

INTRODUCTION



Understanding economics?

- **Economics**— the study of **choices** people make to attain their goals, given **unlimited wants** and **scarce resources**
- **Microeconomics**—studies the behaviour of individual agents: individual consumers, workers, input owners, individual firms, industries etc.
 - Studies micro-economic concepts such as pricing by a firm, employment in a firm, wages of a worker etc.
- **Macroeconomics**—studies the performance and behaviour of the economy as a whole
 - Studies aggregates measures such as inflation, unemployment and economic growth etc.
- While macroeconomics looks at the **beach**, microeconomics looks at the individual pieces of **rock, sand, and shells** making up the beach

Why study economics?

- Better understanding of the economy
 - Better understanding of individual choices (consumption, labour supply)
 - Better understanding of business decision-making (product pricing, wage policy)
 - Better understanding of government policies for improving well-being (poverty, inequality, growth)
- Decision-making in day-to-day life
 - Day-to-day choices about spending our limited time and resources among competing prospects (time management; career decisions)
- Job prospects
 - Learning economics skills ensures sustained higher returns

Major themes in economics

- **Unlimited wants** and **scarce resources**
- **Trade-offs are unavoidable.** Examples include
 - Good grades vs. socialisation
 - Food vs. clothing
 - Consumption vs. savings
 - Wages vs. leisure
 - Labour-intensive vs. capital-intensive technology

Major themes in economics

- **Opportunity cost:** The cost of something is what you give up to get it
 - **Opportunity cost** of using a resource is the value of the best alternative use of the resource that is forgone.
 - $Opportunity\ cost = Economic\ cost = Explicit\ cost + Implicit\ cost$
 - Explicit cost are costs of market-supplied resources such as hired labour, rented capital and purchased raw-material.
 - Implicit costs are opportunity costs of owner-supplied resources such as owner's labour services and any owner-supplied land, building or capital equipment for use in production.

Major themes in economics

- Monetary (or explicit) costs of labour services, any land or buildings supplied by the owner is zero.
- Implicit costs of owner-supplied resources is the income earned by leasing the land, building or labour services in some other activity
- Opportunity cost is different from historical costs and considers only the current market value of a resource
- Opportunity cost in day-to-day life:
 - Opportunity cost of spending an additional hour of study is the forgone time spent on recreation
 - Opportunity cost of spending ₹500 on a movie is the forgone time spent having dinner in restaurant with the family.
 - Opportunity cost of watching the sunset in a beach is the forgone opportunity of watching the sunset in a hill-station

Major themes in economics

- **Marginal analysis**-To choose well focus on the margin
- Most decisions in day-to-day life is a **matter of degree** (and not an all-or-nothing affair).
 - How many hours to work every week?
 - How much money to spend on food or entertainment?
 - How many units of a good to produce?
- How does a marginal (or small) adjustment of choice affect **marginal (or incremental) benefits and costs** (and not total or average benefits or costs).
 - Marginal benefit: Change in total benefit due to a small adjustment of choice
 - Marginal cost: Change in total cost due to a small adjustment of choice
 - If a small adjustment of choice increases marginal benefit more than marginal cost, the adjustment is favourable.

Major themes in economics

- Whether to study an additional hour?
 - Marginal benefit: Better grades
 - Marginal cost: Forgone time that could have been spent on recreation
- Whether to purchase an additional unit of a good?
 - Marginal benefit: The additional satisfaction from the good
 - Marginal cost: The price of a unit of the good
- Whether to produce an additional unit of output?
 - Marginal benefit: The additional revenue from the sale of the good
 - Marginal cost: The cost of producing an additional unit of the good

Major themes in economics

- **Prices provide incentives**

- Increase in the price of a good, increases marginal benefits (profits) for producers and incentivises more production
- Increase in the price of a good increases marginal costs for buyers and lowers demand for the good

Economics & decision making

- **The economic decisions**
 - **What** goods and services will be produced?
 - **How** will those goods and services be produced? Labour intensive vs. capital intensive
 - **Who** will receive the goods and services produced?
- **Economic systems:** decision-making structure of the economy
 - Centrally planned economies vs. market economies

Economic systems

- **Centrally planned economy**: the decisions regarding resource use is made by the central planning agency.
- Advantages:
 - More equitable distribution of resources
 - More responsive to changing circumstances
- Disadvantages:
 - Not responsive to the wants of consumers
 - Lack of incentive to work
 - Requires large decision-making bureaucracy

Economic systems

- **Market economy**: prices determined through interaction of households and private firms ensure resource allocation.
- Economic decision-making and prices: product prices, input prices & incomes
- Advantages:
 - More responsive to the wants of consumers
 - Greater efficiency and freedom
 - Greater incentive to work
- Disadvantages:
 - Greater inequality in resource allocation
 - Greater fluctuations and uncertainty in the economy

Economic systems

- **Mixed economy**: elements of both the market economy and the centrally planned economy
- Most economic decisions made through the interaction between buyers and sellers (price-based mechanism)
- Government intervenes to reduce fluctuations in economic activity and ensure more equitable resource allocation

Nature and functions of profit

- Profit equals **revenue** minus the **cost of production**
- Profit is the most important **indicator** of a **manager's success**
- Profits play an important role in **resource allocation**
 - High profits are a signal to firms to increase production and other firms to enter industry
 - Low profits signal firms to increase efficiency, decrease production, leave industry
- Economic profit vs. Accounting (Business) profit
 - $\text{Economic profit} = \text{Revenue} - \text{Economic cost}$
 $\quad = \text{Revenue} - \text{Explicit cost} - \text{Implicit cost}$
 - $\text{Accounting profit} = \text{Revenue} - \text{Explicit cost}$

The costs and benefits of doing an *MBA*

<i>Benefits</i>	
Value of increase in lifetime earnings	₹3000000
<i>Costs</i>	
<i>Explicit costs</i>	
Tuition fees	₹1000000
<i>Accounting profit = Benefits – Explicit costs</i>	₹2000000
<i>Implicit costs</i>	
Value of salary forgone	₹600000
<i>Economic costs = Implicit costs + Explicit costs</i>	₹1600000
<i>Economic profit = Benefits – Economic costs</i>	₹1400000

- Doing an *MBA*, opportunity costs and recession

Recommended Readings

- ❖ Krugman, P., & Wells, R. (2015). *Economics* (4th ed.). New York, USA: Worth Publishers.
- ❖ Mankiw, G. (2018). *Principles of Economics* (8th ed.). Boston, USA: Cengage Learning.
- ❖ McConnell, C. R., Brue, S. L., & Flynn, S. M. (2018). *Economics: Principles, Problems and Policies* (21st ed.). New York, USA: McGraw-Hill Education.

Recommended Viewing

A movie about life under socialism

❖ Good Bye, Lenin!

https://en.wikipedia.org/wiki/Good_Bye,_Lenin!

THANK YOU