Understanding Basic Economics

BA291 Week 2

THAMMASAT
people & sustainability

Learning Objectives

1. Define economics and explain why scarcity is central to economic decision making
2. Differentiate among the major types of economic systems
3. Explain the interaction between demand and supply

Learning Objectives (cont.)

4. Identify four macro-economic issues that are essential to understanding the behavior of the economy
5. Outline the debate over de-regulation and identify four key roles that governments play in the economy
6. Identify the major ways of measuring economic activity

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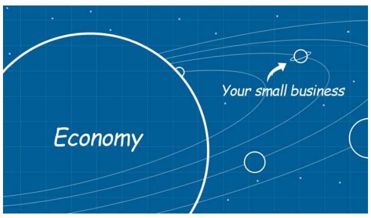
What Is This Thing Called the Economy?

- **Economy**
  - The sum total of all the economic activity within a given region



- **Economics**
  - The study of how a society uses its scarce resources to produce and distribute goods and services

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What Is This Thing Called the Economy?

Macroeconomics

The study of "big picture" issues in an economy, including competitive behavior among firms, the effect of government policies, and overall resource allocation issues

- **Microeconomics**
  - The study of how consumers, businesses, and industries collectively determine the quantity of goods and services demanded and supplied at different prices

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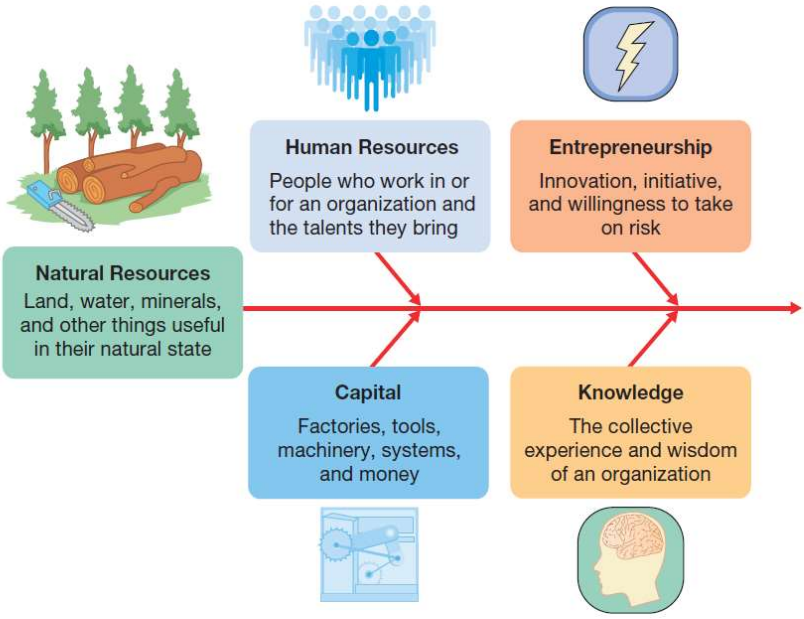
Factors of Production



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Factors of Production

- **Natural resources**
  - Land, forests, minerals, water, and other tangible assets usable in their natural state.
- **Human resources**
  - All the people who work in an organization or on its behalf.
- **Capital**
  - The funds that finance the operations of a business as well as the physical, human-made elements used to produce goods and services, such as factories and computers.
- **Entrepreneurship**
  - The combination of innovation, initiative, and willingness to take the risks required to create and operate new businesses.
- **Knowledge**
  - Expertise gained through experience or association.

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The Economic Impact of Scarcity

- **Scarcity**
  - A condition of any productive resource that has finite supply.
- **Opportunity cost**
  - The value of the most appealing alternative not chosen

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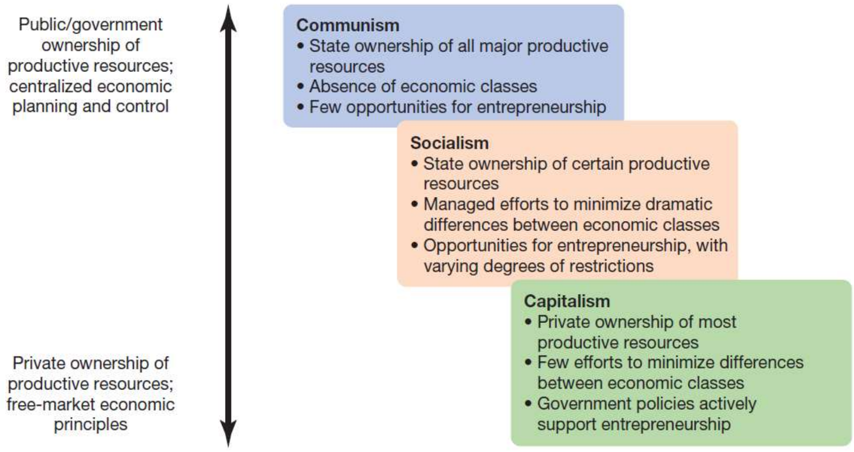
Economic Systems



Economic system

The policies that define a society's particular economic structure; the rules by which a society allocates economic resources

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✓What will we produce?
✓How will we produce it?
✓Who gets it?

Economic System

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Free Market Systems

– An economic system in which, decisions about what to produce and in what quantities, are decided by the market's buyers and sellers

Capitalism

Economic system based on economic freedom and competition.

Private ownership of resources becomes the bases for the production and distribution of good and services

Capitalist are people who personally own or control the physical capital of industrial production such as machinery, factories and distribution networks, raw materials and technology

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Planned Systems

- **Planned system**
  – Economic system in which the government controls most of the factors of production and regulates their allocation.

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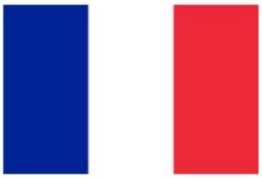
Socialism

- **Socialism**
  - Economic system characterized by public ownership and operation of key industries combined with private ownership and operation of less-vital industries



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Nationalization and Privatization

- **Nationalization**
  - A government's takeover of selected companies
  - or industries
- **Privatization**
  - Turning over services once performed by the government and allowing private businesses to perform them instead

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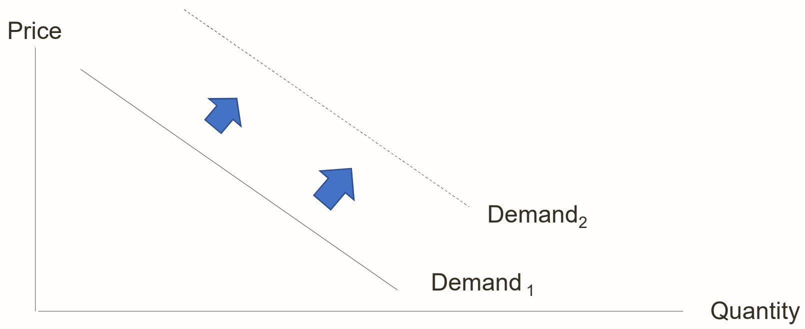
The Forces of Demand and Supply

- **Demand**
  - Buyers' willingness and ability to purchase products at various price points
- **Supply**
  - A specific quantity of a product that the seller is able and willing to provide at various prices

Understanding Demand

- **Demand curve**
  - A graph of the quantities of a product that buyers will purchase at various prices.



Shift in Demand

Major factors that can cause overall demand to increase or decrease:

- Customer income
- Customer preferences toward the product
- The price of substitute products
- The price of complementary products
- Marketing expenditures
- Customer expectations about future prices and their own financial well-being

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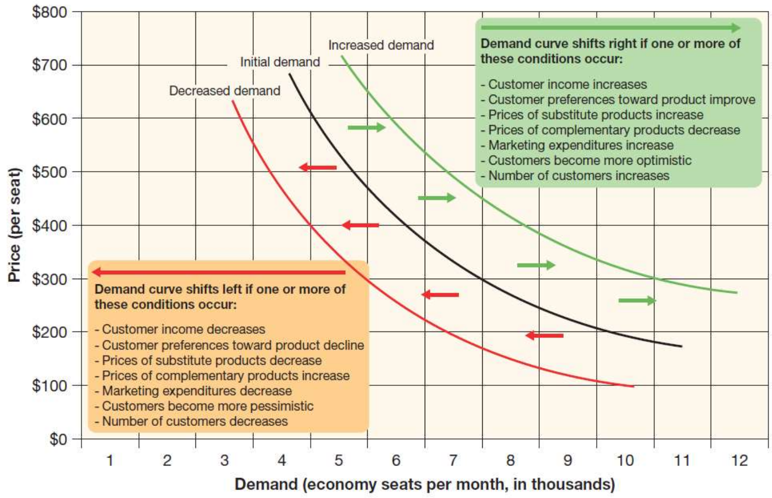
Demand Curve



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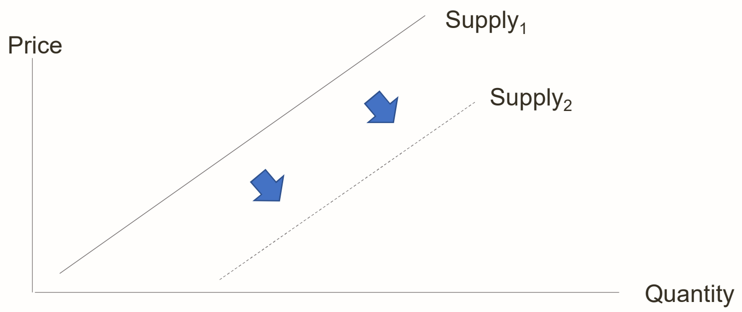
Understanding Supply

- **Supply curve**
  - A graph of the quantities of a product that sellers will offer for sale, regardless of demand, at various prices.



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Shift in Supply

Major factors that can cause overall supply to increase or decrease:

- Cost of production increase
- Competition increase
- Technology decreases production costs
- Taxes and regulatory costs increase

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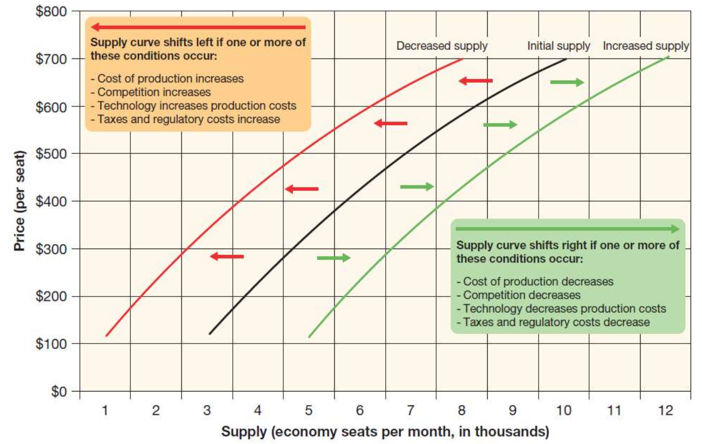
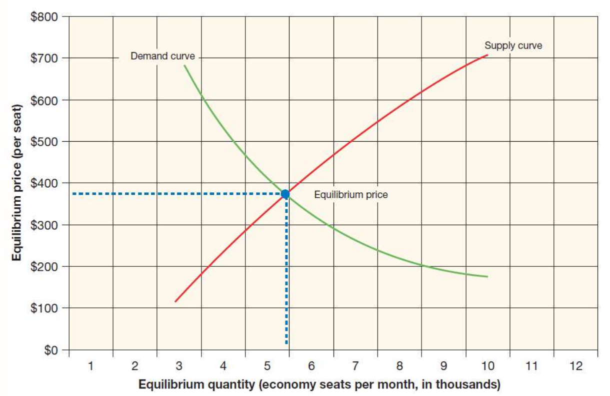
Supply Curve

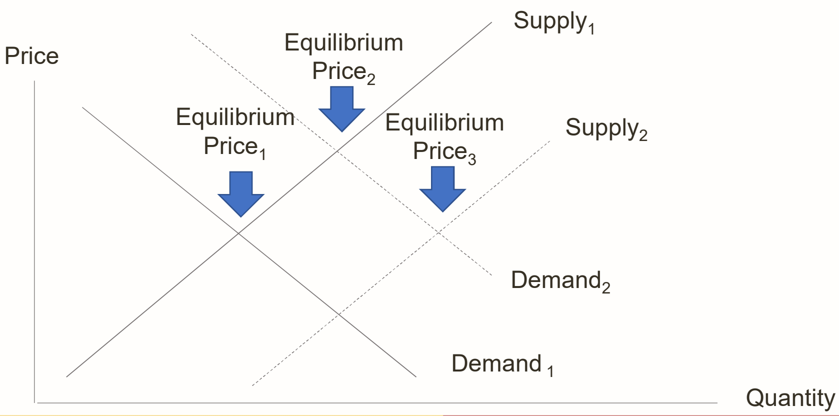


The Relationship Between Demand and Supply



- **Equilibrium point**
  - The point at which quantity supplied equals quantity demanded. Because the supply and demand curves are dynamic, so is the equilibrium point. As variables affecting supply and demand change, so will the equilibrium price.

Understanding How Demand and Supply Interact



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Competition in a Free-Market System

- **Pure competition (Perfect Competition)**
  - A situation in which so many buyers and sellers exist that no single buyer or seller can individually influence market prices
- **Monopolistic competition**
  - A situation in which many sellers differentiate their products from those of competitors, in at least some small way
- **Oligopoly**
  - A market situation in which a very small number of suppliers, sometimes only two, provide a particular good or service
- **Monopoly**
  - A situation in which one company dominates a market to the degree that it can control prices

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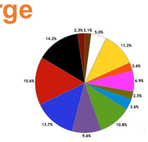
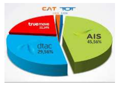
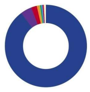
	Perfect Competition	Monopolistic Competition	Oligopoly	Monopoly
1. # of sellers	Large 		Few 	
2. Products	Identical		Identical Differentiated	
3. Market Entry & Exit	Easy; Free		Some	
4. Market Power	None		Large	

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Categories of Competition

Pure Competition
Characteristics:
- Many small suppliers
- Virtually identical products
- Low barriers to entry

Price competition:
- No single firm can grow large enough to influence prices across the market

Buyers' choices:
- Extensive

Monopolistic Competition
Characteristics:
- Can have few or many suppliers, of varying size
- Products can be distinguished but are similar enough to be replacements
- Variable barriers to entry but market open to all

Price competition:
- Firms that excel in one or more aspects can gain some control over pricing

Buyers' choices:
- Extensive

Oligopoly
Characteristics:
- Small number of suppliers, even as few as just two (a *duopoly*)
- Products can be distinguished in important ways, but replacements are still available
- Barriers to entry tend to be high, making entering the market difficult

Price competition:
- Individual firms can have considerable control over pricing

Buyers' choices:
- Limited

Pure Monopoly
Characteristics:
- Only one supplier in a given market
- Monopoly achieved without government intervention, by innovation, specialization, exclusive contracts, or a simple lack of competitors
- Products are unique, with no direct replacements available
- Barriers to entry are extremely high, making entering the market difficult or impossible

Price competition:
- Suppliers can charge as much as they want, at least until people stop buying

Buyers' choices:
- None

Regulated Monopoly
Characteristics:
- Only one supplier in a given market
- Monopoly granted by government mandate, such as a license to provide cable TV and Internet service
- No product competition is allowed
- Barriers to entry are infinitely high; new competitors are not allowed

Price competition:
- Prices are set by government mandate

Buyers' choices:
- None

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Competition in a Free-Market System (cont.)

Market Structure	Seller Entry Barriers	Seller Number
Perfect Competition	No	Unlimited
Monopolistic competition	No	Many
Oligopoly	Yes	Few
Monopoly	Yes	One

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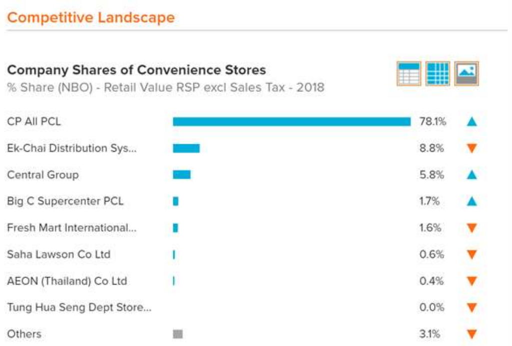
Some key terms: Market Share

- The total percentage of a product a company sells in a particular market

Retail Industry (Convenience Stores) in Thailand



Source: Euromonitor 2019

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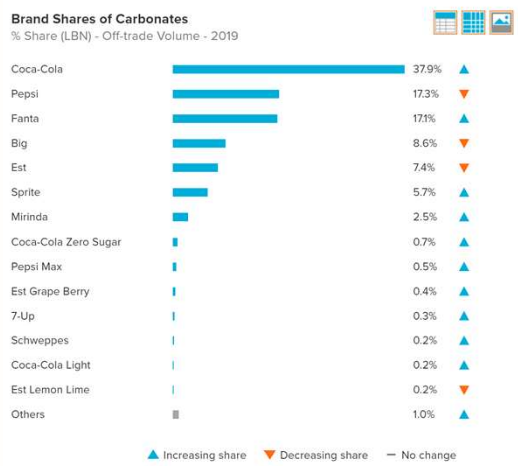
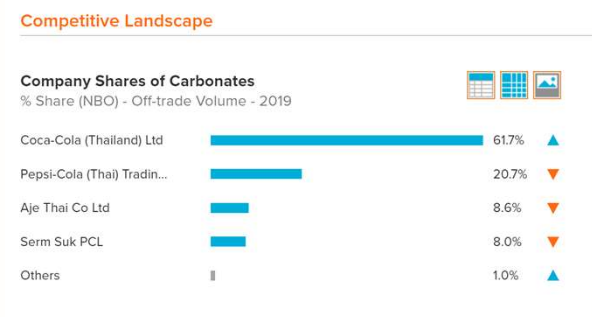
Some key terms: Market Share





Soft Drinks Industry (Carbonates) in Thailand

Source: Euromonitor 2019

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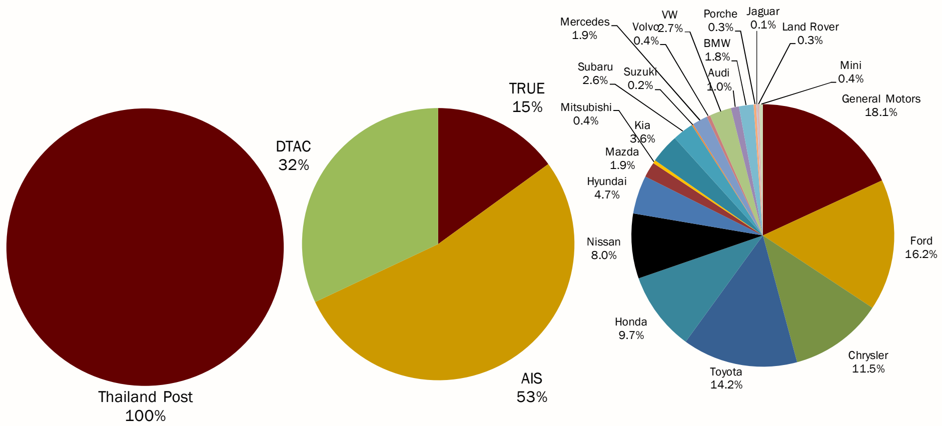
Some key terms: Market Concentration



A rule of thumb is that an oligopoly exists when the top five firms in the market account for more than __60__% of total market sales.

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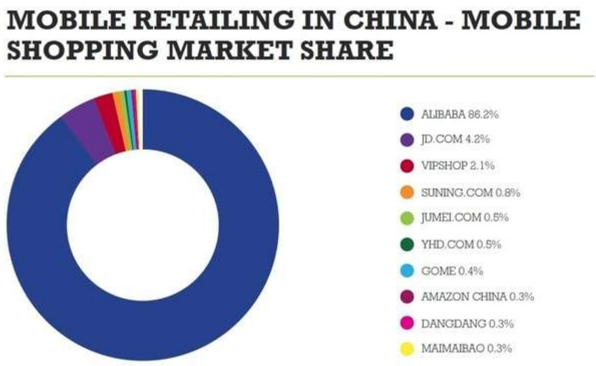

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Gross Domestic Product

- Value of all final goods and services produced in a country within a given period
- $Y = C + I + G + X - M$
  - C = consumption
  - I = investment
  - G = government spending
  - X = export
  - M = import

Rank ▲	Name	GDP (IMF '19)	GDP (UN '16)	GDP Per Capita	2019 Population
1	United States	22.20 trillion	18.62 trillion	$67,063	331,002,651
2	China	15.47 trillion	11.22 trillion	$10,747	1,439,323,776
3	Japan	5.50 trillion	4.94 trillion	$43,450	126,476,461
4	Germany	4.16 trillion	3.48 trillion	$49,617	83,783,942
5	India	3.26 trillion	2.26 trillion	$2,361	1,380,004,385
6	United Kingdom	2.93 trillion	2.65 trillion	$43,118	67,886,011
7	France	2.88 trillion	2.47 trillion	$44,062	65,273,511
8	Italy	2.09 trillion	1.86 trillion	$34,575	60,461,826
9	Brazil	2.06 trillion	1.80 trillion	$9,703	212,559,417
10	Canada	1.83 trillion	1.53 trillion	$48,553	37,742,154
11	South Korea	1.74 trillion	1.41 trillion	$34,024	51,269,185
12	Russia	1.67 trillion	1.25 trillion	$11,426	145,934,462
13	Spain	1.50 trillion	1.24 trillion	$32,020	46,754,778
14	Australia	1.48 trillion	1.30 trillion	$58,097	25,499,884
15	Mexico	1.30 trillion	1.08 trillion	$10,065	128,932,753
16	Indonesia	1.21 trillion	932.26 billion	$4,420	273,523,615
20	Switzerland	740.70 billion	668.85 billion	$85,585	8,654,622
21	Poland	643.27 billion	471.40 billion	$16,997	37,846,611
22	Taiwan	633.70 billion		$26,607	23,816,775
23	Sweden	576.72 billion	514.48 billion	$57,105	10,099,265
24	Belgium	553.78 billion	467.96 billion	$47,782	11,589,623
25	Thailand	547.43 billion	407.03 billion	$7,843	69,799,978
26	Argentina	515.35 billion	545.87 billion	$11,403	45,195,774

Source: Worldpopulationreview.com

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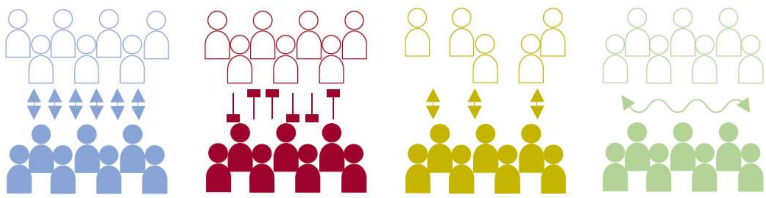
Unemployment

- **Unemployment rate**
  - The portion of the labor force (everyone over 16 who has or is looking for a job) currently without a job

Types of Unemployment



Frictional Unemployment
- The "natural" flow of workers into and out of jobs, such as when a person leaves one job without first lining up a new job
- Always some level of frictional unemployment in the economy

Structural Unemployment
- A mismatch between workers' skills and current employer needs
- Workers can't find jobs that match their qualifications, and employers can't find employees with the skills their job openings require
- A never-ending concern as changes in the external environments of business make some skills obsolete and create demand for new skills

Cyclical Unemployment
- Caused by economic fluctuations
- When demand for goods and services drops, businesses reduce production, thereby requiring fewer workers
- An increasing number of people who want to work can't find jobs
- During catastrophic depressions, can run as high as 20 or 25 percent

Seasonal Unemployment
- Predictable increases and decreases in the need for workers in industries with seasonal fluctuations in customer demand
- Common in agriculture, leisure and entertainment, retailing, and accounting services

Inflation and Deflation

- **Inflation**
  - An economic condition in which prices rise steadily throughout the economy and consequently, the purchasing power of currency is falling.

Deflation

An economic condition in which prices fall steadily throughout the economy

Deflation is not necessarily bad, but often periods of deflation can lead to economic stagnation and periods of high unemployment. This is because deflation can discourage spending because things will be cheaper in the future. Deflation can also increase debt burdens – reducing the spending power of firms and consumers.

- It is bad for the economy
- It is bad for debtors
- It is bad for companies
- It stops people spending
- It makes it difficult for central bankers to control the economy.

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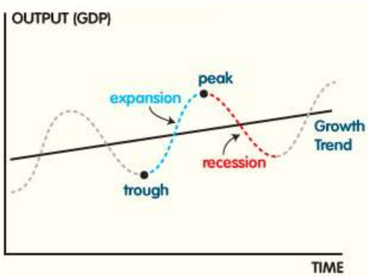
Business Cycles

- **Business cycles**
  - Pattern of expansion (recovery) and contraction (recession) in economic activity around the path of trend growth
  - Fluctuations in the rate of growth that an economy experiences over a period of several years
  - Inflation, growth, and unemployment are related through the business cycle
- **Recession**
  - A period during which national income, employment, and production all fall; defined as at least six months of decline in the GDP



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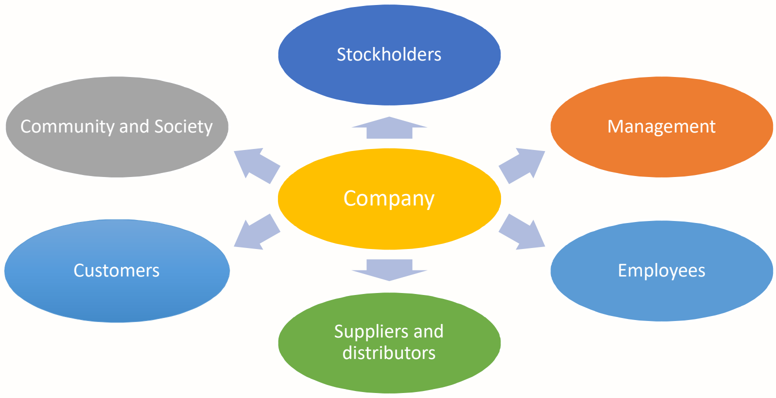
Stakeholders

People or groups of people who supply a company with productive resources and thereby have an interest or effected by the company behaviors



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Government's Role in a Free-Market System

- Protecting stakeholders
- Fostering competition
- Encouraging innovation and economic development
- Stabilizing and stimulating the economy

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Government's Role in a Free-Market System (cont.)

- **Regulation**
  - Relying more on laws and policies than on market forces to govern economic activity
- **De-regulation**
  - Removing regulations to allow the market to prevent excesses and correct itself over time

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Stabilizing and Stimulating the Economy

- **Monetary policy**
  - Government policy and actions taken by the Federal Reserve Board to regulate the nation's **money supply**

Interest rate   Interest rate

- **Fiscal policy**
  - Strategy for the use of **government revenue** collection and **spending**, to influence the business cycle

Government Spending
Tax

Government Spending
Tax

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Economic Measures and Monitors

- **Economic indicators**
  - Statistics that measure the performance of the economy

Leading indicators suggest changes that may happen to the economy in the future and are therefore valuable for planning. In contrast, *lagging indicators* provide confirmation that something has occurred in the past.

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Price Indexes

- **Consumer Price Index (CPI)**
  - A monthly statistic that measures changes in the prices of a representative collection of consumer goods and services
- **Producer Price Index (PPI)**
  - A statistical measure of price trends at the producer and wholesaler levels

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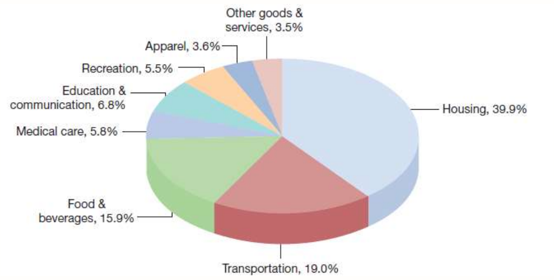
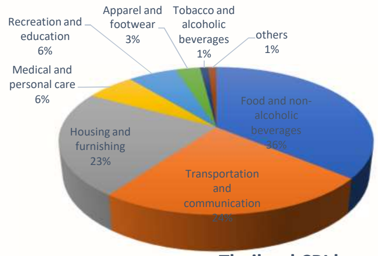
Composition of the Consumer Price Index





Thailand CPI by category

Source: U.S. Bureau of Labor Statistics, "Relative Importance of Items in the Consumer Price Index," December 2012, www.bls.gov.

Source: https://tradingeconomics.com/