TOPICS:

INTRODUCTION

Economics traces back to the beginning of civilization. Economics emerged due to the need of man to satisfy his unlimited wants with minimal resources at his disposal.

**Schools of thought**

Economics as a discipline emerged in later years. As scholars began to study interaction of man with society, different schools of thought emerged. The most notable ones are:

(i) Classical –

The father of economics Adam Smith is credited for development of classical economics. Other scholars that emerged from this school of thought include David Ricardo and John Stuart among others. The main idea under this school of thought was that market should be left to function on their own without government interference. Classical economist believed that markets would regulate themselves in the long -run. Adam Smith called this property **“invisible hand’**.

(ii) Neo classical

This school of thought emerged later after the classical. Here the consumer is viewed as a rational thinker whose main objective is to maximize his own satisfaction (Utility), while firm’s main aim is to maximize profits.

(iii) Keynesian

In the 1930, the world was faced with a new economic crisis that would later be referred to as the ‘Great Depression’. Within a short period, the world was faced with increased unemployment, increase in prices of basic and low production. The classical notion of the market regulating itself failed. There was need to save the economy. The Keynesian school of thought emerged arguing the government to increase spending as a way of jump-starting the economy. This school lay most of its ideologies from John Maynard Keynes. In short, Keynesian school of thought argues that the government is responsible for increasing **aggregate demand**.

(iv) Monetarist

This school of thought argues that the role the government should play in the economy is to regulate inflation. This is possible through establishment of central banks that regulate the supply of money. This school of thought developed from the works of Milton Friedman.

TYPES OF ECONOMIC SYSTEMS

An economic system is simply how a country does its production, distribution and allocates resources. There are various types of economic systems that exist in the modern world. As you will see later, though there are a variety of economic system, there are no true ‘pure’ system; rather, most of them are hybrid systems.

**(i) Capitalistic Economic system**

A capital system is a kind of economic system whereby individuals own the factors of production and the main concern is making profits. In this system, there is no government intervention and markets regulate themselves hence commonly referred to as free market.

Here are the notable characteristics of a Capitalistic economy

1. Factors of production are owned by private individuals

2. Profit motivated

In this type of system, individuals are more concerned of increasing their profits disregarding all other factors.

3. Self-interest

In this system, individuals are concerned with their own welfare. This is advantageous as it acts as a motivating factor to work harder and explore riskier opportunities.

4. No government interference

The government does not play any role in regulating this type of system and the market is in charge of its own existence.

5. Price mechanism

In this system, demand and supply of the market are responsible for determining the prices of goods and services.

**(ii) Command Economies**

In this economic system, the factors of production are owned by the state. There are two categories of command economies:

(a) Communist

As the name suggest, this type of system is geared towards the community. The state ultimately owns and control all factors of production. The states determines what the economy produces. The state is also responsible for determining when the production will occur and the quantity to be produced. Example of communist countries as North Korea and China

(b) Socialist

This is a special type of command economy where the state owns and control most but not all factors of production. The production, distribution and pricing of goods and services is determined by the state. The main aim of a socialist economy is to reduce inequality. The government ensures that the basic needs of its citizens are met. The downside of this is that since the basic needs of the population is met; labor productivity may be low due to lack of incentives.

Characteristics of command Economies are:

(i) Government owns most of the factors of production

(ii) Government determines resource allocation

**(iii) Mixed Economies**

This type of economy combines the features of both capitalist and command economies.

INTRODUCTION TO MARKETS

DEMAND AND SUPPLY

Demand refers to the willingness and ability of an individual to buy a commodity at the prevailing prices in a particular point in time. Supply on the other hand refers to the willingness and ability of suppliers to supply a particular commodity to the market at the prevailing prices.

Demand and supply is one of the most important topics in Economics and Finance. As you will see later, these two aspect play a major role in determination of prices.

Law of Demand

This law states that individuals will be willing to buy less of a commodity if the price of that commodity is high. As the price of the commodity decreases, individuals will buy more of that commodity. For example, if the price of a car is $120,000 few individuals will afford but if the price is lowered to $60,000 most people will be able to afford hence increase in demand.

**Factors affecting the Demand of a Commodity**

*(i) Price*

As mentioned earlier, the demand for a commodity is closely associated with the price. In fact, in mathematics, it is referred to as an inverse relationship whereby when the price of the commodity increase, its demand will fall and vice versa.

Example:

The data is derived from Mark’s Coffee Shop

|  |  |
| --- | --- |
| **Number of Coffee Cups Bought** | **Price of Coffee** |
| 12 | $20.60 |
| 33 | $16.40 |
| 45 | $14.00 |
| 53 | $12.40 |
| 66 | $9.80 |
| 4 | $22.20 |

As you would expect, more people will buy coffee when the prices are low. If the data was to be drawn on a graph, it would represent a **demand curve**.

**A demand curve** is simply a graphical representation of price of a good and the quantity demanded.

From basic mathematics, you realize that the relationship between price and quantity is a linear relationship in the form and we can model the demand curve equation. To arrive at this we first need to determine the slope (Gradient) of the graph.

i.e.

We pick two points from the graph

|  |  |
| --- | --- |
| 12 | $20.60 |
| 33 | $16.40 |

You realize that the gradient is negative as the relationship is inverse.

We can now use the gradient to find the y- intercept using any pair of points in this case:

|  |  |
| --- | --- |
| 12 | $20.60 |

The equation becomes:

Therefore, Mark can use the equation to forecast sales or set a target

In General:

Demand is a function of price and quantity []. As noted earlier, this relationship is an inverse one meaning a negative sloped graph

Where p is price, q is quantity, c is a constant and m is the slope.

Theoretically, the price of a commodity cannot be zero (If it were the case, they would be no suppliers in the market and hence no commodity). However, quantity can be zero. People may be willing to buy a new series of IPhone at a particular price even though the iPhone is not yet in the market.

In summary, the following axioms hold for a demand curve

(i) i.e price cannot be zero or [[1]](#footnote-1)negative

(ii) i.e The gradient of a demand curve is negative[[2]](#footnote-2)

*(ii) Supply*

As you will see later, supply plays a major role on the quantity of a product demanded. If supply of a commodity increase, then the demand reduce.

*(iii) Level of Income*

The demand for a commodity is also affected by incomes of individuals. Increase in income leads to increase in consumption hence increase in demand. This additional income is called **disposable income**. **Disposable income** refers to income that individuals have for spending and saving after the tax has been paid. In short,

Disposable income = Gross income – Taxes

(iv) Fashion, Tastes and preferences

Different types of commodities in the market bring about taste and preferences in consumers. The demand of a product may increase because consumers prefer the product or the product is in fashion. Advertisement and product promotion are essential in increasing tastes and preferences among consumers. In addition, innovation is critical in ensuring the product continues to remain fashionable. A good example is Apple that through innovation have made their products stay in fashion.

*(v) Weather and climate*

The daily changes in weather can affect the demand of a product. For example, the presence of rain leads to higher demand for umbrellas. Hot weather on the other hand may lead to higher demand of ice cream

*(v) Future expectation*

The perception of consumers on the future does affect demand. When consumers believe that the prices of commodities in future are expected to rise, they will tend to buy more of that commodity now. An example of this phenomenon is seen in land, stock, gold among others.

**Theories of Consumer Demand for a good**

There are various theories that economists have developed over the years to understand why consumers demand a type of good. The two notable theories will cover include cardinal and ordinal utility theories. Before we begin, we need to understand first what utility is:

**Utility:-** Utility is defined as usefulness of a commodity to an individual. Utility varies from one individual to another. In economics, utility can either be quantitative (cardinal) or qualitative (Ordinal).

**Total Utility:-**

It is normally assumed that individuals are rational and will at all-times try to maximize their utility. Individuals will tend to consume goods that they consider to add value to them.

*Law of Diminishing Returns*

This law states that the marginal utility of a commodity decreases with increase in consumption of the commodity.

Example:

Assuming it is a very hot day, you feel thirst and there is some water on the fridge. Assuming that you need 500ml of water to quench you thirst, using a 100ml glass of water, and the first glass of water will be useful, but you will still be thirsty. This will be the case with the second until the fifth when your thirst is fully quenched. Plotting the util values in a hypothetical table as below:

|  |  |  |
| --- | --- | --- |
| **Glass of Water (100ml)** | **Total Utility (Utils)** | **Marginal Utility (Utils)** |
| 1 | 10 | 20 |
| 2 | 15 | 15 |
| 3 | 17 | 14 |
| 4 | 19 | 12 |
| 5 | 20 | 9 |
| 6 | 20 | 7 |
| 7 | 19 | 4 |
| 8 | 17 | 3 |
| 9 | 16 | 0 |
| 10 | 15 | -4 |

What consumers

MACROECONOMICS EQUATION

MONEY AND BANKING

STOCK MARKET

1. This may not universally hold as there a times prices may be negative [↑](#footnote-ref-1)
2. This will hold for most goods but not all e.g inelastic goods [↑](#footnote-ref-2)