- Robbins gave a more scientific definition of Economics. His definition is as follows: "Economics is the science which studies human behaviour as a relationship between ends and scarce means which have alternative uses"
- How individuals and societies choose to use the scarce resources ?
- A system or process that works to transform the resources that nature and previous generations provide into useful form ?
- Economics is both a science and an art.

Scarcity and Efficiency

- Scarcity of resources but wants are unlimited.
- Economics deal with efficient allocation of resources with scarcity of resources which satisfying people's wants and needs.
- What will happened if there will be no scarcity of resources?

Businesses would not need to fret over the cost of labor or health care.

Governments would not need to struggle over taxes or spending or pollution.

No one would be concerned about the distribution of incomes among different people or classes.

Economic efficiency

- Produce the highest combination of quantity and quality of goods and services given its technology and scarce resources
- An economy is producing efficiently when no individual's economic welfare can be improved unless someone else is made worse off.
- With the rapid economic growth, does production in the United States is enough to meet everyone's desires?

What is Managerial Economics

“Managerial Economics refers to the application of economic theory and the tools of analysis of decision science to examine how an organization can achieve its objectives most effectively”

Salvatore

How Managerial Economics Helps

- With the environment in which the firms will operate
- The decisions that the Managers take
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- The effects of such decisions on themselves and on the stakeholders (Customers, competitors, employees and the society)

What we will Gain?

- This course will provide an understanding about the theories that future Managers will need-
- Demand Analysis
- Cost Analysis
- Pricing Practices and Policies
- Analysis of Business Environment
- Management of Externalities

Emergence of Managerial Economics

- Growing complexity of business decision making process due to changing market conditions and business environment.
- The increasing use of economic logic, conceptual theories and tools of economic analysis in the process of business decision making process.
- Rapid increase in demand for professionally trained managerial manpower

Starting point

- Unlimited wants?
- Limited resources having alternative uses
- Scarcity and Choices
- Alternative combinations of produced goods and services
- Alternative final distributions

Three basic questions to understand the functioning of the economic system

- What gets produced?
- How is it produced?
- Who gets what is produced?

Cont...

What gets produced?

- What commodity needs to be produced?
- Basic goods (bread, rice, pulses etc.) or capital goods (machinery, equipment etc.)

How is it produced?

- What factors of production need to be used
- Capital intensive or labour intensive?

Who gets what is produced?

- Rich or poor

How economic system works in different societies?

- Modern societies-Government plays a big role
- A laissez-faire Economy- individuals independently pursue their own self interest.

Decisions in market Economy

- Individuals and private firms make the major decisions about production and consumption.
- Firms produce the commodities that yield the highest profits (the what) by the techniques of production that are least costly (the how)
- Consumption is determined by individuals' decisions about how to spend the wages and property incomes generated by their labor and property ownership (the for whom)
- The extreme case of a market economy, is called a laissez-faire economy.

Decisions in Command Economy

- The government makes all important decisions about production and distribution
- The government answers the major economic questions through its ownership of resources and its power to enforce decisions

Mixed Economy

- All societies are now mixed economies, with elements of market and command.
- Economic life is organized either through hierarchical command or decentralized voluntary markets.
- Decisions are made in the marketplace. But the government plays an important role in overseeing the functioning of the market.
- Governments pass laws that regulate economic life, produce educational and police services, and control pollution.

SOCIETY'S TECHNOLOGICAL POSSIBILITIES

- Every society must make choices about the economy's inputs and outputs.
- Inputs are commodities or services that are used to produce goods and services.
- Outputs-Outputs are the various useful goods or services that result from the production process and are either consumed or employed in further production.

Production Possibility Frontier (PPF)

- Suppose an economy produces only two economic goods X and Y.
- The firm has to decide the proportion in which to produce them.
- For allocation of available resources how much of the given commodity will produce can be decided with the help of PPF.

Assumptions of PPF

- The firm has given quantities of input with which it produces the two products.
- There is no change in production technique.
- It can produce the two goods with different proportions.

Alternative Production Possibilities

Table 1.1. Alternative Production Possibilities

Production possibilities	Cloth (in thousand metres)	Wheat (in thousand quintals)
A	0	15
B	1	14
C	2	12
D	3	9
E	4	5
F	5	0

Production Possibility Curve

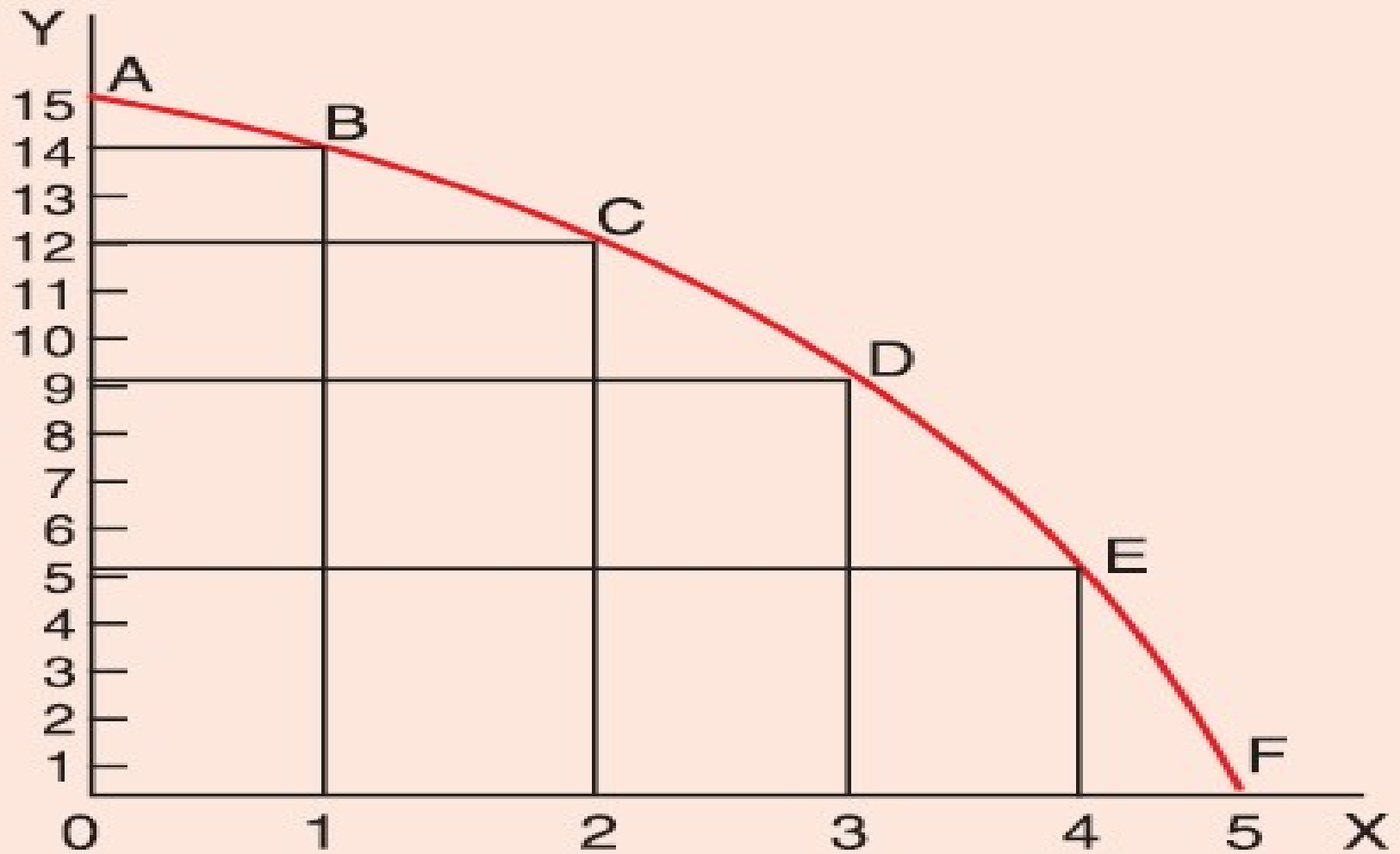


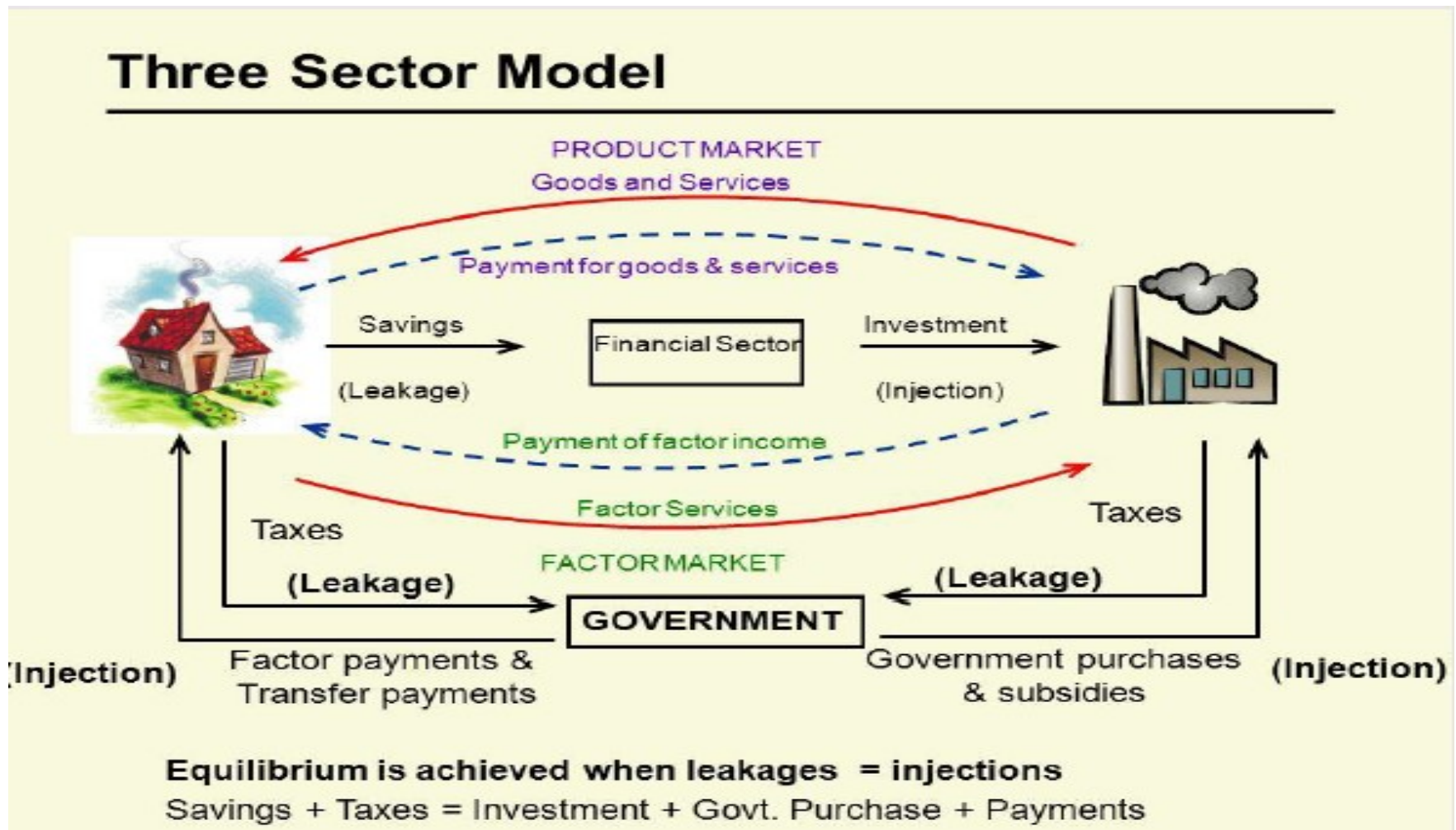
Fig. 1.1. *Production Possibility Curve*

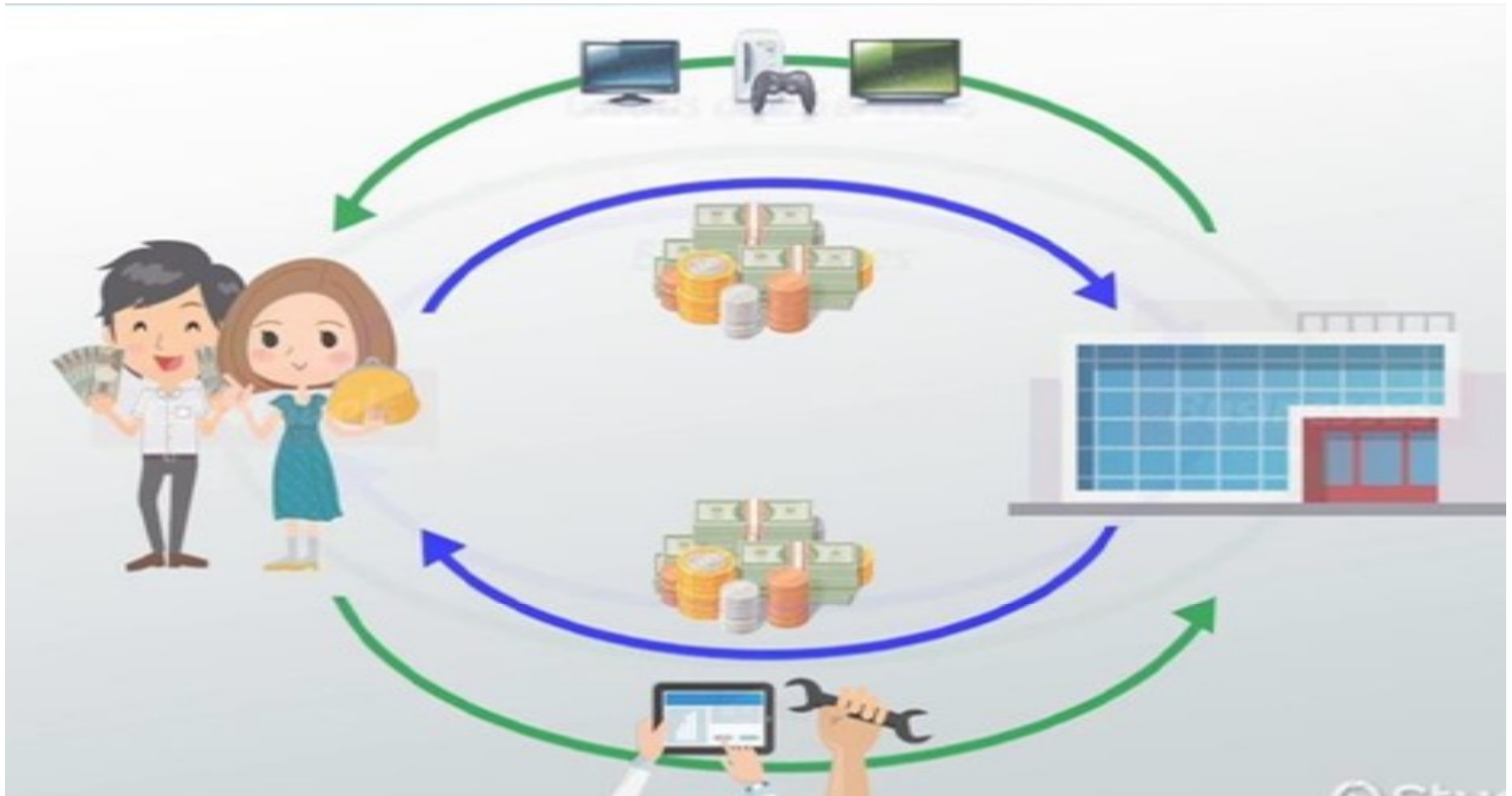
Applying the PPF to Society's Choices

- PPF can be applied to a broad range of economic choices
- Thus the more resources the government uses to spend on public highways, the less will be left to produce private goods like houses
- The more food we choose, the less we can consume of clothing
- The more an economy consumes today, the less can be its production of capital goods

Circular Flow of an Economy

- Circulation of income between producers and consumers.
- Interdependence of consumers and sellers





- Real Flow and Money Flow
- Real Flow- flow of factor services from households to firms and corresponding flow of goods and services from firms to households.
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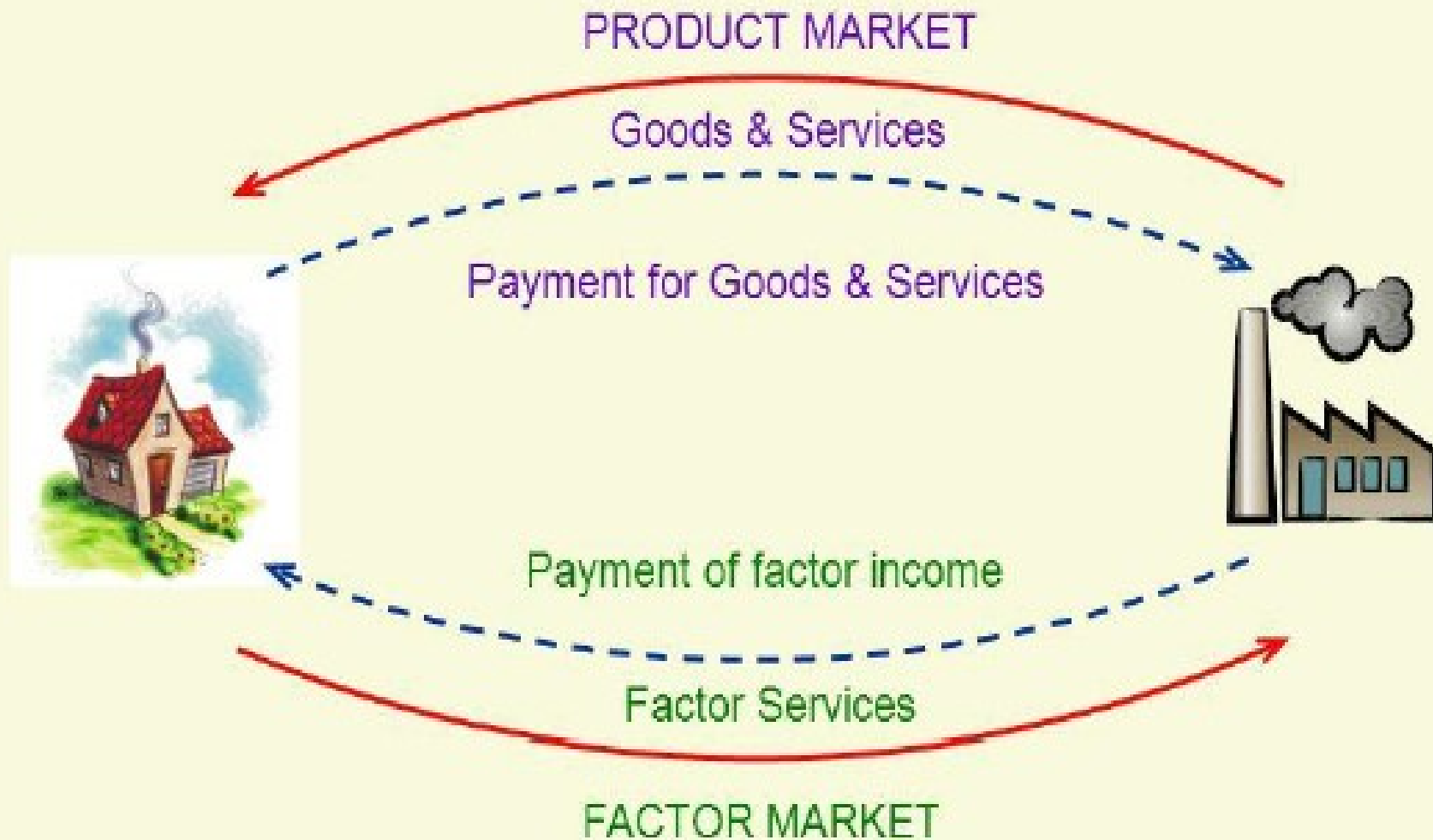
Circular Flow in a Two Sector Economy

- Two players in the economy-Households and Firms
- Households are the owners of the factors of production and the consumers of all consumer goods
- Firms are units which provides consumers with goods and services

The **assumptions** are

1. Households spend their total income
2. Firms produce as much as demanded
3. Firms make factor payments in terms of rent, wages, interest, and profits
4. There is no inflow/outflow of income/goods and services from any outside source

The Circular Flow of Income – 2 Sector Model



Two Sector Model with Financial Sector



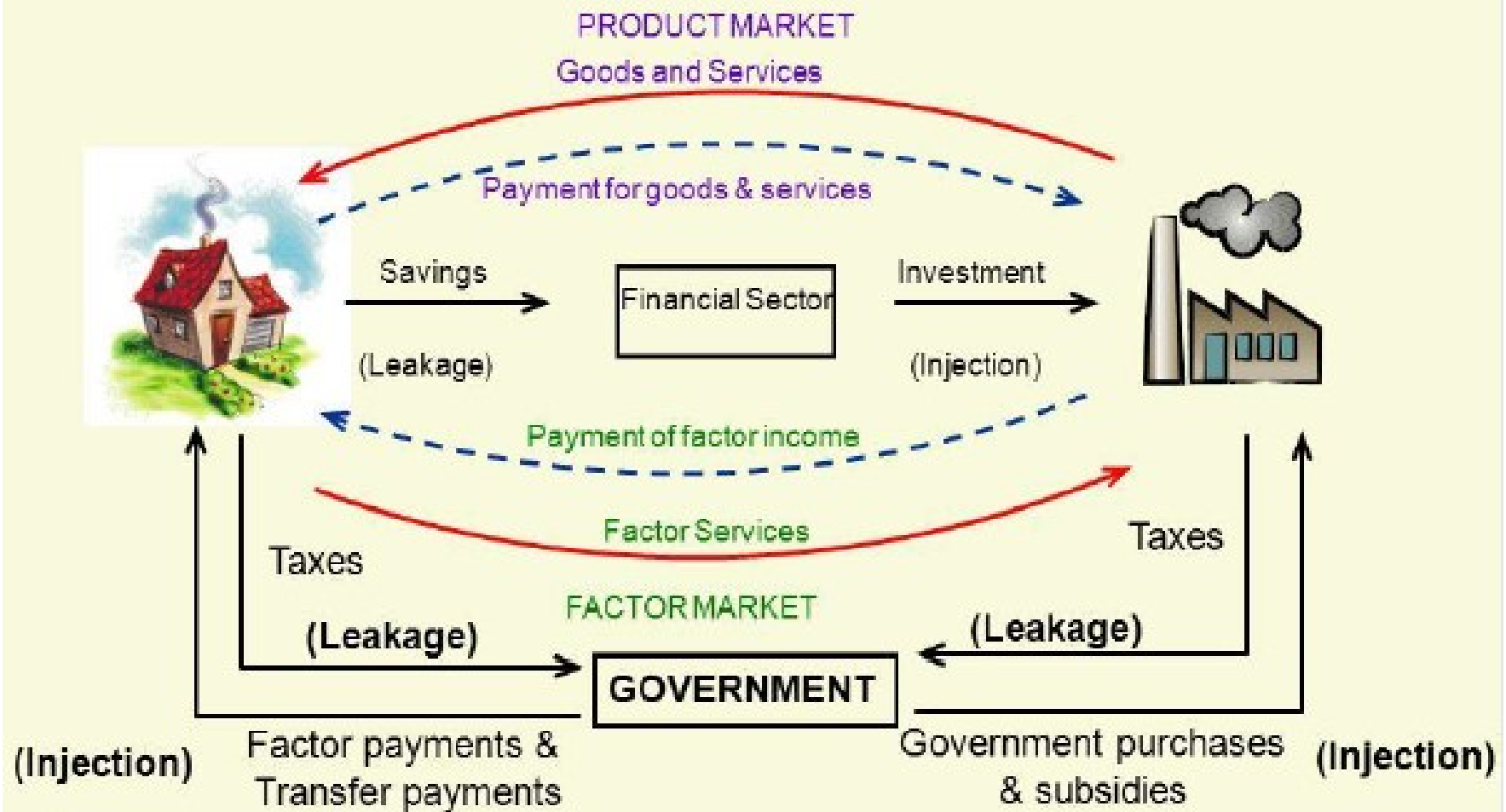
Savings : Residual income that households do not use to purchase goods and services

Investment : Expenditure on capital goods

Circular Flow in a Three Sector Economy

- Government is added to the two sector model
- Govt. creates basic infrastructure and thus total expenditure is $E=C+I+G$
Total Income $Y=C+S+T$

Three Sector Model



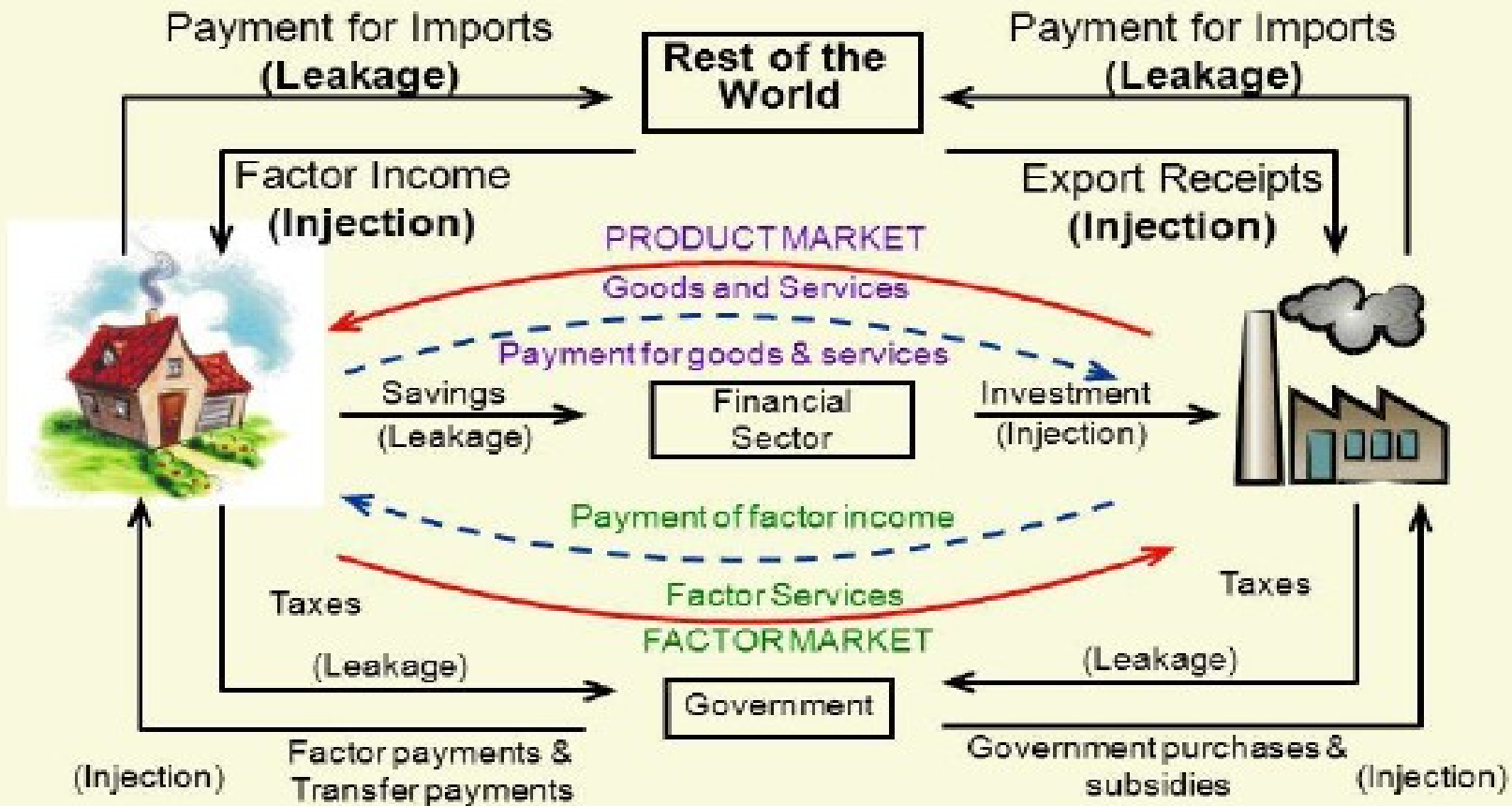
Equilibrium is achieved when leakages = injections

Savings + Taxes = Investment + Govt. Purchase + Payments

Circular Flow in a Four Sector Economy

- Foreign Sector is added in the Three Sector Model
- External Sector consists of Exports and Imports of goods and services
- The export and import of goods and non-labour services are made only by the firms
- The households export only labour

Four Sector Model



In Equilibrium : Leakages = Injections

$Savings + Taxes + Imports = Investment + Govt. Expenditure \& Transfers + Exports$

The Market Mechanism

- A market “is a mechanism through which buyers and sellers interact to determine prices and exchange goods, services, and assets”.
- A market economy is a mechanism for coordinating people, activities, and businesses through a system of prices and markets

Market Equilibrium

- Balance between quantity demanded and supply in a market.
- Markets also can solve the three economic problems (what, how, and for whom) through the market mechanism.

How Markets Solve the Three Economic problems?

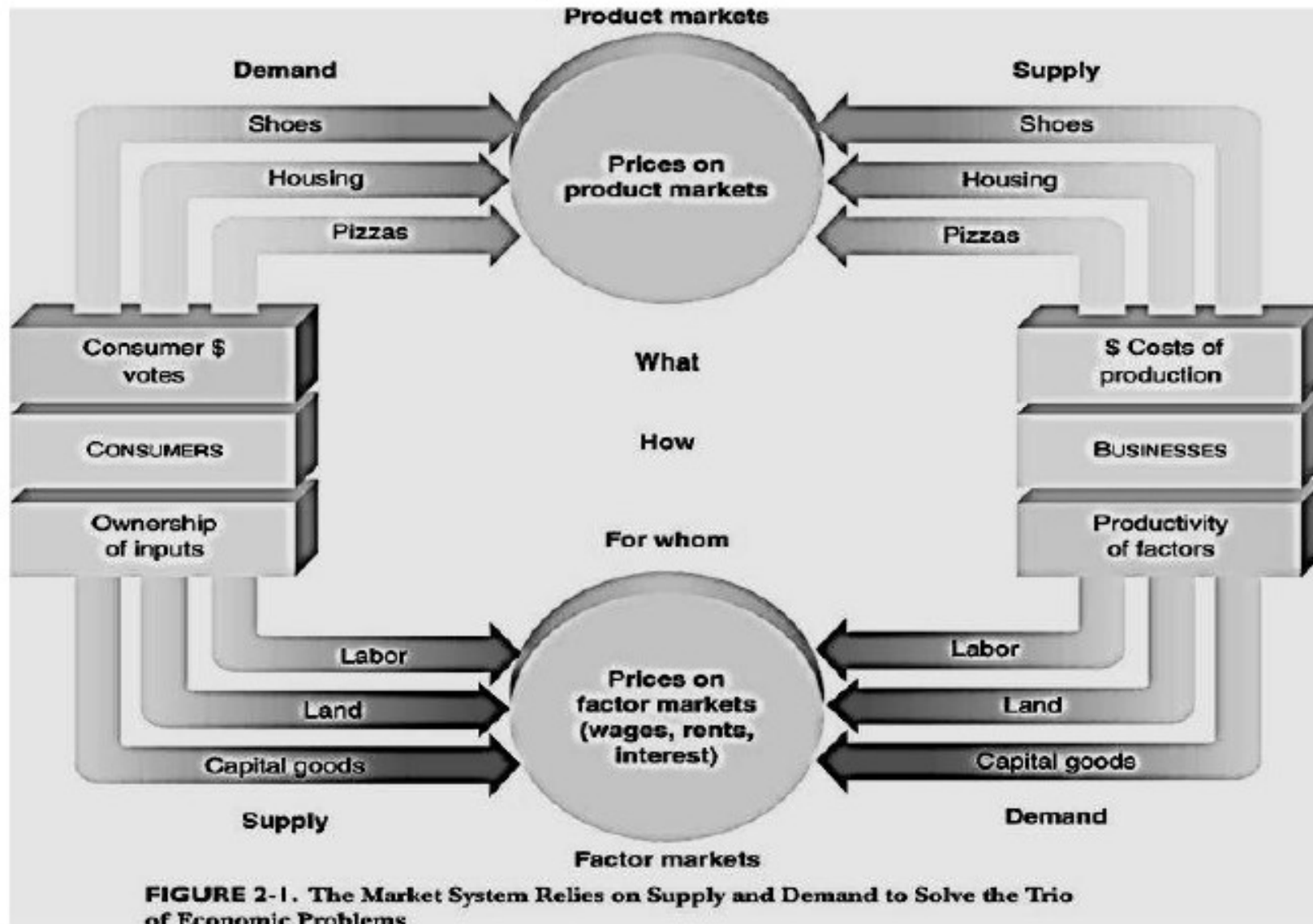


FIGURE 2-1. The Market System Relies on Supply and Demand to Solve the Trio of Economic Problems

Thank You