Economics and Business

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Contents

Learning Objectives

- Describe the foundational philosophoes of capitalism and socialism.
- Discuss private property rights and why they are key to economic development.
- Discuss the concept of GDP.
- Explain the difference between fiscal and monetary policy.
- Discuss the concept of unemployment rate measurement.
- Discuss the concepts of inflation and deflation.
- Explain other key terms related to this chapter including supply, demand, equilibrium price, monopoly, recession, and depression.

Economics

Economics is the study of the production, distribution, and consumption of goods and services. Some key terms of economics:

Resources

It's the inputs used to produce outputs. The resources can be the following:

- Land and Natural Resources
- Physical and Mental labor
- Entrepreneurship
- Knowledge

Factors of Production

It is all resources used by a business to produce goods and services. An example is the factors of production for a shirt:

- Land and Natural Resources: *Factories*, *Equipment*, *Land* the factories sit on, *Electricity*, *Raw Cotton*, and *Money* used in manufacturing process.
- Labor: *Laborers* for physical labor.
- Entrepreneurship: *Entrepreneurship Skill*
- Knowledge: *Manufacturing Process Knowledge*.

Inputs and Outputs of Markets

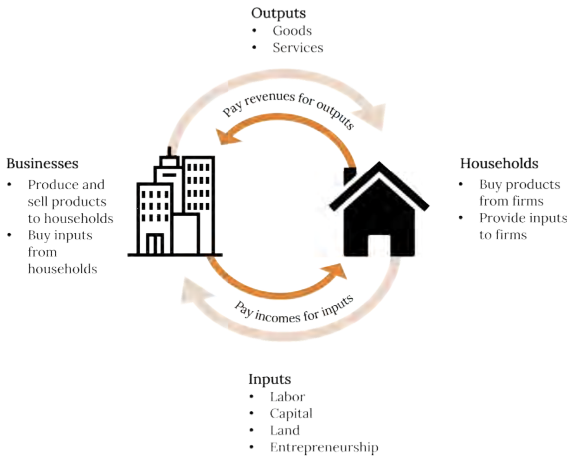

Figure 1: Circular Flow of Inputs and Outputs

Based on *fig. 1*, we can understand the dual roles of businesses and households:

- Housholds provide factors of production and consume goods and services.
- Businesses buy, produce, and sell goods and services.

Economic Systems

To understand what is a country's economic system, economics try to answer the following questions:

- What goods and services should be produced to meet the consumer's needs? In what quantity and when?
- How should goods and services be produced? Who should produce them. What resources should be combined to produce them.
- Who should receive the goods and services produced. How should they be allocated among consumers.

Economic Systems are the means of the society to decide how to *allocate, produce, and distribute* goods and services. There are two types of economic systems:

Planned Systems

It is an economic system where the government exert control on the allocation, production, and distribution of all or some of the goods and services. The highest level of planned systems is **communism**, where the government exert total control(own) on how to allocate, produce, and distribute the goods and services.

Socialism is a lower level of communism, where the government exerts control (own) on only essential services, such as: Banking and Healthcare.

Free Market Systems

It is an economic system where most businesses are owned by individuals. It is also known as **Capitalism**. In such a system, **competition** dictates how goods and services are allocated. Furthermore, government involvement is limited to *regulations* - which is dictating how businesses are permitted to operate.

A key concept in this economic system is **private property rights**, which is that a business owner can own their land, buildings, machine, etc, and keep majority of the profit except for taxes.

Mixed Market Systems

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It is an economic syste that relies on both government and businesses to allocate reousrces. Most countries are mixed economies with a leaning toward either free market or socialistic principles. With the start of the 21st century, a lot of socialistic/communistic countries have started to move toward **privatization**. It is a process of converting businesses previously owned by the government to private ownership. One such country is China.
Others, while not a lot have been moving toward socialistic and communistic systems. This is done through **nationalization**. It is a pricess of government taking control of industries, such as oil. One such country is Venezuela.

Current Economies

A lot more countries have started to move toward mixed economies, where:

- Communist countries are disappearing.
- Socialist countries are cutting back on social programs, lowering tax, and moving towards capitalism.
- Capitalistic countries are increasing social programs and moving towards more socialism.

Supply and Demand

Demand is the quantity of product the buyers are willing to purchase at various prices.

- The higher the prices, the less people buying said product.
- The lower the prices, the more people buying said product.

Buyers want to buy with price in mind.

Supply is the quantity of product the sellers are willing to sell at various prices.

- The higher the prices, more businesses are inclined to sell said product.
- The lower the prices, less businesses are inclined to sell said product.

Business want to sell with profit in mind.

Equilibrium Price

It is the price where consumers are willing purchase everything a business is willing to make. This price is characterized with:

- No surplus or shortage of products.

Competitions

There are many types of competitions that drive the captialistic economies:

Perfect Competition

Perfect competition exists when *many* consumers buy a *standardized* products from *numerous* small business. This type of competition does not allow for any business big or small to influence and affect prices. Hence, sellers and buyers accept the **going proce**.
Characterization of Perfect Competition:

- Many small companies sell identical products.
- The price is determined by supply and demand.

Soybeans and corn are excellent examples.

Monopolistic Competitions

Monopolistic Competition exist when many consumers buy *differentiated* products from *numerous* businesses. **Differentiated product** are products that serve a similar puprose but they are differentiated depending on quality, style, convenience, location, and brand name. An example is toothpastes.
Prices have limited control over prices because if prices too high, the business will lose customers to a competitor.

Oligopoly

Oligopoly is a competition that has many consumers but few sellers. An example is automible and airline companies.

Monopoly

Monopoly is a competition that has only one sellers in the market. The market can be a geographic area, city, regional area, country, etc. There are two categories of monopolies:

Natural Monopoly

Natural Monopoly is a monopoly that include public utilities. Such monopolies are electricity and gas companies. Although they inhibit competition, prices are heavily regulated by the government.

Legal Monopoly

Legal Monopoly is a monopoly in relation to patents. A **patent** gives exclusive right for companies who invented a product or a process. This is done so that the company can recover the heavy costs of R&D.

Economic Goals

The world's economy share three main goals:

Growth

Gross Domestic Product (GDP) is the market value of all goods and services produced by the economy each year. It only includes goods and services produced domestically, and excludes any produces internationally.

High Employment

A strong economy is one where its citizens spend a lot on goods and services. To keep a strong economy, a country needs to make jobs available for anyone who wants to work. They follow a **full employment** principle, where everyone who wants to work has a job. However, this is not attainable. Hence, in practice we say that we have full employment when about 95 percent of those wanting to work are employed.

Unemployment Rate

Unemployment rate is the percent of unemployed and *actively seeking* work. $\frac{No.Unemployed}{No.Unemployed+No.Employed}$

Price Stability

Price Stability means that the average price of goods and services does not change or changes very little. Where rising prices are an issue for both individuals and businesses.

- An individual will have to pay more for things they need when prices rise.
- For businesses, rising prices mean less consumers.

Inflation is when the overall prices increase. **Deflation** is when the overall price decrease. Both situations listing above are damaging for the economy.

Consumer Price Index (CPI)

Consumer Price Index (CPI) is the most widely publicize measure of inflation. It measures the rate of inflation determining the changes of a hypothetical basket of goods that is bought by a typical household.

Economic Indicators

Economic indicators are a measure using statistics to get a sense of where the economy is heading. There are two types:

- **Laggings** is an indicator that reports the status of the economy a few months in the past.
- **Leading** is an indicator that reports the status of the economy a three to twelve months in the future.

Economic Recession and Depression

Recession

A **recession** occurs when there is slowdown in economic activity. It causes GDP decreases, unemployment rises, and because people have less money to spend, business revenues decline.

Depression

If, however, a recession lasts a long time (perhaps a decade or so), while unemployment remains very high and production is severely curtailed, the economy could sink into a **depression**. It is characterized by its duration.

Government's Role in Managing the Economy

There are two main policies a government work with to manage the economy:

Fiscal Policy

- **Fiscal Policy** is the federal government's efforts to keep the economy stable by increasing or decreasing taxes or government spending. Its tools:
  - Taxations
  - Government spending

Monetary Policy

- **Monetary Policy** is the management of the money supply and interest rates by the federal reserve board. Its tools:
  - Interest Rates
  - Money Supply