

# **IS 2230 ECONOMIC APPLICATIONS IN BUSINESS**

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Introduction to Economics

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## **Business Foundation** - (understanding a business)

A closer, in-depth observation of a business

## **Business Economics** (understanding the economy in which businesses operate)

- Workings of markets
- Firm behaviour
- Market structures
- Factor markets
- Workings of the economy as a whole (including growth, unemployment, inflation and exchange rates)

Better Decision Making

# Learning Outcomes

At the end of the session, you should be able to:

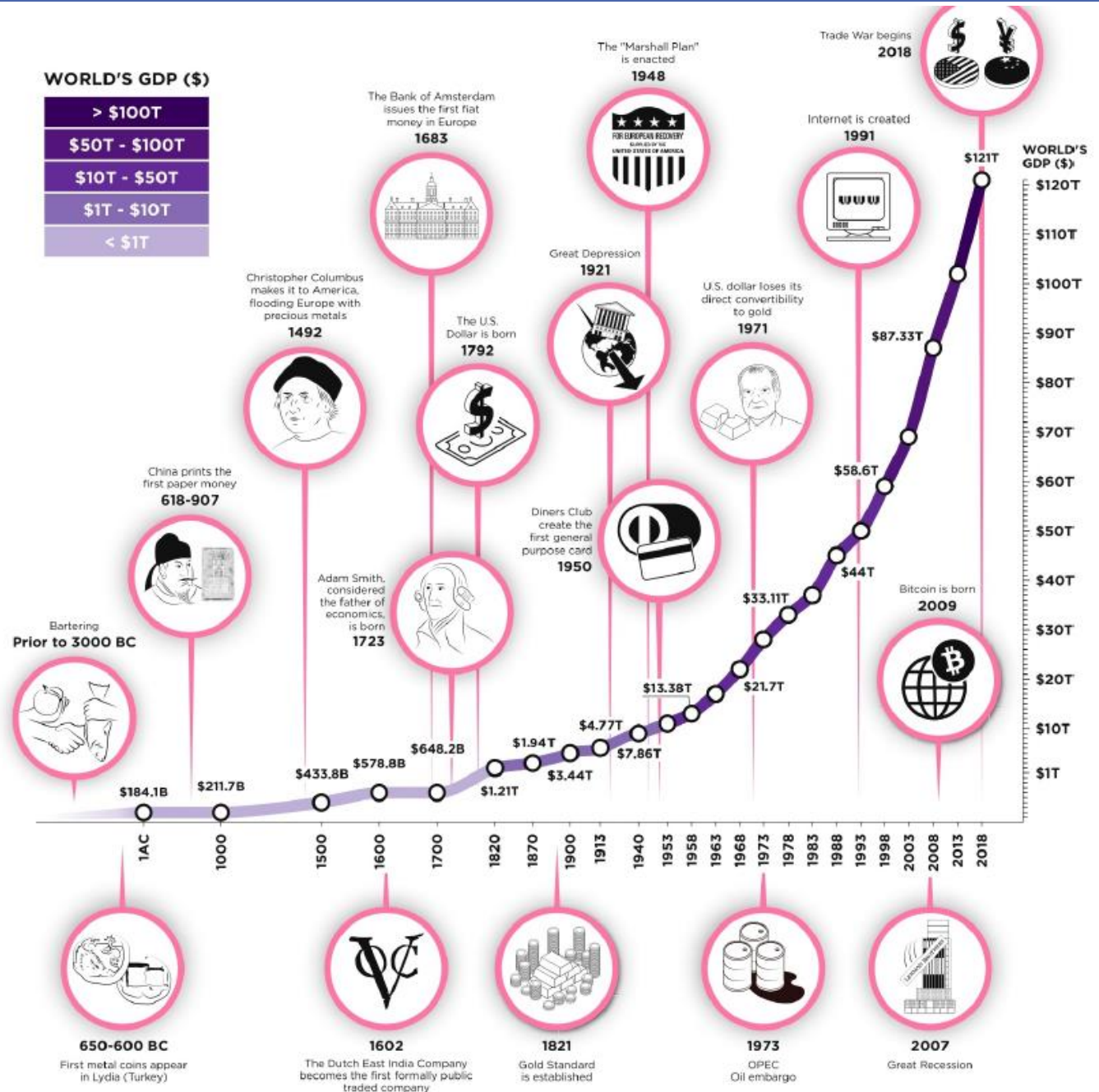
- ✓ Explain the evolution of economy
- ✓ Define what is an economy
- ✓ Define what is economics
- ✓ Explain why management of resources is important
- ✓ Identify the link among trade-offs, opportunity costs and decision making
- ✓ Explain the production possibility frontier
- ✓ Differentiate microeconomics and macroeconomics

# Timeline of the World's Economic History

## Major Economic Events

(Refer the Moodle page for clearer view)

2/11/2025





Addressing the unprecedented spike in coconut prices

26 Jan 2025 | By Nelie Munasinghe



GOVT. TO CONDUCT FIRST-EVER NATIONWIDE MONKEY CENSUS

The government is set to conduct its first island-wide census of the monkey population, aiming to address the alarming destruction of coconut crops caused by these primates.

www.dailymirror.lk



Maximum retail price imposed on sugar lifted

November 21, 2023 10:12 pm



Govt. will not lift rice price controls – Minister

January 28, 2025 02:31 pm

Problems with price controls

05 Jan 2025 | By Maneesha Dullewa



Sellers misleading customers: Concern over what is happening over VAT

View(s): 503

By Natara Abeywickrema

The trend of adding Value-Added Tax (VAT) to the tag price is rampant in Sri Lanka, as most sellers fleece gullible customers, heaping an additional tax burden on them. Traders have been reportedly misleading customers by tacking on VAT to the tag price of both VAT-inclusive and exclusive goods or services, forcing them to pay more than what was originally displayed.



Pic by M. A. Pushpa Kumara

"It is illegal on the part of restaurateurs, shopkeepers, and department store owners to charge more than the VAT on the price of any food item mentioned in the menu or the tag price of a product," a Consumer Affairs Authority (CAA) spokesperson said. The early announcement of the proposed increase in VAT also helped traders import certain stocks in large quantities before the tax was increased on January 1.



# IMF urges swift action on debt restructuring

Saturday, 13 January 2024 01:18 - 255



- **IMF Communications Director Julie Kozack says satisfactory program performance**
- **Highlights importance next steps – negotiations with external commercial creditors, implementing agreements with official creditors**
- **Describes ongoing mission in town as staff visit, serving as fact-finding or technical mission**



IMF Communications  
Director  
Julie Kozack

The International Monetary Fund (IMF) wants Sri Lanka to conclude the negotiations with external commercial creditors and implement agreements with official creditors.

"The next steps on the debt restructuring are to conclude the negotiations with external commercial creditors and to implement agreements with official creditors," IMF Communications Director Julie Kozack said on Thursday.

A team of IMF officials is also in Sri Lanka to discuss the Fund program, Kozack announced.

"Our Executive Board approved the first review of the program on 12 December 2023 with a disbursement of \$ 337 million. Program performance has been satisfactory, as signalled by the completion of the review. And the next steps are the mission that is currently on the ground right now. This mission is a staff visit. It is kind of a fact

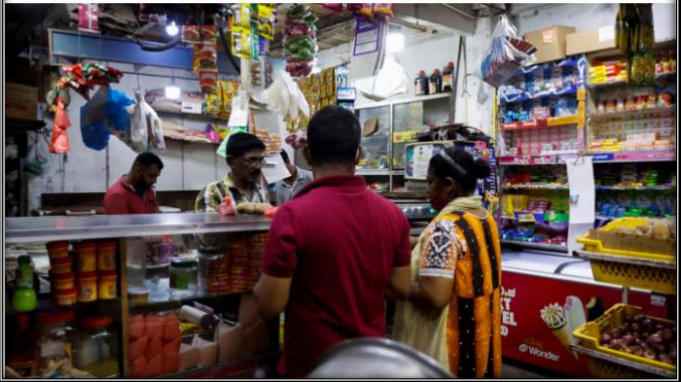
finding or technical mission. The goal of this mission is to discuss targets and commitments," she added.



IMF to review Sri Lanka's recent tax revisions

## Sri Lanka's inflation drops to minus 2% in December

Prices in the food category moved to minus 1.0% after posting 0.0% in November. In the non-food category, prices changed to minus 2.9% on the month from minus 3.1% in November



## Sri Lanka eases vehicle import ban, but can people afford a new car?

5 days ago

Share Save

Anbarasan Ethirajan  
South Asia Regional Editor



Sri Lanka imports almost all its vehicles, many of them from countries like Japan and India





## Sri Lanka and India vow to boost trade, investment as ETCA negotiations resume after 5 years

November 2, 2023 11:41 am

## Strengthening economic ties: “Export Bahrain” explores trade expansion with Sri Lanka

Thursday, 11 January 2024 00:00 - 182



## SRI LANKA REVISES FUEL PRICES FROM FEBRUARY 1, 2025

POSTED BY EDITOR ON JANUARY 31, 2025 - 8:11 PM



## Sri Lanka and China agree on early conclusion of comprehensive FTA

January 16, 2025 05:46 pm

2/11/2025

**Starbucks hikes prices with more on the way, but insists demand is 'very strong'**

258

Starbucks CEO warns of supply chain disruptions, price hikes in earnings call  
Yahoo Finance's Brooke DiPalma discusses the impact of supply chain disruptions and inflation on Starbucks ear...

Quote Lookup

Symbol	Last Price	Change	% Change
SBUX	91.98	-0.96	-1.03%
Starbucks Corporation			

**TRENDING**

1. Mental strain, deepening risks as Israel's war with Hamas reaches 100 days
2. Agrarians at the Gate Lead the Revolt Against Olaf Scholz
3. Israelis wear dog tags in solidarity with hostages and each other

**EARNINGS ALERT**

**BROOKE DIPALMA**  
Yahoo Finance / @BrookeDiPalma

**LIVE**

## RESEARCH ARTICLE

# Price elasticities of pharmaceuticals in a value based-formulary setting

Kai Yeung ✉, Anirban Basu, Ryan N. Hansen, Sean D. Sullivan

First published: 20 July 2018 | <https://doi.org/10.1002/hec.3801> | Citations: 12

[Read the full text >](#)

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## Summary

Empirical estimates of price elasticities of demand (PED) for pharmaceuticals suggest that they are relatively price inelastic. However, in many settings, a medication and its substitutes and complements face simultaneous differential changes in prices that affect the observed “composite” PED. We exploit an implementation of a value-based formulary (VBF) that utilized drug-specific incremental cost-effectiveness ratios (ICERs) to inform drug copayments, resulting in increases in copayments for some medications and decreases in copayments for others. We first show theoretically that by changing the price of a medication and its substitute in opposite directions, VBF designs can leverage cross-price effects to increase the range of composite PEDs. We then empirically estimate PED and welfare effects using a consumer surplus approach. Overall PED was  $-0.16$ , similar to the RAND Health Insurance Experiment estimate. However, there was substantial dispersion of PED across the VBF copayment tiers ranging from  $-0.09$  to  $-0.87$  with a statistically significant trend aligned with the levels of value as reflected by the ICER estimates ( $p < 0.001$ ). The net welfare increase was \$147,000 for the cohort or \$28 per member over the postpolicy year. Further experimentations of VBF designs with alternative cost-effectiveness thresholds, copayment levels and value definitions could be quite promising for improving welfare.



# What is an economy?

- “Economy is the collective interaction between individuals in the process of production and exchange in a defined area”
  - ✓ Group of people interacting with one another as they go about their lives.
  - ✓ This interaction is invariably through a process of exchange.
- Examples of such interactions :
  - An individual buying a coffee, or
  - A business buying several tonnes of steel for a construction project, or
  - Government funding higher education institutions

# Basic Economic Problems

- There are three basic problem any human society must address;
- **What:**
  - What to produce in which quantities?
- **How:**
  - What resources are utilized to do what?
- **For whom to produce**
  - Is the distribution of income and wealth fair and equitable? Who should get what?



# What is economics?

- At its simplest, economics is the study of how society manages its resources

## Why management of resources is important?

- Because resources are scarce.
  - **Scarcity** means that society has limited resources and therefore cannot produce all the products people desire.
  - Just as a household cannot give every member everything he or she wants, a society cannot give every individual the highest standard of living to which he or she might aspire.

(Source: Mankiw, N.G., Taylor, M.P., & Ashwin, A. (2019), Business Economics (3rd Ed.), Cengage Learning.)

# Resources

- Factors of production is an economic term that describes the inputs used in the production of goods or services to make an economic profit.
- These include any resource needed for the creation of a good or service.
- The factors of production are land, labor, capital, and entrepreneurship.
  1. Land : all natural resources.
  2. Labour : all human resources. Both mental and physical.
  3. Capital : all manmade things that are used in the production process to produce other things.
  4. Entrepreneurship : risk taken to produce new things or new ways to produce old.



# Decision Making Involving Trade-Offs

**“There is no such thing as a free lunch”**



- When individuals, businesses or governments make decisions, they have to make a judgement between two or more courses of action.
- Each course of action will have certain benefits.
- Usually, when one course of action is chosen, that decision would involve having to give up the benefits of the other courses of action.
- The benefits that have to be given up are said to be the trade-offs of that decision.
- Therefore, making decisions requires trading off the benefits of one action against the benefits of other.
- Acknowledging trade offs is important:
  - Because people and businesses are likely to make good decisions only if they understand the options that they have and can quantify them in some way to make informed decisions.

# Opportunity Cost

- When we select the best option, the cost of the **next best alternative forgone** is called the opportunity cost.
- In other words, the cost expressed in terms of the **benefits sacrificed of the next best alternative**.
- *May not always be simple as it may appear:*
- Consider a decision by business to cease production of a product that is not having good sales.
- You have to also consider costs beyond pure money costs : Cost of loss of goodwill, worker and customer loyalty, bad publicity, etc. (These may not be immediately obvious and sometimes not easy to work out)



# Opportunity Cost (Cont'd.)

## In-class Activity 1 (MCQ):

During the time when Saman took a quiz, he could instead have practiced violin or done his English homework. He thinks that if he had not taken the quiz, he would have done his English homework. His opportunity cost of taking the quiz is the value of:

- i. practicing violin and doing his English homework
- ii. practicing violin
- iii. doing his English homework
- iv. the time it took to do the quiz

# Opportunity Cost (Cont'd.)

## In-class Activity 2:

Hashan must decide what to do when he graduates from the university. He has studied Agricultural Engineering, and he really likes farm management, especially crop production. His father has some land near his residence which he can use to start a farm. He would be the farm manager and would make all of the important decisions. However, leading company in the field of agriculture in Sri Lanka has offered him a good job with an attractive package and accommodation. It is a job he really likes, and the pay is better than what he would earn developing his father's land. However, he wouldn't be the "boss" and wouldn't make nearly as many decisions himself if he worked for the company. He also would have to move far away from his family as he lives in Nuwara Eliya.

- I. Which job do you think Hashan should take?
- II. What is the opportunity cost of the decision you made for Hashan in part I ?

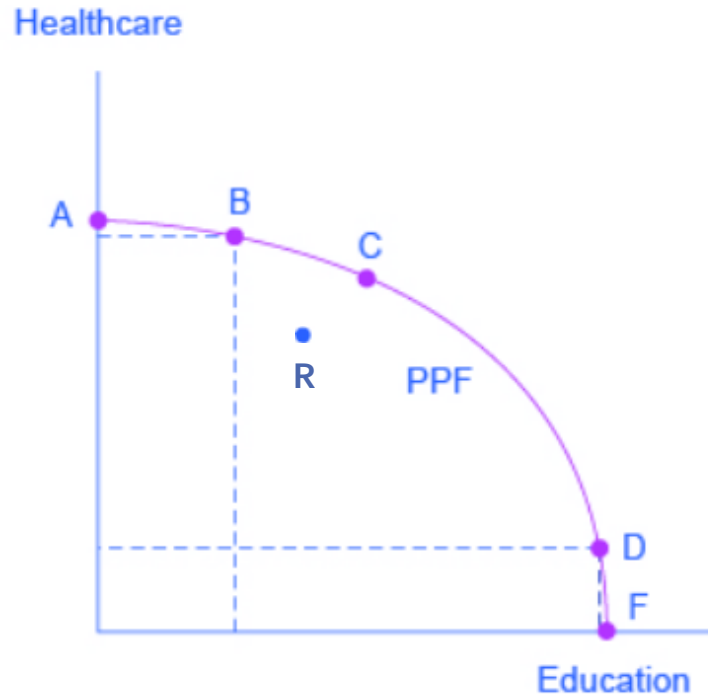
*Either of the decisions made by Hashan would involve an opportunity cost*

# Production Possibilities Frontier

- Just as individuals cannot have everything they want and must instead make choices, society as a whole cannot have everything it might want, either.
- How society as a whole deals with this → can be explained by using a model called the production possibilities frontier (PPF).
- The PPF captures the concepts of scarcity, choice, and tradeoffs.
- Assume that only two commodities are produced in an economy.
- The PPF is a graph that shows all the different combinations of output of two goods that can be produced using available resources and technology.



# Production Possibilities Frontier (Cont'd.)



The Shape of the PPF → According to the Law of Diminishing Returns

- This PPF shows a tradeoff between devoting social resources to healthcare and devoting them to education.
- At A all resources go to healthcare and at B, most go to healthcare. At D most resources go to education, and at F, all go to education.
- **Productive efficiency** means that, given the available inputs and technology, it is impossible to produce more of one good without decreasing the quantity that is produced of another good. All choices on the PPF in this graph, including A, B, C, D, and F, display productive efficiency.
- However, any choice inside the production possibilities frontier is productively inefficient and wasteful because it is possible to produce more of one good, the other good, or some combination of both goods. Thus, point R is productively inefficient.

# Major Branches of Economics

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graph TD; A[Major Branches of Economics] --> B[Microeconomics]; A --> C[Macroeconomics]
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Microeconomics

Macroeconomics

# Microeconomics

- It is the study of the choice that individuals and businesses make and how changes in such choices affect the actors of the economy (household, firms, government, and the rest of the world)
- Areas covered;
  - Demand and supply
  - Consumer behaviour
  - Market structures
  - Production and cost
  - Government interventions



# Macroeconomics

- The study of aggregate effect on the national economy and the global economy of the choice economic actors make and how they are implemented.
- Areas covered;
  - Aggregate demand and supply
  - Employment
  - Demand and supply of money
  - Balance of payment and exchange rates

# Summary

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