LEARNING OUTCOME 1- BASICS OF BUSINESS ECONOMICS

What is economics?

- Origin of the word ECONOMICS:

Greek words:

OIKOS = house, household

NOMOS = order, custom, law

- Literal translation: house management, housekeeping
- In a broader sense: managing or running an economy

companies, cities, countries ...

Definitions of economics

- *Economics is the science of choice. It studies how people choose to use scarce or limited production resources (labor, equipment, knowledge ...) to produce different goods and distribute them for consumption.*
- *Economics is the study of money, banking, capital and wealth.*
- *The economy asks what (which goods) should be produced, how they should be produced and for whom they should be produced.*
- *Economics is the study of how societies use scarce resources to produce valuable goods and distribute them to different people.*
- *Economics is the scientific study of how societies use resources to produce useful goods and distribute them to different people*

Common features of definitions

- **Economics is the study (science which studies) how societies use scarce resources to produce valuable goods and distribute them to different people in order to satisfy theirs needs and desires. (definition)**

Key elements of the definition

- Scarce resources
- Unlimited Needs
- Exchange for other goods

The law of scarcity

- **The law of scarcity says that if goods were not scarce then all human desires and needs could be met and resources should not be rationed, as literally everything could be produced - then there would be no basic problems in the economy contained in the questions of what, how and for whom to produce.**

Economic good

- The goods are scarce because people want much more than what the economy can produce.
- Economic goods are scarce, not free, and society must choose between limited goods that can produce available resources

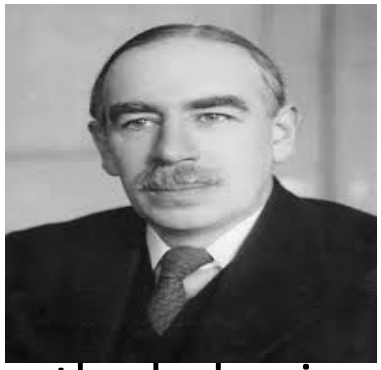
Economics and maximization

- Economics is also the science of maximization
- Maximization = find the maximum value of a function
- Economists want to achieve the best possible result with as few resources as possible
  - While students want to achieve the best possible grade with as little learning as possible ☺…
- … Manufacturers want to make as much profit as possible with as little cost as possible
- … Consumers want to satisfy their needs with as little money as possible
- … Investors want to make as much profit as possible with as little investment as possible
- Etc.…

MICROECONOMICS

- A branch of economics that studies the behavior and functioning of microeconomic entities - individuals, households, enterprises and industries.
- The founder of microeconomics is Adam Smith (1723 - 1790), who in 1776 published "The Wealth of Nations", a kind of economic Bible in which he explained the functioning of the market economy.
- We consider him the father of the modern Western economy
- Fundamental issues: Rarity of resources and goods, human needs, value of goods, prices of factors of production, business behavior, consumer behavior, market, costs, income, profit, interest, wages, supply and demand ...

MACROECONOMICS



- Macroeconomics is a branch of economics that studies the behavior and functioning of the economy as a whole.
- The founder of macroeconomics is John Maynard Keynes (1883 - 1946) who in 1936 published the work "General Theory of Employment, Interest and Money ”where the foundations of macroeconomics are given.
- Unlike microeconomics, which is based on the functioning of the market, macroeconomics is based on state regulation of the economy.
- Basic issues: Selection and functioning of the economic system, total production and employment, national income, general economic balance, general price level, inflation ...

RELATIONSHIP BETWEEN MICRO AND MACROECONOMICS

- Microeconomics and macroeconomics are not separate economic disciplines. They complement each other because the activities of microeconomic entities take place in a macroeconomic environment.
- In addition, the net profits of some global companies are the same as the gross domestic product of some countries (and higher!)
- https: // www.businessinsider.com/25-giant-companies-that-earn-more-than-entire-countries-2018-7#johnson-and-johnson-generated-greater-revenues-in-2017-than- ethiopias-gdp-14

1. Of the 100 largest economies in the world, 51 are corporations; only 49 are countries. Wal-Mart-the number 12 corporation-is bigger than 161 countries, including Israel, Poland, and Greece. [4] Mitsubishi is larger than the f ourth most populous nation on earth: Indonesia. General Motors is bigger than Denmark. Ford is bigger than South Africa. Toyota is bigger than Norway.

2. The combined sales of the world's Top 200 corporations are far greater than a quarter of the world's economic activity. Our calculations indicate that the Top 200's share of global economic activity has been growing rapidly over the past d ecade. In 1982, the Top 200 firms had sales that were the equivalent of 24.2 percent of the world's GDP. Today, that figure has grown to 28.3 percent of world GDP.

3. The Top 200 corporations' combined sales are bigger than the combined economies of all countries minus the biggest 9; that is they surpass the combined economies of 182 countries. At latest count, the world has 191 countries. If you subtr act the GDP of the big nine economies: the United States, Japan, Germany, France, Italy, the United Kingdom, Brazil, Canada, and China, the combined GDP's of the other 182 countries is $6.9 trillion. The combined sales of the Top 200 corporations is $7. 1 trillion.

4. The Top 200 have almost twice the economic clout of the poorest four-fifths of humanity. The world's economic income and wealth remain highly concentrated among the rich. Indeed, according to the United Nations, some 85 percent of the worl d's GDP is controlled by the richest fifth of humanity; only 15 percent is controlled by the poorest four-fifths. [5] Hence, the poorer 4.5 billion people in the world account for only $3.9 trillion dollars of economic activity; this is only a little over half the combined revenues of the Top 200's $7.1 trillion.

5. The Top 200 have been net job destroyers in recent years. Their combined global employment is only 18.8 million, which is less than a third of one percent of the world's people. The world has just over 5.6 billion people. [6] Of these, around 2.6 billion are in the workforce. [7] Hence, the Top 200 employ less than three-fourths of one percent of the world's workers. Of the world's top five employers, four are U.S. (General Motors, Wal-Mart, PepsiCo, and Ford), and one is German (Siemens). If one also includes the public sector in these calculations, the U.S. Postal Service is the world's biggest employer, at 870,160, roughly 160,000 more workers than GM's 709,000 workers. [8]

6. Not only are the world's largest corporations cutting workers, their CEOs often benefit financially from the job cuts. A total of 59 of the Global Top 200 are U.S. firms. Of these, 9 laid off at least 3,000 workers in 1995: AT&T, Boeing, Lockheed-Martin, BellSouth, Kmart, Chase Manhattan, GTE, Mobil, and Texaco. Even worse, the CEOs of these 9 made millions of dollars in the increased value of their stock options after announcing the layoffs. Indeed, on the day that the CEOs of these 9 firms announced the layoffs, the value of the stock options of their 9 CEOs rose $25,218,819. [9]

7. Japanese corporations have surpassed U.S. corporations in the ranking of the Top 200. Six of the top 10 firms are Japanese; only 3 are from the United States. Of the Top 200, the 58 Japanese firms account for almost 39 percent of total sales, while the U.S.'s 59 firms account for only 28 percent of total sales. The vast majority (186) of the Top 200 are headquartered in just 7 countries: Japan, the United States, Germany, France, the United Kingdom, the Netherlands, and Switzerland. South Korea and Brazil are the only developing countries to break into the Top 200.

Source: Corporate Watch . 2000: " Top 200: The Rise of Global Corporate Power ", https://www.globalpolicy.org/component/content/article/221/47211.html

Economic science

- Developed from economic practice
- It is the reflection of situations in:
- - Society
- - Economy

Economics as a scientific discipline

- Until the 18th century, it was taught as part of philosophy. It was part of comprehensive subjects that studied law, morality and economics.
- The rapid development of the economy, colonialism and the beginnings of the first industrial revolution created it as a separate discipline
- The beginning of the study of economics as a science is 1776 - when Adam Smith wrote "The Wealth of Nations"

Economics as a science studies:

Big area of social science which studies and explains :

- Production, supply and demand
- Distribution
- Exchange and consumption of goods and services in
- a certain time
- at a certain location
- and in a certain society

Theoretical economy is divided into :

Positive economics

- Positive economics researches functional and causal relationships between economic variables without judgment about them
- It studies economic occurrences such as they are
- It is also called „Economic analysis”
- Example : “ Unemployment in 2003, in Croatia was over 17 % of the labour force” ; "Tourism is the main economic branch in Croatia "

Normative economics

- Normative economics contains :

- Judgment on economic reality very often from an ethical point of view

- Vision of economic reality

- Instructions (rules or norms)

- It says what economic occurrences should be

- Example : “ High unemployment in Croatia is economically and politically unacceptable so employment policies must be one of the priorities of the overall economic policies . ” "Croatia should not rely so much on tourism, but on developing manufacturing."

Link between efficiency and scarcity of resources

- When we produce as many goods and services as possible with as few resources as possible, then we operate efficiently.
- through efficiency we increase the success of production, earnings, etc.
- Being efficient means that we have achieved a very good result with very few resources.
- Efficiency in learning means that in a short time you can master big amounts of learning material.
- Efficient investment - little money invested and getting high return.
- Efficiency is related to the relationship between what we have invested and how much we have earned
- To be efficient, we need to think about three basic problems of economic organization - what, how and for whom to produce

3 basic problems of economic organization

- What to produce - society determines what to produce (what goods and services) given the scarce resources it has (wood or furniture ?; basic sewing or designed clothing?, IT or tourism?) and given what the consumers in society want to buy
- How will it be produced - who will produce, with what technology, what production techniques will be used (sophisticated software or cheap labor?). E.g. will we produce electricity from coal, oil or from solar energy?
- For whom will it be produced - how will the total production of the country be divided - will the rich have a majority and the poor a minority? Producers want to gain profit and will produce for those who have money. However, what with the poor people – how will the society take care of them (dole, universal income or do they have to work to eat?)

Different economic systems

- Society answers the questions of what, how and for whom in different ways
- We distinguish three basic ways of organizing an economy

1. Market economy - one in which individuals and private companies make major decisions about production and consumption. (South Korea)

- *Companies produce the goods that bring the biggest profits (what) using the cheapest production techniques (how). Consumption is determined by the decisions of individuals on how to spend wages and profits (for whom).*

- Extreme market economy - " laissez - faire or let them work" (the state does not interfere in economic decisions at all)

2. Command economy - the state makes all important decisions on production and consumption, it owns resources, directs the company's operations and is the employer of most workers (former USSR, Yugoslavia, today Cuba)

MIXED ECONOMIES

- The vast majority of modern societies are mixed economies with elements of a market and command economy
- Today, for example. in the USA, most economic decisions are made on the market, but the state is important for passing laws that regulate economic life, the state provides education services, controls pollution etc.
- The state "redeems" the sins of the private sector through taxpayers' money - 2008 US banking crisis (bailout fund), saving the U.S. auto industry with U.S. taxpayer money

Society's technological possibilities

The production-possibility frontier

The production-possibility frontier

- An economic model that describes what and in which quantities a society can produce
- It is based on several assumptions:

- Countries, states do not have unlimited quantities of goods
  - All resources are limited
  - Technology is also limiting
- You have to choose between limited options

Inputs and outputs

- **Inputs** are commodities or services that are used to produce goods and services. An economy uses its existing technology to combine inputs to produce outputs.
- **Outputs** are the various useful goods or services that result from the production process and are either consumed or employed in further production.
- Consider the “production” of pizza. We say that the eggs, flour, heat, pizza oven, and chef’s skilled labor are the inputs. The tasty pizza is the output.

Factors of production

- **Another term for inputs are factors of production**
- **These are:**

Land - all natural resources collectively referred to as the Land (eg forests, drinking water, arable and non-arable land, fish stocks, etc.)

Labour

-The totality of mental and physical knowledge, skills and abilities that a person has and can use in the production process

Capital

-Durable goods produced with the intention of producing and increasing the value of other goods

Choosing how much to produce

- Society consists of a certain number of inhabitants, technology, capital goods, natural resources, etc.
- These are resources
- Scarcity of resource forces people and societies to choose between alternative uses of scarce resources, that is, to choose what to produce among relatively scarce goods.
- Question: how to allocate resources among thousands of different products that can be produced? What are the options for choosing between goods in a society (given the limited resources for their production)?
- The problem is being solved by an economic model of the production-possibility frontier (PPF)
- The model assumes that only two different goods can be produced, so the choice can be easily displayed

The production-possibility frontier -PPF

Shows the maximum quantity of goods that can be efficiently produced by an economy, given its technological knowledge and the quantity of available inputs.

Example 1

- Let's take the specific dilemma in which almost every country in the world finds itself - how much of its resources to allocate to national defense and how much to "civilian" products.
- A simplified example - a country's economy produces only two products - tanks and wheat

Table: production of two products of economy X

Interpretation:

-Choice A - what happens when all resources are invested in the production of only wheat (0 pieces of tanks) - the economy is able to produce a maximum of 1 million bushels with the given resources

-Choice F - all resources are invested in the production of tanks and the economy with the given resources can produce a maximum of 5,000 tanks per year

-Choice B - the economy has decided to direct part of its resources to the production of tanks, which leaves it with fewer resources for wheat production. For the production of 1,000 tanks, the maximum possibility of producing 950,000 bushels of wheat remains

-With the choice of C, D, E - tank production grows by 1,000 pieces per year, which leaves less and less resources for wheat production

TABLE I

Production of Tanks and Wheat

Choice	Tank Production (number per year)	Wheat Production (bushels per year)
A	0	1,000,000
B	1,000	950,000
C	2,000	850,000
D	3,000	700,000
E	4,000	400,000
F	5,000	0

Note: 1 bushel = 27 kg

Graphical representation of PPF and the concept of opportunity cost

If you want to produce more of one good, you must necessarily produce less of the other good (if we are on the frontier of production capacity - all resources are max used)

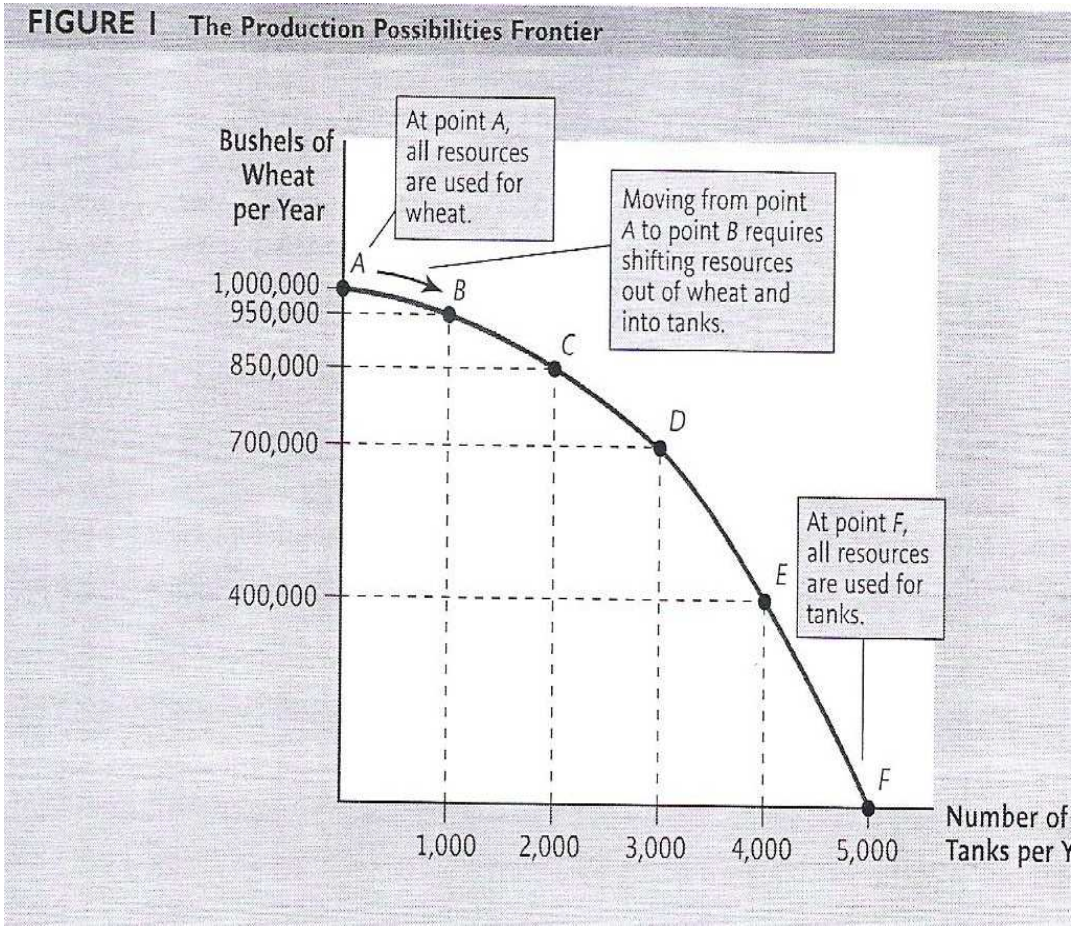
This is called **opportunity cost in economics**

Opport.cost. is equal to the amount of good that needs to be given up in order to get more of the other good produced

For example, if we are at point B where we produce 1000 tanks and 950,000 bushels of wheat, to move to point C - production of additional 1,000 tanks (for a total of 2,000) requires that we reduce wheat production to 850,000 bushels, ie less by 100,000 bushels

The opportunity cost of producing an additional 1,000 tanks is 100,000 bushels of wheat that we have to give up.

The more tanks we produce, the more wheat production we have to give up - the law of increasing opportunity costs.



Why are opportunity costs rising/increasing as we move along the PPF curve?

- **Because most resources—by their very nature—are better suited to some purposes than to others**.
- If the economy were operating at point *A* - we'd be using *all* of our resources for wheat, even those that are much better suited to make tanks. People who would be better at factory work than farming would nevertheless be pressed into working on farms. And we'd be growing wheat on all the land available, even land that would be fine for a tank factory but awful for growing crops.
- As we move rightward along the PPF, say from *A* to *B*, we would shift resources out of wheat production and into tank production. But we would *first* shift those resources *best suited* to tank production—and least suited for wheat. When these resources are shifted, an additional 1000 tanks causes only a small drop in wheat production. This is why, at first, the PPF is very flat: a small vertical drop for the rightward movement.
- As we continue moving rightward, however, we are forced to shift resources away from wheat—resources that are less and less suited to tanks and more and more suited to wheat. As a result, the PPF becomes steeper.

Efficient and inefficient economy

Efficient

- The economy operates at the PPF
- Limited resources are used efficiently - everything that can be obtained is obtained from the resources that are in possession
- This means:
  - An increase in the production of one product can only be achieved at the expense of a decrease in the production of another product
- Points ON the PPF curve

Inefficient

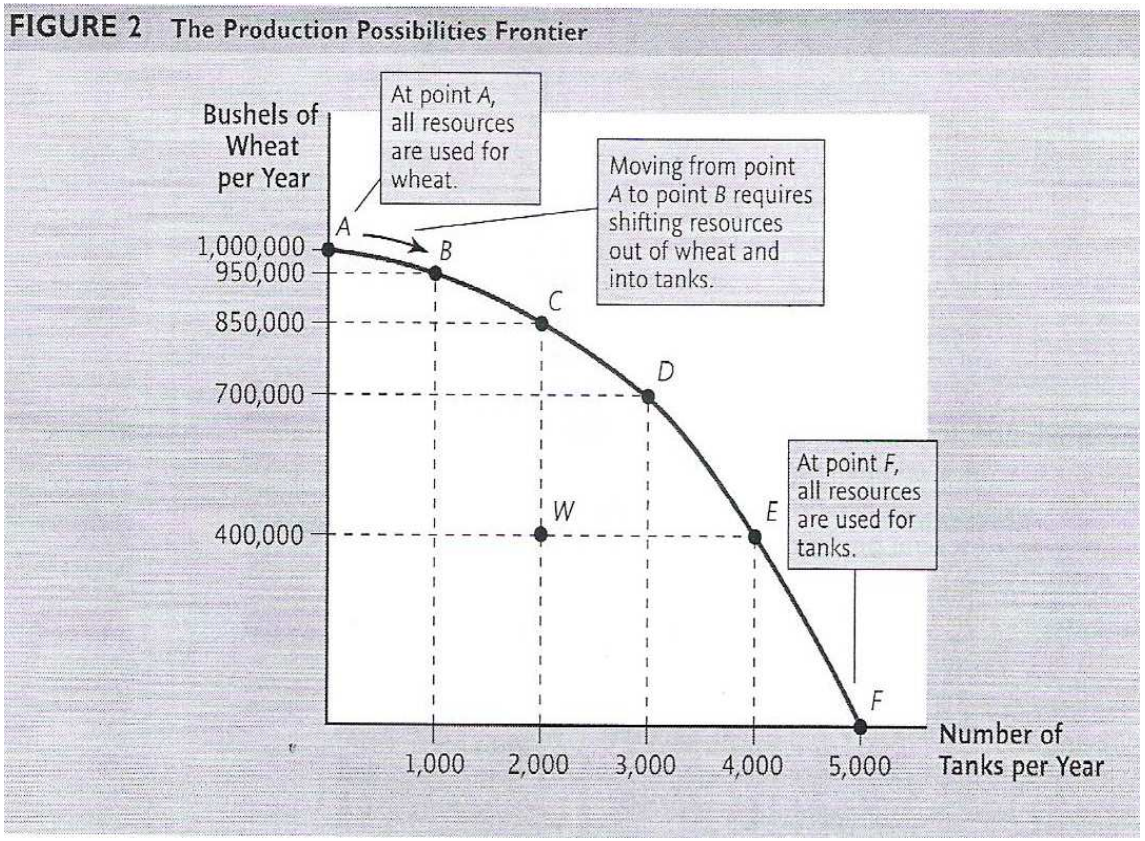
- there are unemployed resources, the economy is not on its production-possibility frontier at all but, rather, somewhere *inside* it.
- It is possible to increase the production of one product without causing a decrease in the production of another product
- It occurs due to inefficiency in one of the stages of the production process

Efficient and inefficient economy

Inefficient economy - point W - we produce 2,000 tanks and 400,000 bushels of wheat

Eg. we could move from point *W* to point *E* and produce 2,000 more tanks, with no sacrifice of wheat. Or, starting at point *W*, we could move to point *C* (more wheat with no sacrifice of tanks), or to a point like *D* (more of *both* wheat and tanks)

Why is it so - we do not use resources in the most efficient way. Maybe the people who produce tanks now could be better farmers, and maybe some people stuck in agriculture would be better at the tank factory.



An example of solving inefficiencies in the production stages - Starbucks

- In 2000, they conducted an analysis of how they produce their beverages and noticed a number of inefficiencies
- Some they eliminated

- E.g. Requirement for signatures to pay by credit card for smaller amounts - cancelled
- Using larger spoons for chilled beverages - fewer worker movements in making and speeding up the beverage making process

An example of the shift from an inefficient to an efficient economy - the United States during World War II

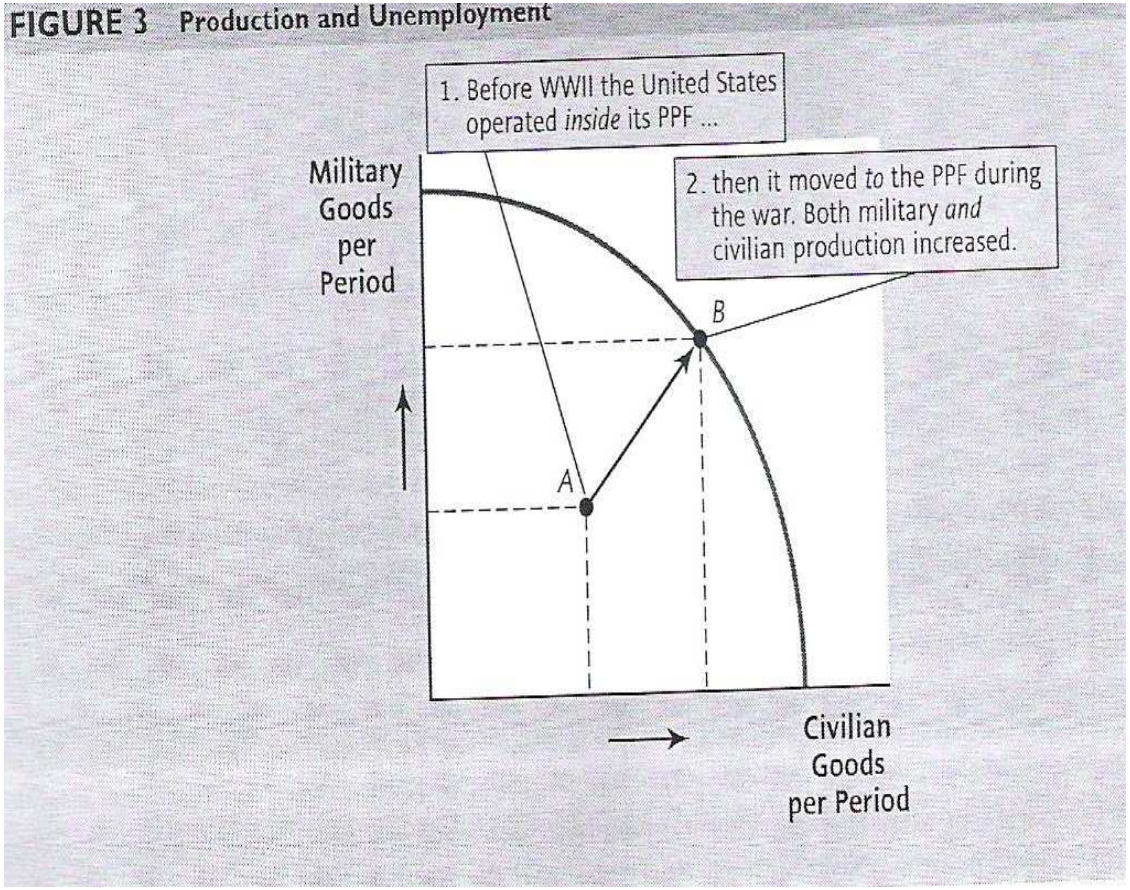
the reason for the inefficiency of the economy may be a state of recession or depression - the overall decline in economic activity (domestic production and consequent employment)

In a recession, many resources are unemployed - people do not have a job even though they want to work, factories are closing, so capital (machinery) is not employed etc.

By entering World War II, the United States began to use vast resources for military and civilian use. Only then did they begin to recover from the economic depression that had lasted since 1929.

They produced more tanks and more wheat (food in general).

Of course, war is not the best solution to get out of the recession and no government should choose it to promote the well-being of their country !!!!



Shifting the production-possibility frontier

- Human needs are unlimited and resources are limited
- Therefore, every economy has the problem of organizing production with limited resources to meet the needs of society at the highest possible level.
- However PPF can change!
- It is based on a certain level of technology and fixed amounts of resources

- *Can we move the production-possibility frontier, ie the efficiency of the economy?*

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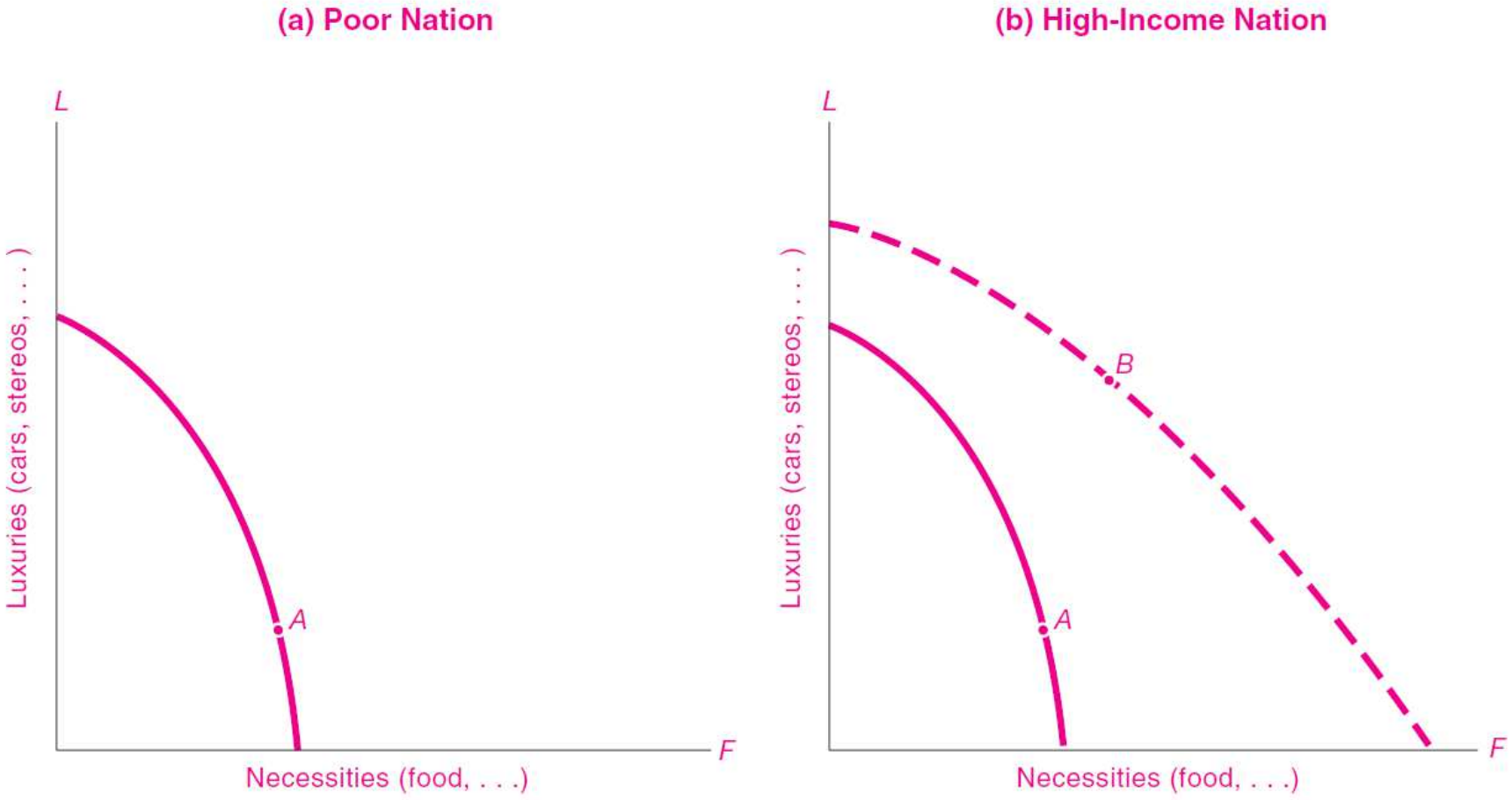
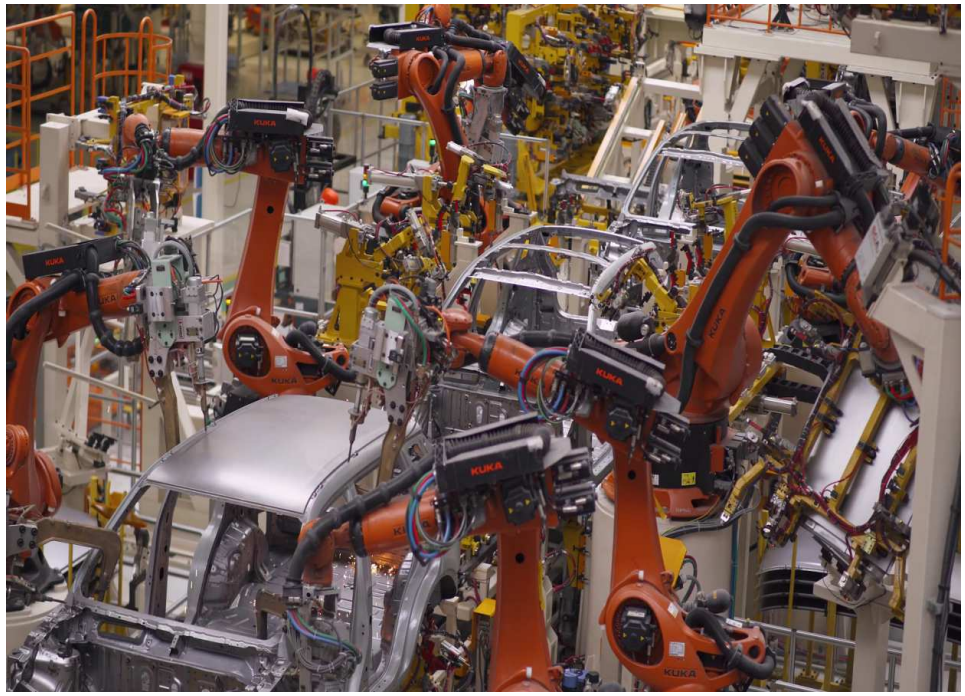


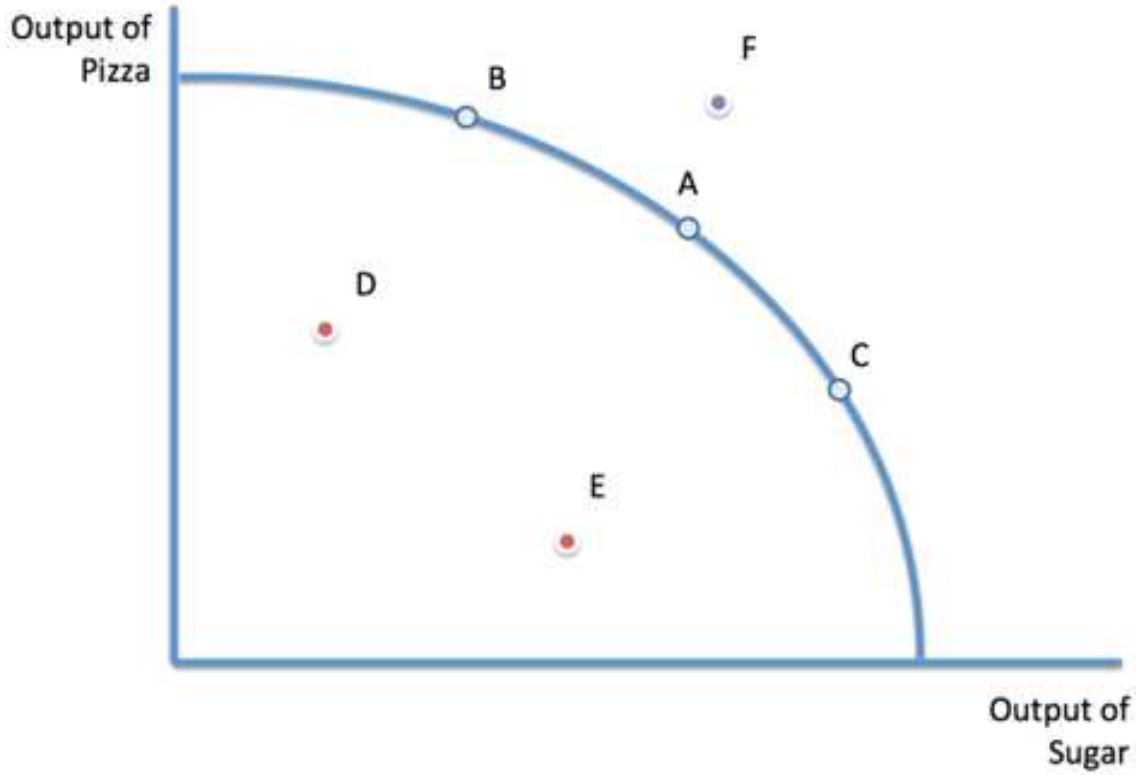
FIGURE 1-3. Economic Growth Shifts the *PPF* Outward

Car production then and now



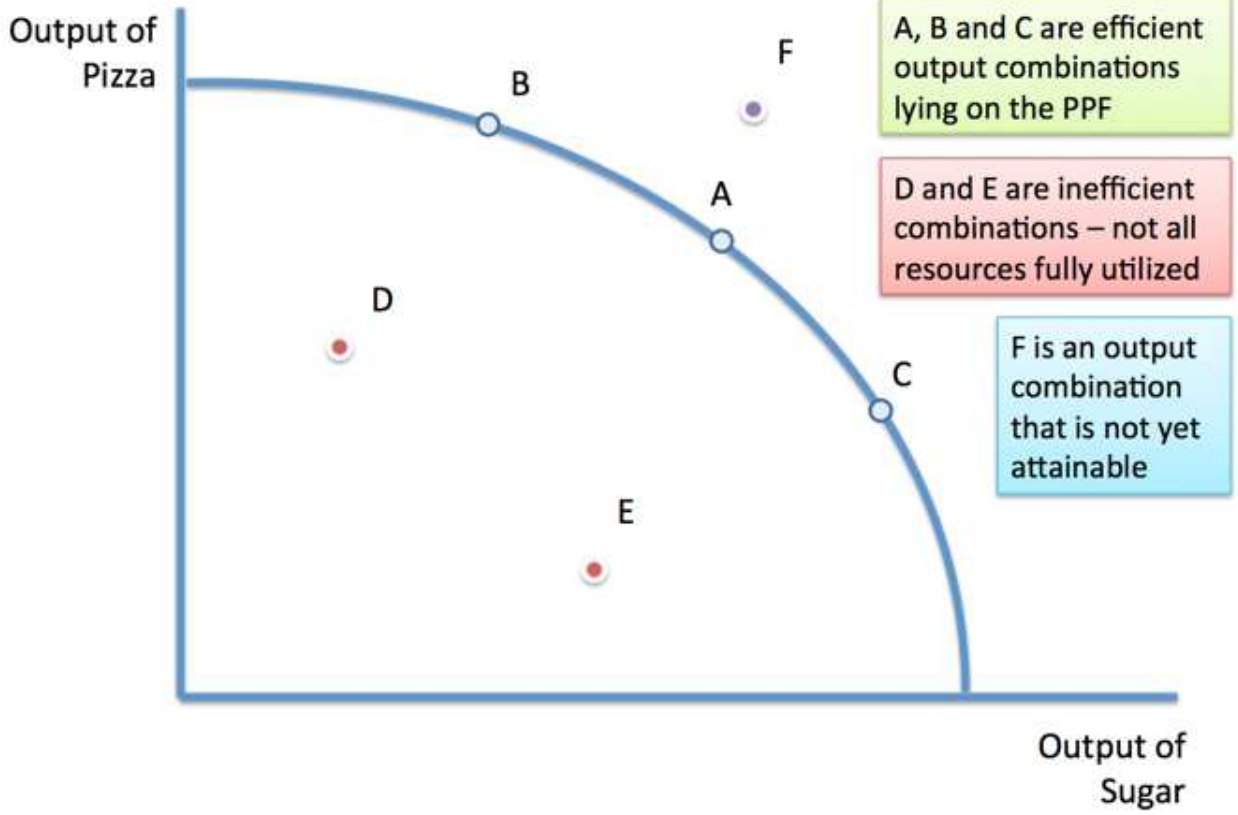
PPF shift

- **Technological advances** can change the PPF
- It can increase it, move it from the origin of the chart
- Production possibilities are increasing, more can be produced
- A shift is also achieved when the **amount of resources increases**
- When technology or the amount of resources change, the PPF curve changes its position and the economy can produce more products with full employment of available resources



Which points indicate inefficient, which points indicate efficient, and which points impossible production?

Production Possibility Frontier (PPF)



A, B and C are efficient output combinations lying on the PPF

D and E are inefficient combinations – not all resources fully utilized

F is an output combination that is not yet attainable

Mini task…

Mini task

- Draw the PPF curve according to the following table:

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

- Mark on the curve:
  - One point that represents efficient production (point X)
  - One point representing inefficient production (point Y)
  - One point that represents production that cannot be achieved because it exceeds the available resources and technological possibilities (point Q)