Understanding Basic Economics

BA291

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

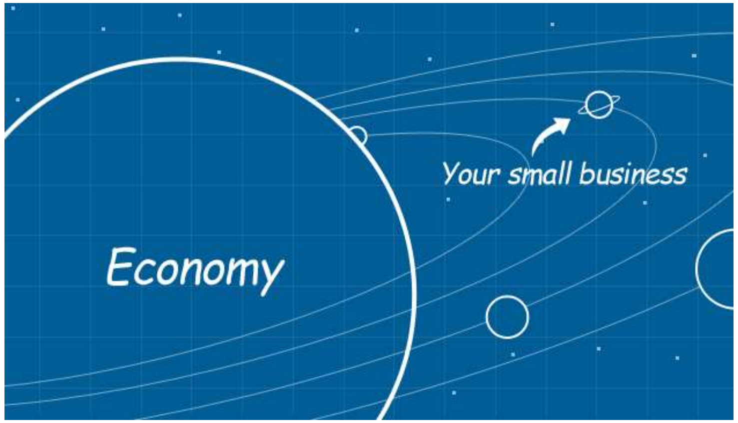
What Is This Thing Called the Economy?

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



What Is This Thing Called the Economy?

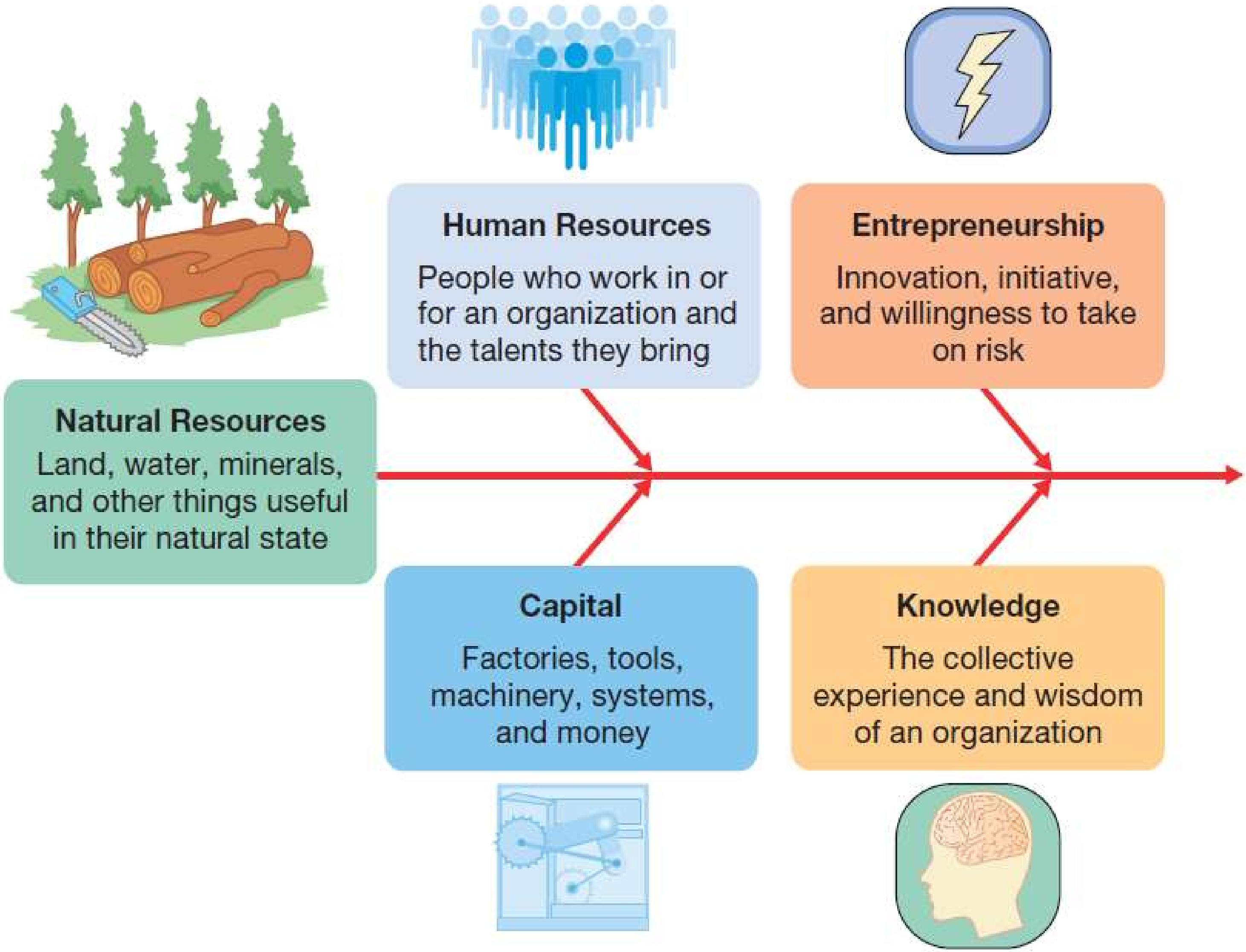
Macroeconomics

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

Factors of Production



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.

The Economic Impact of Scarcity

Scarcity

A condition of any productive resource that has finite supply.

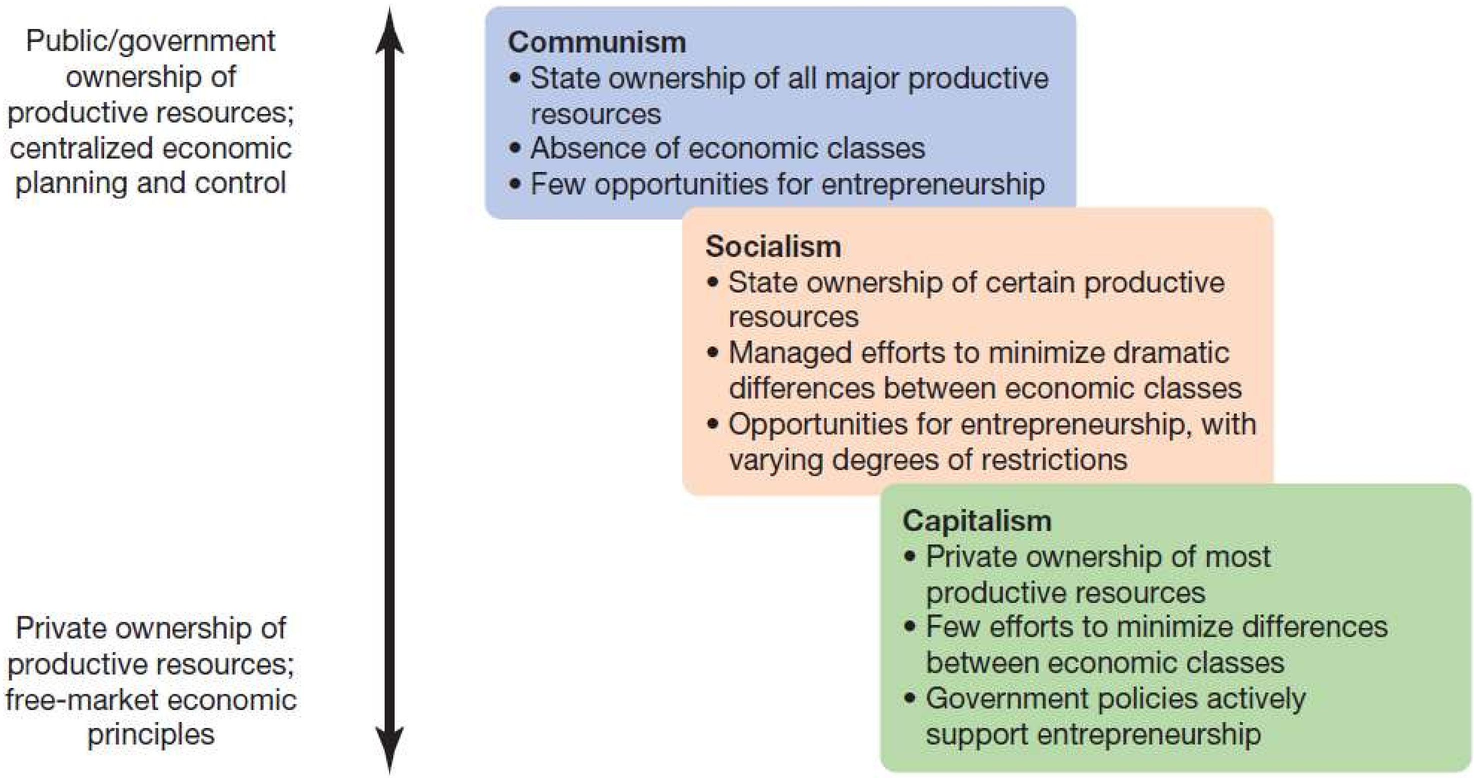
Opportunity cost

The value of the most appealing alternative not chosen

Economic Systems

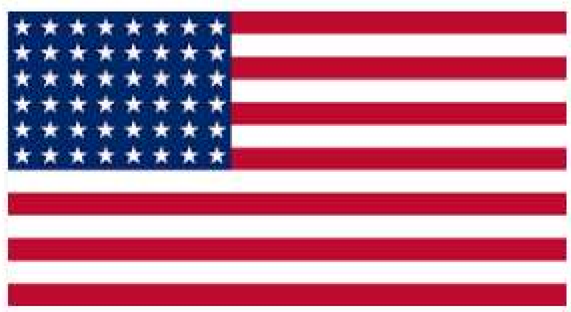
Economic system

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



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

Planned Systems

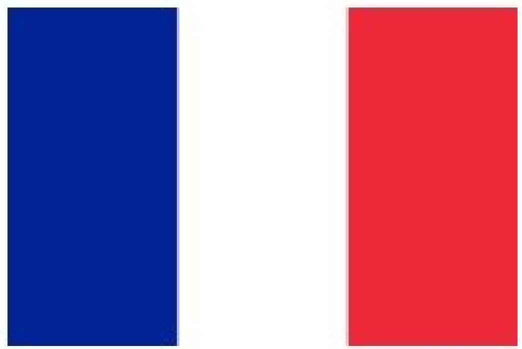
Planned system

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

Socialism

Socialism

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



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

The Forces of Demand and Supply

Demand

Buyers' willingness and ability to purchase products at various price points

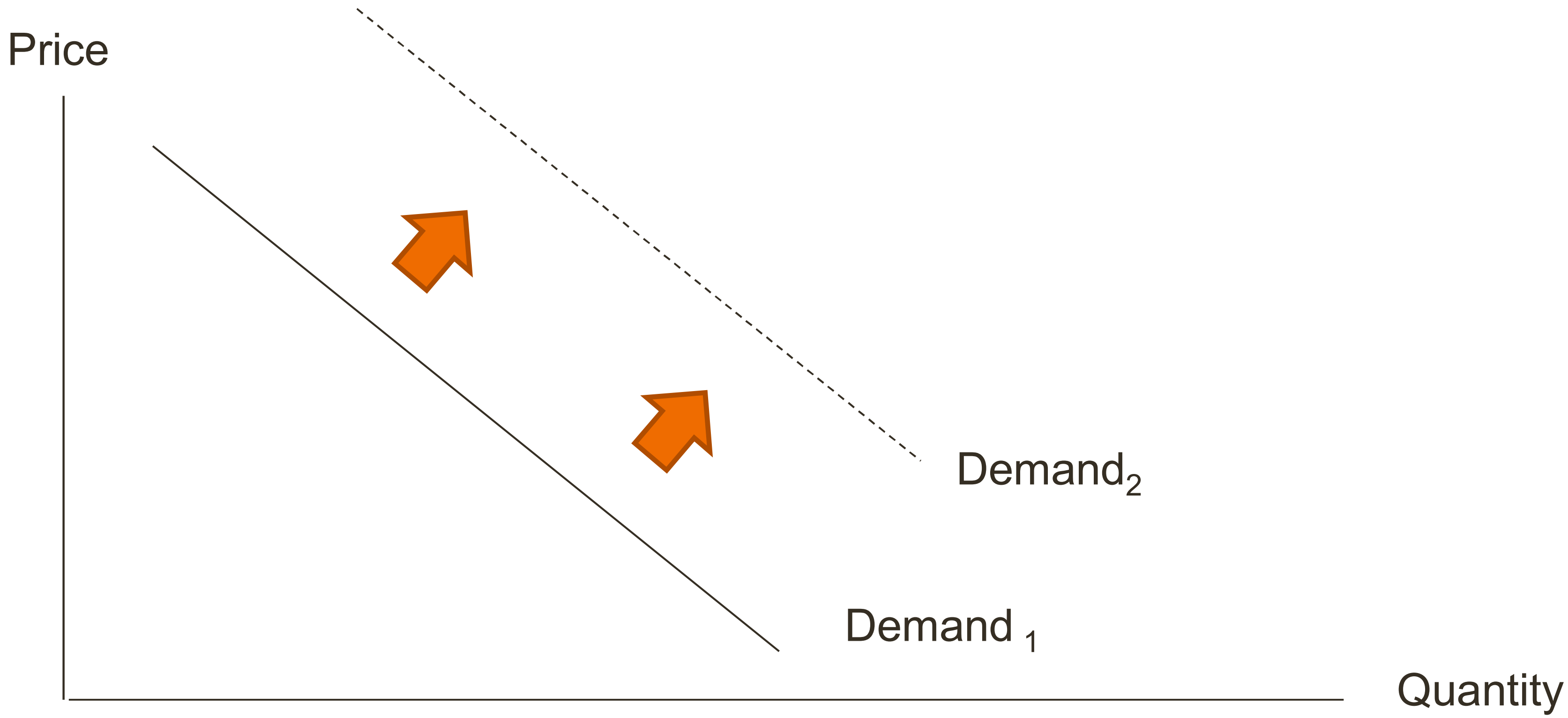
Supply

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.

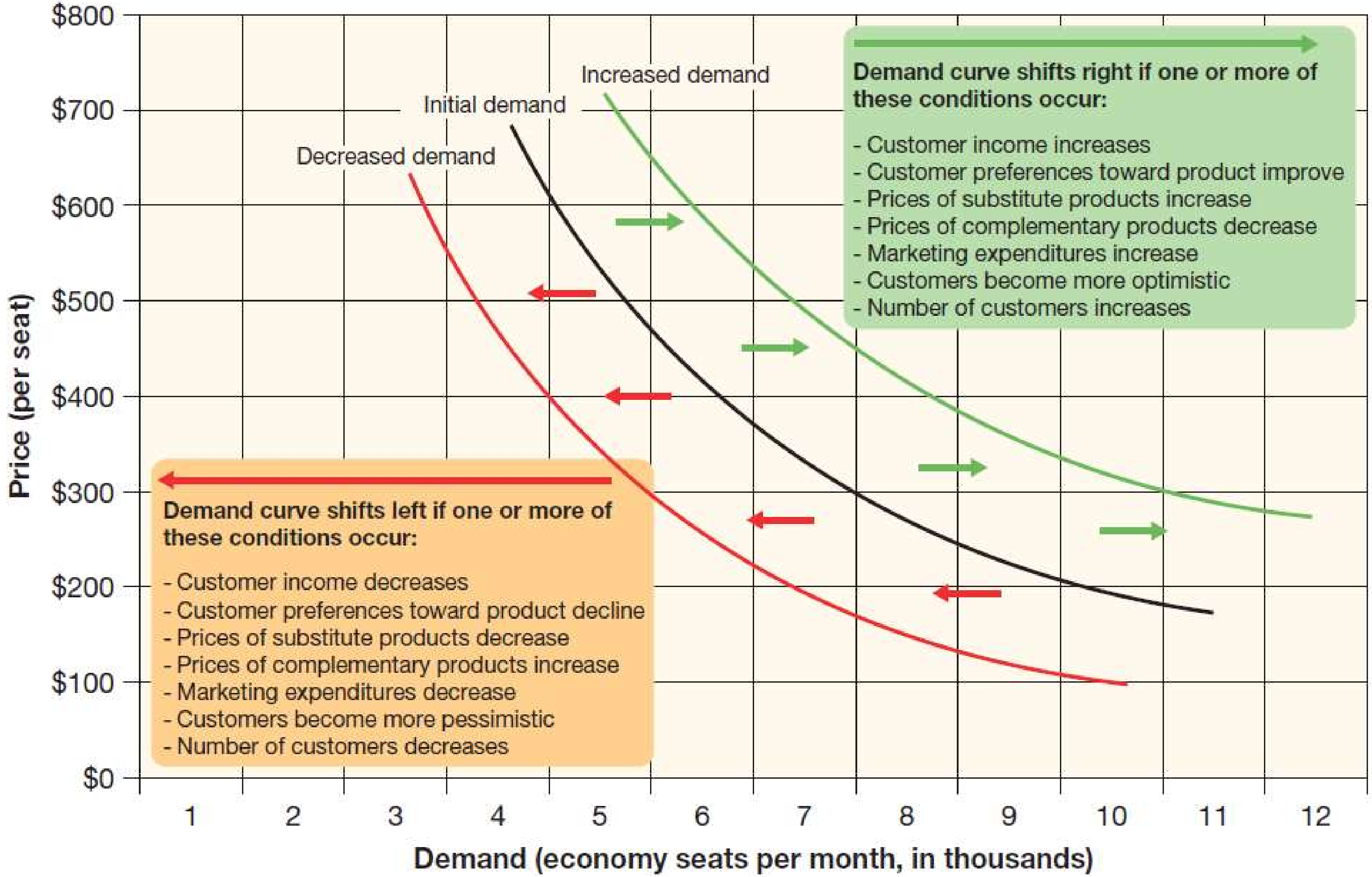


Shift in Demand

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

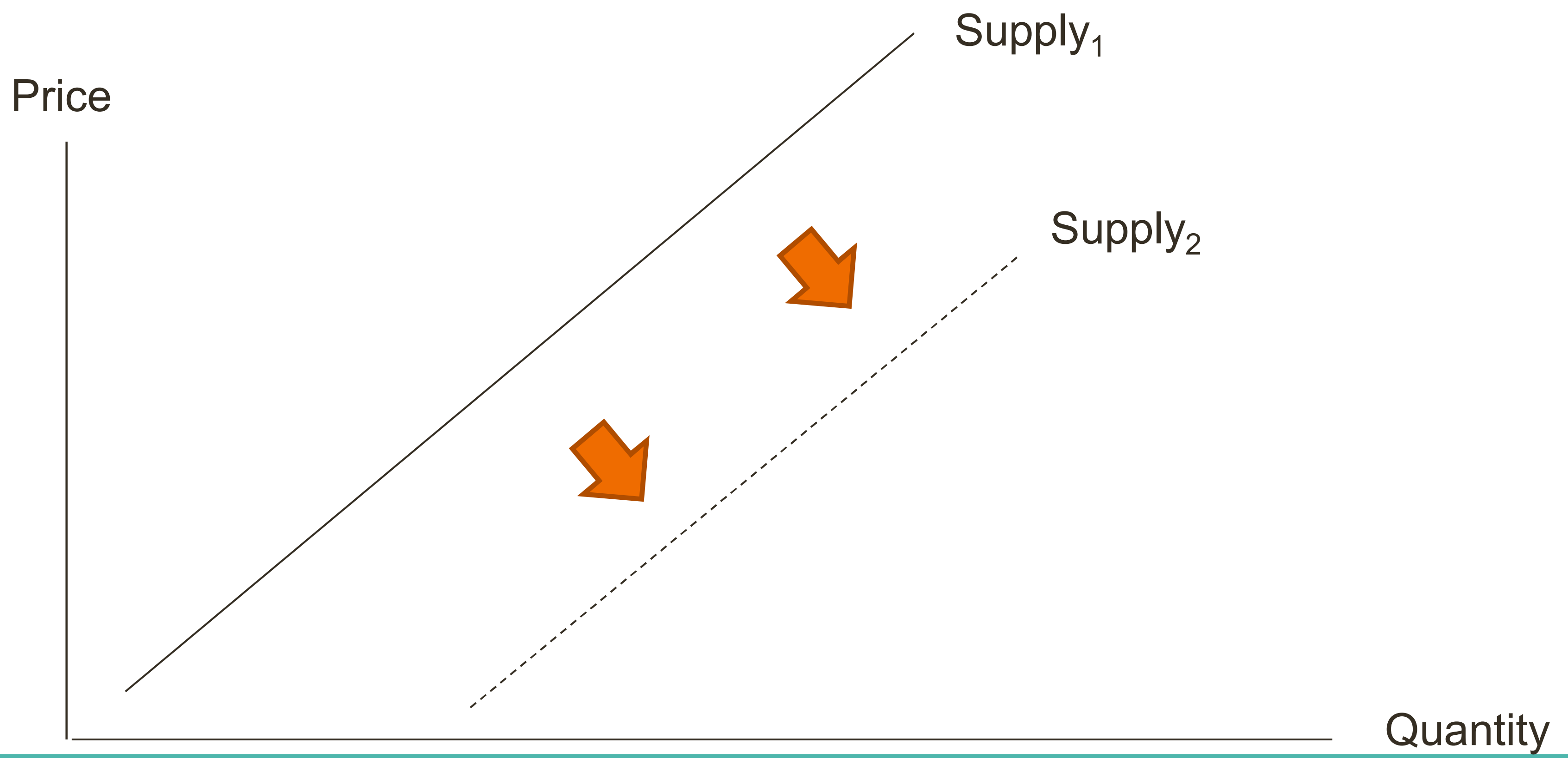
Demand Curve



Understanding Supply

Supply curve

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

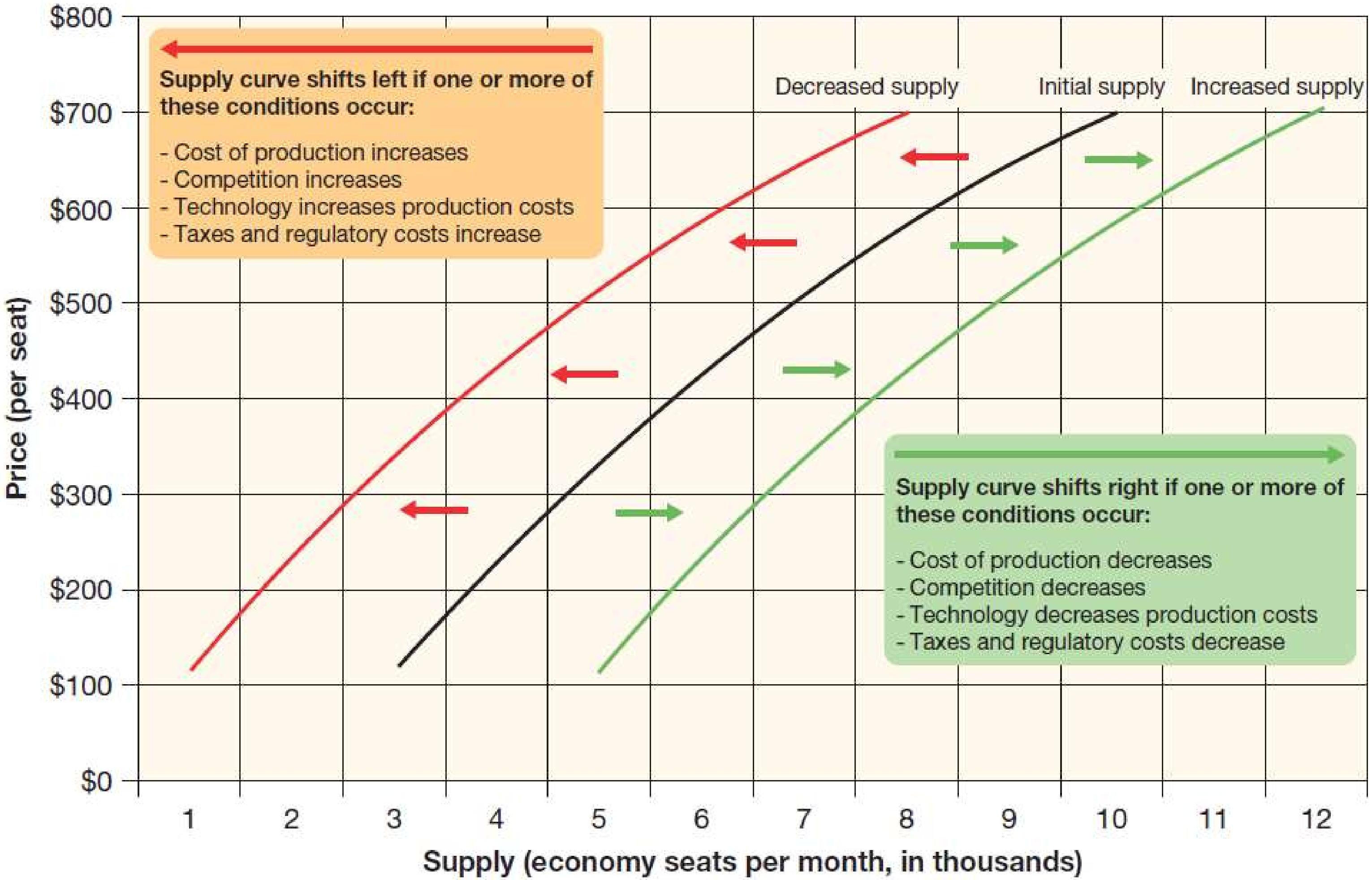


Shift in Supply

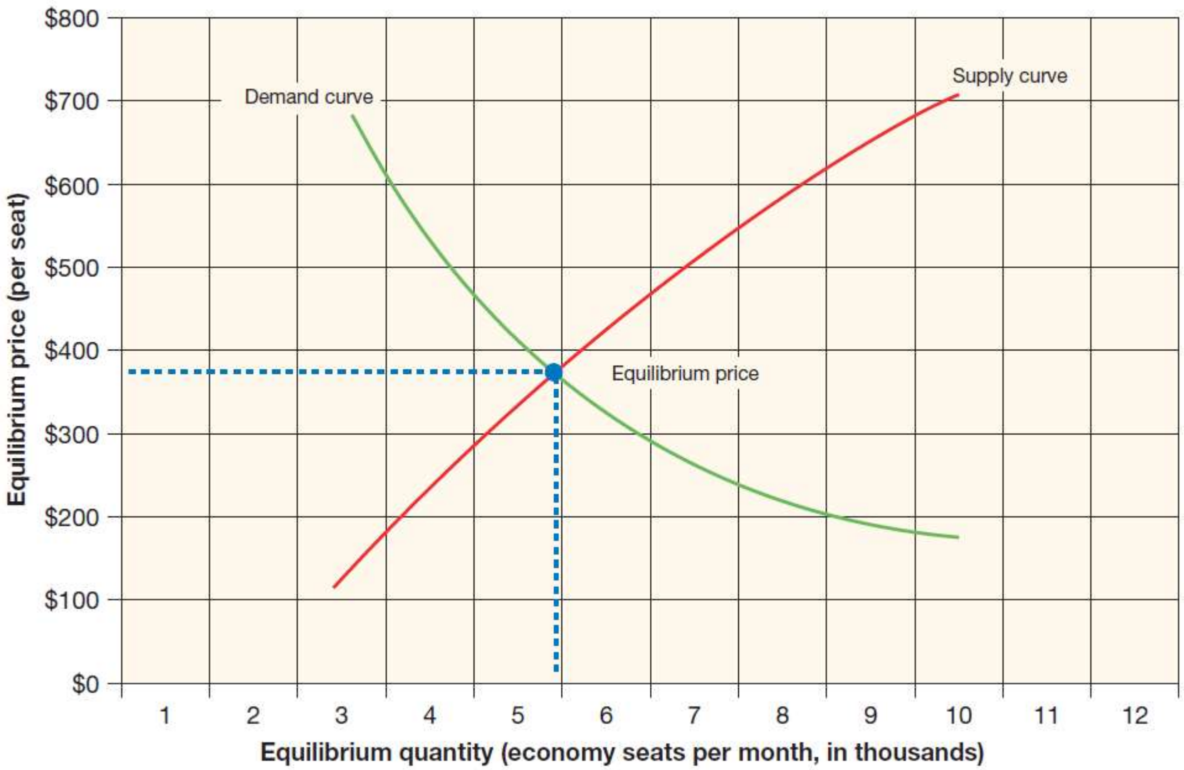
Major factors that can cause overall supply to increase or decrease:

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

Supply Curve



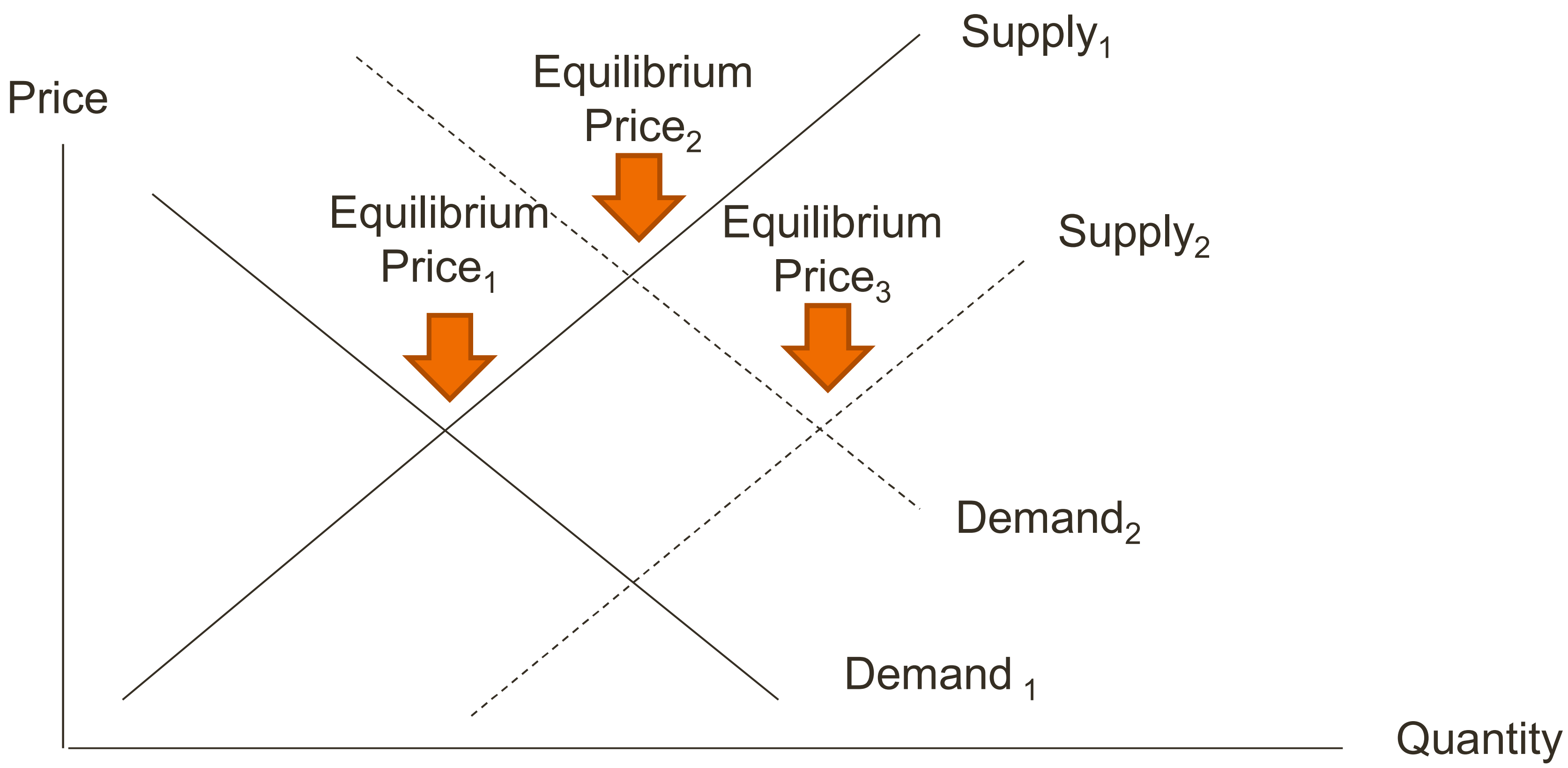
The Relationship Between Demand and Supply



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



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

Perfect Competition | Monopolistic Competition | Oligopoly | Monopoly

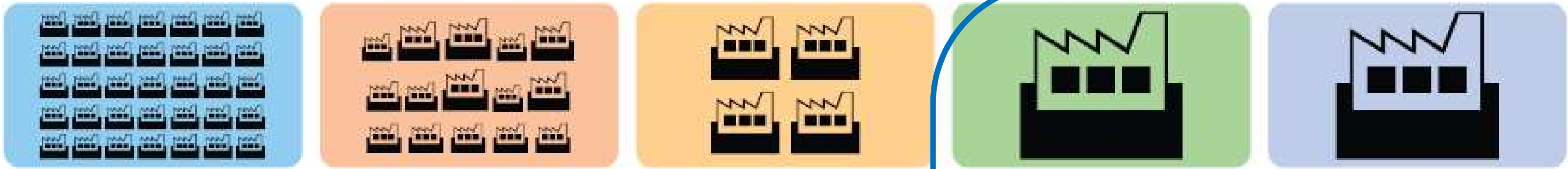
1. # of sellers

2. Products

3. Market Entry & Exit

4. Market Power

Categories of Competition



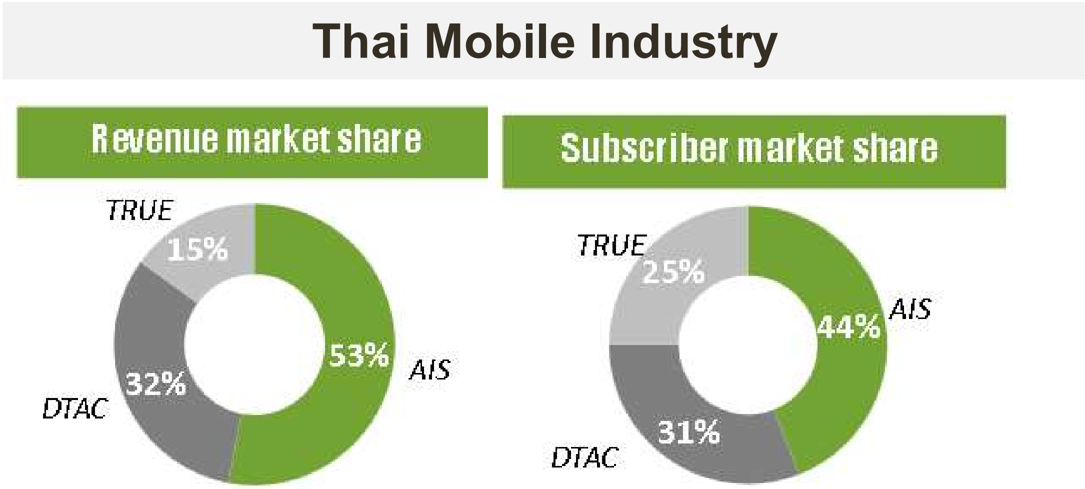
Pure Competition	Monopolistic Competition	Oligopoly	Pure Monopoly	Regulated Monopoly
Characteristics: • Many small suppliers • Virtually identical products • Low barriers to entry	**Characteristics:** • Can have few or many suppliers, of varying size • Products can be distinguished but are similar enough to be replacements • Variable barriers to entry but market open to all	**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	**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	**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: • No single firm can grow large enough to influence prices across the market	**Price competition:** • Firms that excel in one or more aspects can gain some control over pricing	**Price competition:** • Individual firms can have considerable control over pricing	**Price competition:** • Suppliers can charge as much as they want, at least until people stop buying	**Price competition:** • Prices are set by government mandate
Buyers' choices: • Extensive	**Buyers' choices:** • Extensive	**Buyers' choices:** • Limited	**Buyers' choices:** • None	**Buyers' choices:** • None

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

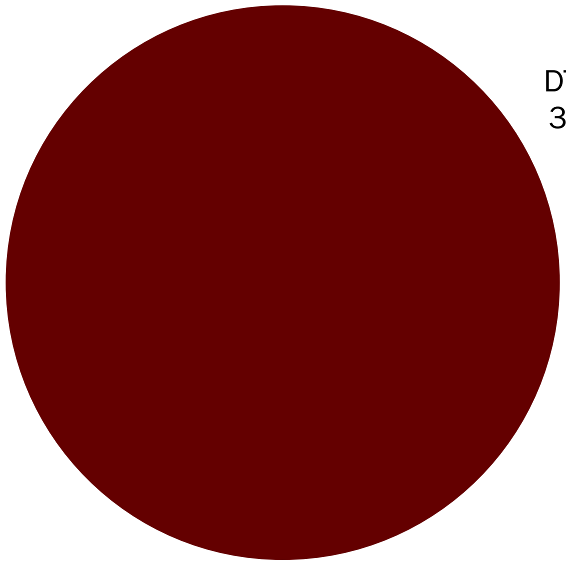
Market Share

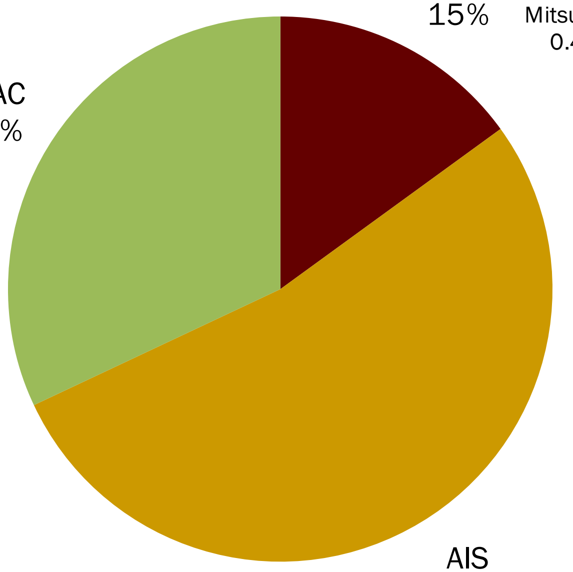
The total percentage of a product a company sells in a particular market

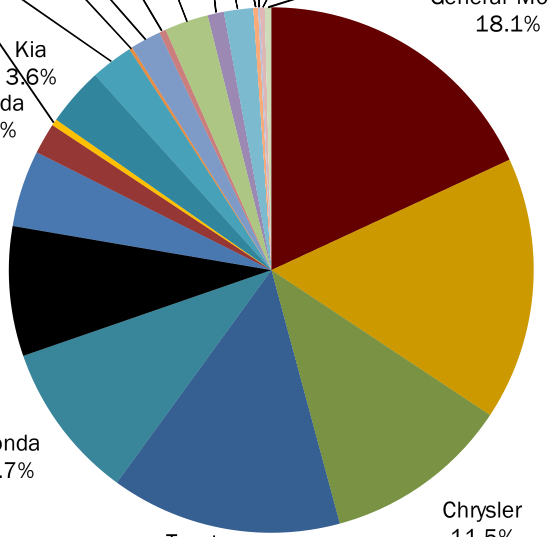


Source: AIS factsheet, May 2013

Market Concentration







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

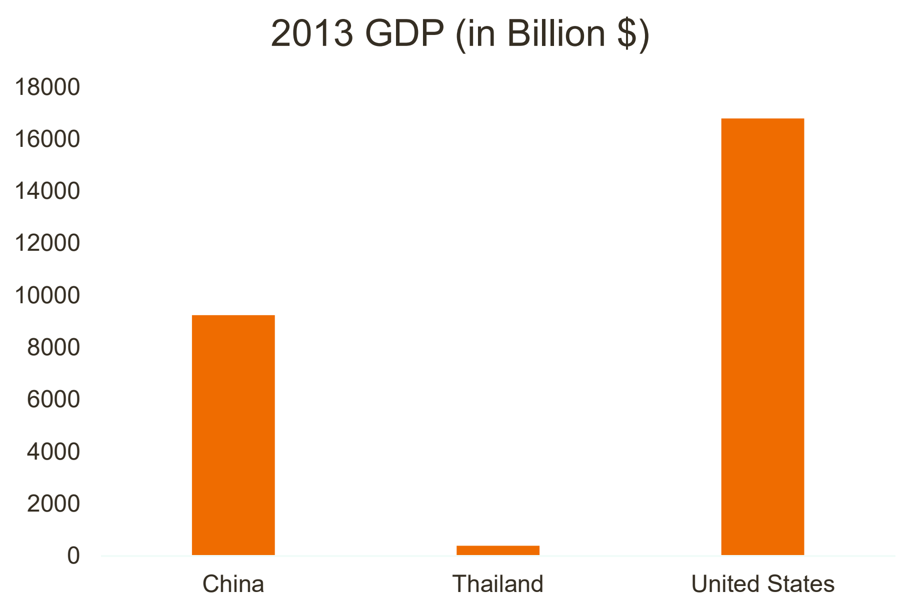
I = investment

G = government spending

X = export

M = import

Country	2013 GDP (in Billion US$)
China	9,240
Thailand	387
US	16,800

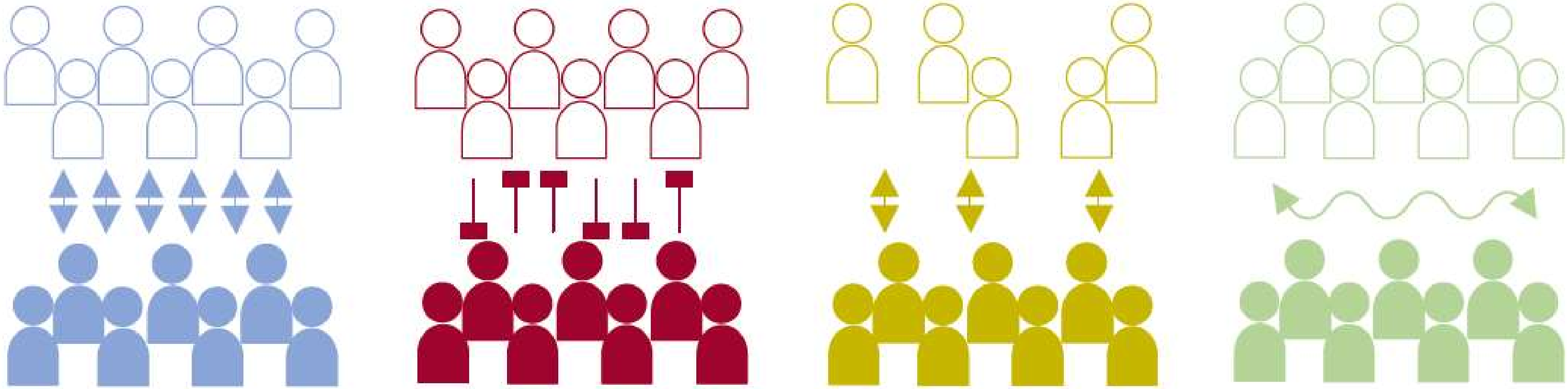


Unemployment

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 con cern 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 entertain-ment, 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.

Business Cycles

Business cycles

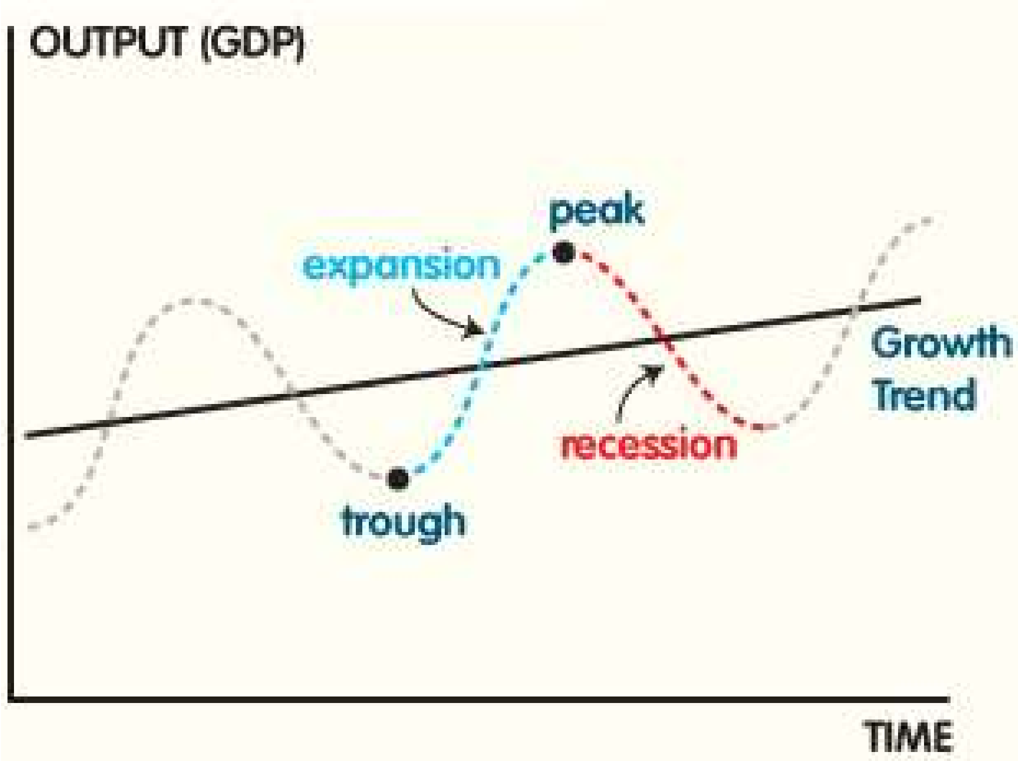
Pattern of expansion (recovery) and contraction (recession) in economic activity around the path of trend growth

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

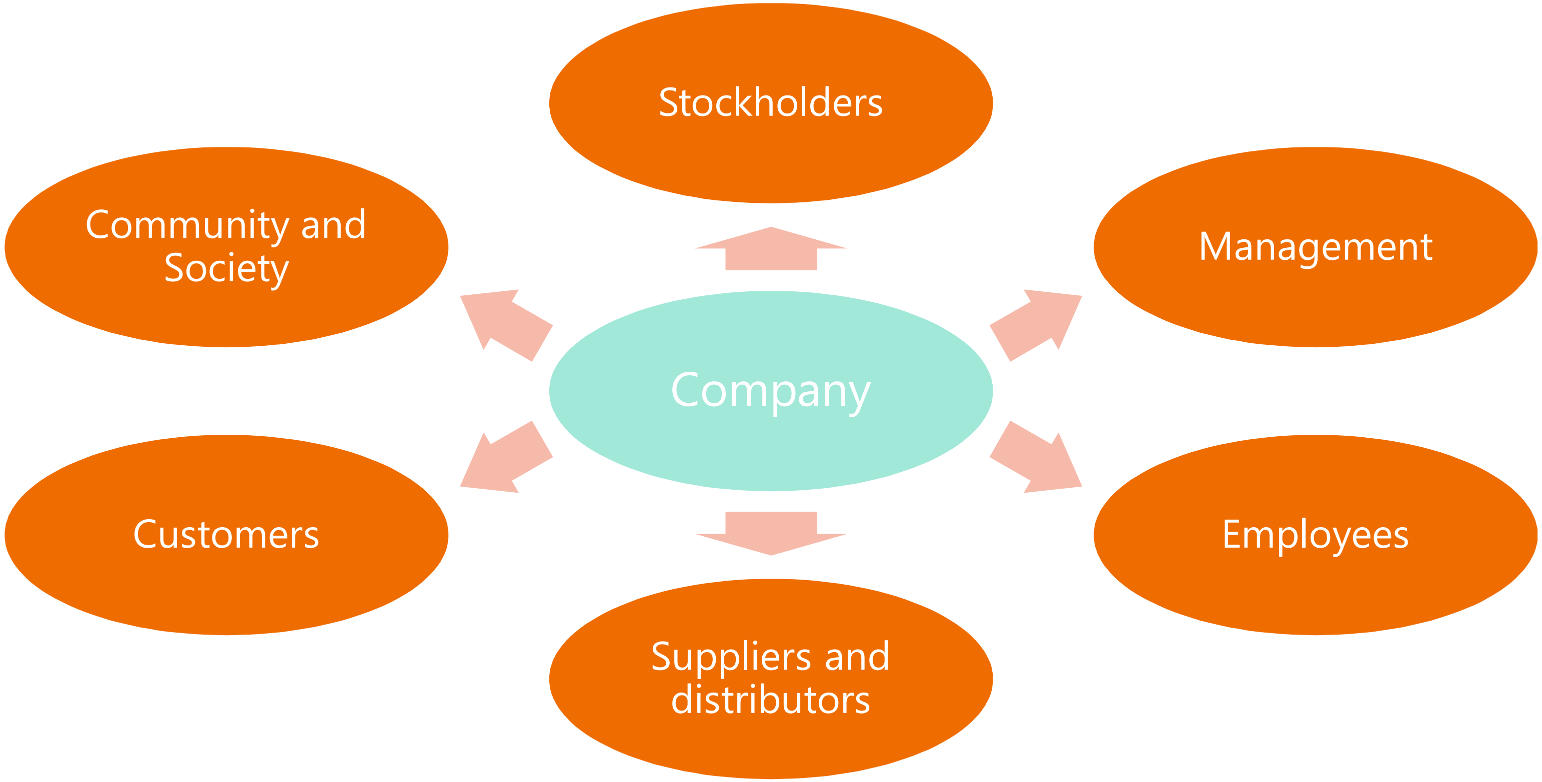
Recession

A period during which national income, employment, and production all fall; defined as at least six months of decline in the GDP



Stakeholders

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



Government’s Role in a Free-Market System

Protecting stakeholders

Fostering competition

Encouraging innovation and economic development

Stabilizing and stimulating the economy

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

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

Economic Measures and Monitors

Economic indicators

Statistics that measure the performance of the economy

Leading, lagging

Price Indexes

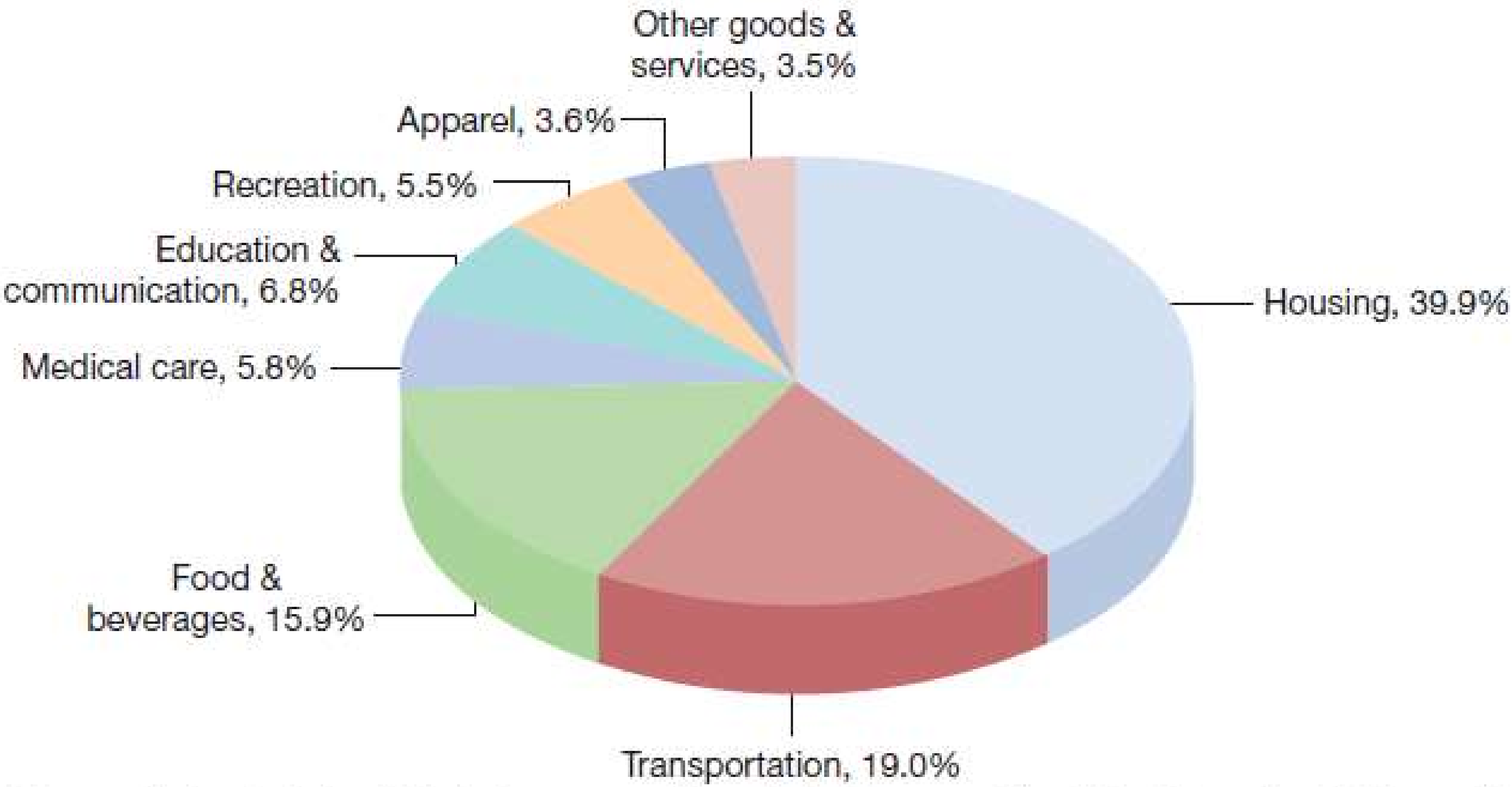
Consumer Price Index (CPI)

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

Composition of the Consumer Price Index



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