

## Chapter # 18

### ⇒ Economics

The word economy comes from a Greek word "Οικονομία" or "Oiko Nomia", which means "Management of House". A household and an economy faces many decisions.

- • Who will work?
- • What goods and how many of them should be produced?
- • What resources should be used in production?
- • At what price, should the goods be sold?

### ⇒ Society and Scarce Resources

The management of society resources is important because the resources are limited / scarce.

⇒ Scarcity

society      Scarcity means  
has      limited      the  
resources.

⇒ What is Economics?

"Economics is the study  
of how society manages  
its scarce resources."

"Ten principles of Economics"

It is divided into three  
different parts.

- i) How people make decisions.
- ii) How people interact.
- iii) How the economy works as a whole.

⇒ How people make decisions

(3)

means Choices

## 1. People face Tradeoffs ↑

"Tradeoff" is a situation that involves losing one quality or aspects of something in return for gaining another quality or aspects.

→ It is also summarized in one line as,

"There is no such thing as a free lunch"  
"It's your job to live your life as best as you can."

Examples &  
~~examples~~

i) Guns vs Butter

"Means a country or a choice to produce Guns or butter."

ii) Food vs Clothing.

→ Another tradeoff society faces is b/w efficiency or equity.

(4)

## Efficiency &

beneficial

"Means the Society is getting the most it can from its scarce/limited resources."

"In the limited resources society"  
"to be job and work to be done"

## Equity &

"Means that the benefit of these resources are distributed fairly among Society members."

"How will society distribute the benefits gotten from the limited resources among the members of a society?"

Trade off b/w efficiency and equity is to give people guarantee health care or not.

The cost of something is what you get give up to

Decisions require comparing costs and benefits of alternatives.

- Whether to go to college or to work?
- Whether to study or go out party?
- Whether to go to class or sleep in?

### Opportunity Cost & ~~funny~~

"The opportunity cost is an item is what you give up to obtain that item",

مثال على ذلك وقت العمل

- ③ Rational People think at the Margin<sup>8</sup> Marginal changes.

↑ Total cost  $\rightarrow$   $C_1, C_2, C_3, \dots, C_n$   
 Marginal cost  $\rightarrow$   $c_1, c_2, c_3, \dots, c_n$  of Total benefit  
 $\rightarrow$   $B_1, B_2, B_3, \dots, B_n$  Marginal benefit  $\rightarrow b_1, b_2, b_3, \dots, b_n$

- Marginal changes are small incremental to plan an action.

People make decisions by comparing costs and benefits at the margin and the marginal comparison

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benefits must be exceeded from  
marginal cost.

say it up?

## 4. People respond to Incentives

Because people make decisions by comparing costs and benefits, their behavior may change when cost or benefits change. That is, people respond to incentives.

### Example 8

When a price of an apple rises, for instance, people decide to eat more grapes and fewer apples because the cost of apples are higher. At the same time apple supplier decide to hire more workers to harvest more apples because the benefit of an apple is also high.

Like buy-one-get-one-free-sale.

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V21

How people interact with each other &

(5) Trade can make everyone better off

"Trade can make or allows each person to specialize at what he or she does best, whether it's farming, sewing, or home building".

In the same way nations can specialize in what they do best. In both cases, people get a wider range of choices at lower prices.

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(8)

- \* What goods to produce.
- \* How to produce.
- \* How much of each to produce.
- \* Who get them.

## → Market economy

A market economy is an economic system in which the economy decisions and the pricing of goods and services are guided by the interactions of a country's individual citizens and businesses.

- Firms decide whom to hire and what to make.
- Households decide which firms to work for and what to buy with their incomes.

In this principle they say that when ever the firms and household do decisions there should be no influence of any other party upon decisions.

(9)

✓  
7) Governments can sometimes improve market outcomes.

There are two broad reasons for the government to interfere with the economy, the promotion of efficiency and equality.

- \* Government policy can be most useful when there is market failure.

Market failures

A situation in which

- a. market left on its own fails to allocate resources efficiently.

⇒ examples of market failure

(i) Externality

the impact of one person's actions on the well-being of a bystander (ex & pollution)

(ii) Market Power

(Monopoly)

The ability of a single

(10)

economy  
actors) actor (or small group of  
influence to have a substantial  
on market prices.

In such cases, Public Policy  
may promote efficiency.  
Government may change market  
outcomes to promote equity.

(3) How the economy as a whole works

We started by discussing how  
individuals make decisions and  
then looked at how people  
interact with one another. All  
these decisions and interaction  
together make up the "economy".  
The last three principles  
concern the working of the  
economy as a whole.

(8) A country's standard of living  
depends on its ability to  
produce goods and services.

(11)

The most important determinant of living Standard

The explanation for differences in living standards lies in difference in productivity

**Productivity** is the amount of goods and services produced per unit of labour.

Productivity depends on the equipment, skills and technology available to workers.

High productivity implies a high standard of living.

So, in any country where there is high productivity so they will employ more workers and the standard of living of workers will be high so in a country where the standard of living of population is high the country's standard of living will be definitely

(12)

high.

(9) Price rise when the government prints too much money.

When the government creates a large amount of money, the value of money falls, and which always causes inflation.

\* The faster the government creates money, the greater the inflation rate!

\* Inflation refers to sustained increased in the overall level of prices in the economy.

(10) Society faces a short run trade off between Inflation and unemployment.

The curve that represents the trade off between inflation.

and unemployment is called "Phillips Curve".

- \* It has inverse relation with each other, it means when inflation increases, it reduces the rate of unemployment and vice versa.
- \* An increase in the money amount in the economy stimulates spending and increase the demand of goods and services in the economy.
- \* Higher demand may over time cause firms to raise their prices but in the meantime, they tends to produce more so for that they hire more workers to produce those goods and services.
- \* More hiring means lower unemployment.

(14)

## ⇒ Business Cycles

The business cycle also known as the economic cycle or trade cycle is the downward and upward movement of gross domestic product (GDP) around its long term growth trend.

→ The downward and upward movement of GDP around its long term growth trend is called Business cycle or economic , trade cycle

The downward and upward movement of GDP around its long term growth trend is called Business cycle or economic trade cycle.

## Chapter # 2

(15)

### thinking like an Economist

- \* Every field of study has its own language and way of thinking.

For example mathematicians talk about axioms, integrals and vector spaces, Biologists discuss about life.

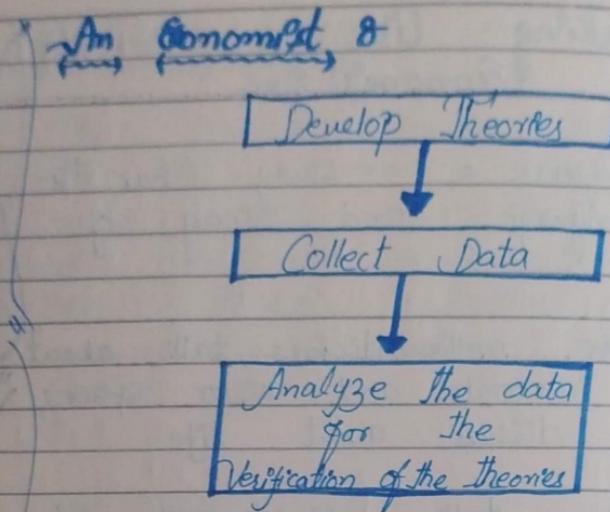
Economists talk about demand, Supply, Consumer Surplus, Incentive and Profit etc

### Economist as Scientist

An economist tries to explain his/her subject in the same way;

a physicist approaches the study of matter and a biologist approaches the study of life. They develop theories, collect data, and analyze these data to prove their theories. They verify

(116)



- The scientific method :  
observation and theory :
- The essence of Science is the  
"Scientific Method"
- Albert Einstein says, The whole of Science  
is nothing more than the refinement  
of every day thinking.
- An observation motivated Newton to  
develop a Theory of gravity.

(17)

- The relationship between theory and observation also occurs in economics.
- An observation of rapidly increasing price; developed a theory of inflation.
- The Theory might state that high inflation arises when the Govt. prints too much money.
- After this the theory is to be tested.

### → The Role of Assumptions

- Assumptions can simplify the complex world and make it easier to understand.
- To study the impacts of international trade, for instance, we might assume that the world consists of only two countries and each country produces two products.

### → Economic Models &

We use models to learn }

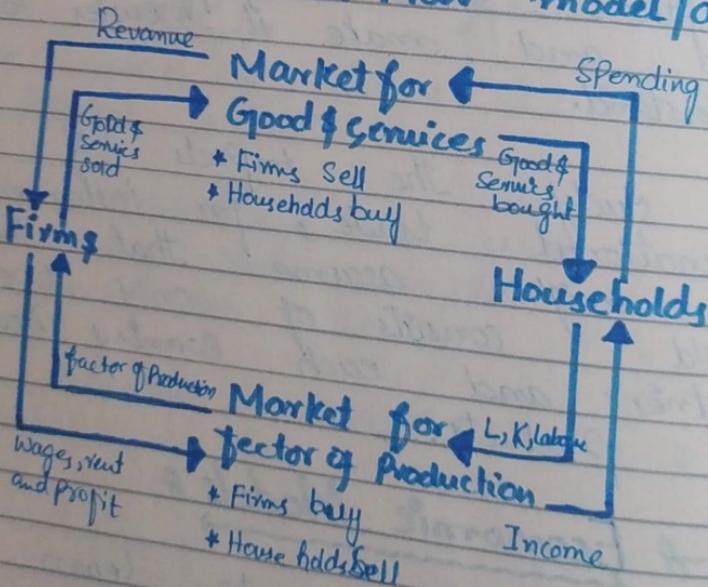
about the world, mostly  
are imposed of diagrams,  
and  
equations.

Eg's

→ The visual model of an economy  
The Circular Flow diagram.

In this model, the economy  
includes only two types of  
decision makers i.e.  
firms and households.

The Circular Flow model / diagram



(19)

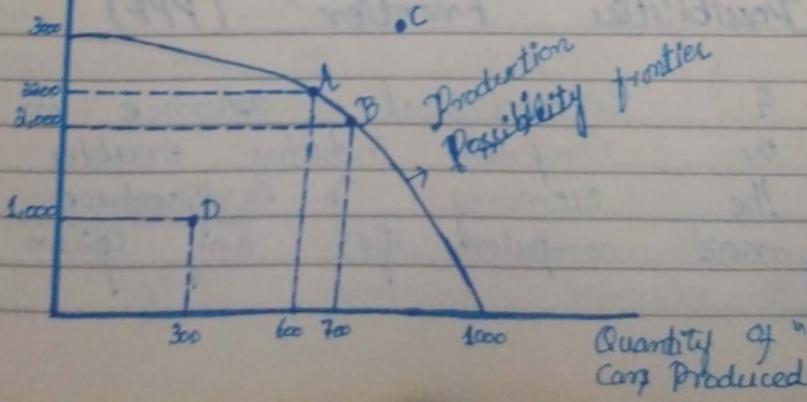
## → Second Model:

### (PPF) The Production Possibilities Frontier.

- Most economic models build using the tools of mathematics e.g. PPF model.
- PPF is a graph that shows the various combinations of output that the economy can possibly produce given the available factors of production and available technology.

PPF &

Quantity of  
Computers  
Produced



(20)

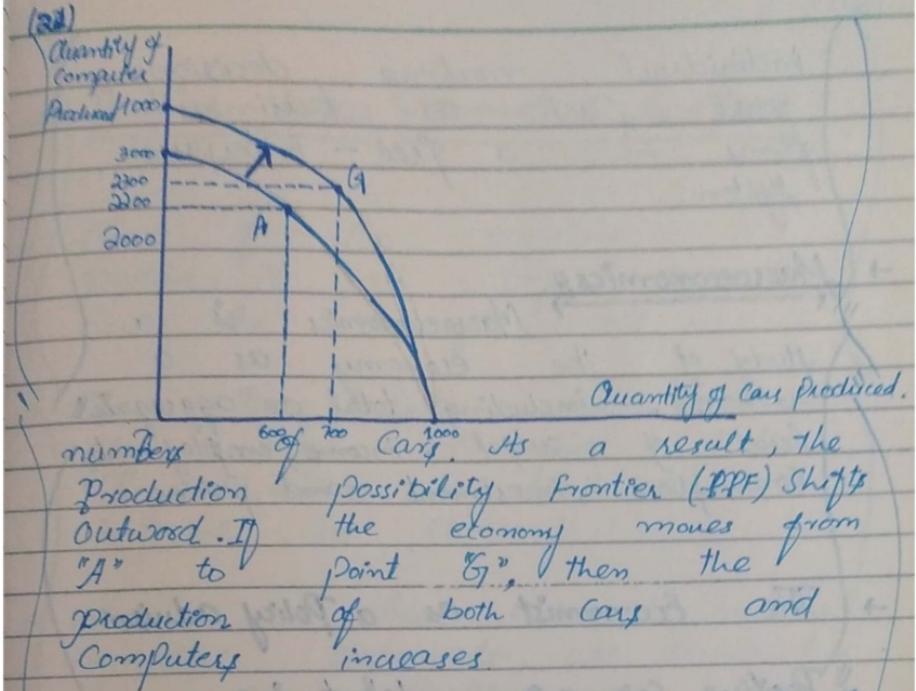
→ In the PPF Graph drawn on the last page

- \* We don't select "D" because "D" is below the PPF curve means we have more and better option to produce more than that at point "D", so that's why we don't select D.

- \* And same as the point "C". We cannot select point "C" because it's out of the PPF curve, because we don't have enough technology and factory of production to produce the product of quantity at point "C".

### → A shift in the Production Possibilities Frontier (PPF)

A technological advance in computer industry enables the economy to produce more computers for any given



## Economic Theory

Economic theories seek to predict and explain economic behavior. It refers to microeconomics and macroeconomics. It usually begins with a model.

### Microeconomics

Study of

Microeconomics is a study of economic behavior of

individual making decisions unit, such as business firms in a free-enterprise system.

## → Macroeconomics

Macroeconomics is a study of the economy as a whole, including total or aggregate level of output, income, employment, consumption, investment and prices.

## → The Economist as a Policy advisor

- Positive Science & What is?
- Normative Science & What Should be?

e.g. Suppose two persons are discussing minimum wage laws. Here are the two statements.

A&

Minimum wage laws cause unemployment.

B&

stop raise  
minimum wage.

## → Positive Versus Normative Analysis

- Much of the economy is positive: It just try to explain how the economy works.
- Thus those who use economics often have normative goals: They want to learn how to improve the economy.
- When we hear economists making normative statements, we know they are speaking not as scientist but as a policy adviser.

## → Why Economists disagree?

- \* Economists often give conflicting policy advice.
- \* They sometimes disagree about the validity of alternative positive theories about the world.
- \* They may have different values therefore different normative views

(24)

- about what policy should try to accomplish
- \* Yet, there are many propositions about which most economists agree

### Summary

- \* As scientists, economists try to explain the world using models with appropriate assumptions.
- \* Two simple models are the circular-flow diagram and the Production Possibility Frontier (PPF).
- \* Microeconomics studies the behavior of individual/consumers and firms, and their interactions in market.
- \* Macroeconomics studied the economy as a whole.
- \* As policy advisors, economists offer advice on how to improve the world.

## Chapter No 4

### The Supply Market forces of and Demand.

#### Introduction

Supply and Demand are the two words that economists use most often

- Supply and Demand are the forces that make market economies work.
- Modern microeconomics is about supply, demand, and market equilibrium.

#### Market

A market is a group of buyers and sellers of a particular good or service.

- The term supply and demand refers to the behavior of people as they interact with one another in market.

→ Buyers determine demand.  
→ Sellers determine supply.

### → Competitive Market

→ A competitive market is a market in which there are many buyers and sellers so that each has a negligible impact on the market price.

→ So, if one seller increase the price of the good, it has no impact on the buyer, because the buyer can buy the same good cheap in the same market, so it has a negligible impact on the buyer.

So, both the buyers and sellers have to take the price as given.

### Form of the Markets

→ Perfect competition  
→ Products are the same

- Numerous buyers and sellers so that each has no influence over price.
- Buyers and Sellers are the price takers.

### → Monopoly ↗

When there is only one seller of a particular good and services and many numbers of buyers and the seller has a complete control over price is called Monopoly.

Eg: → WAPDA → Single seller of electricity and it has a complete control over price.

(ii) Local cable television Company.

+ One seller, and seller controls price

### → Oligopoly ↗

It is a type of a market where there are few sellers and due to which there is not always aggressive competition is called Oligopoly.

→ Monopolistic Competition  
It is a type of market in which there are many sellers who produce slightly differentiated products and each seller may set price for its own product.

Eg: Many factories that produce sweets of a different tastes.

## ⇒ Demand & Supply

The Demand have following four conditions

- (1) We should have the desire for that commodity or services.
- (2) The commodity or services must have some price.
- (3) Whatever the price of that commodity, we should have the ability to pay.

(4) We should have willing to pay for that commodity.

→ If the above four conditions are not satisfied, then it will not be considered as a Demand.

### → Law of Demand

The Law of demand states that, the quantity demanded of a good falls when the price of the good rises with other things remain equal / same.

So, there is inverse relationship between price and quantity demanded of a product.

### → The Demand curve:

Relationship b/w Price and Quantity Demanded

### Demand Schedule

The demand schedule is a table that shows the relationship between the price of the good and the quantity demanded.

egg Ahmed's demand schedule is  
as following

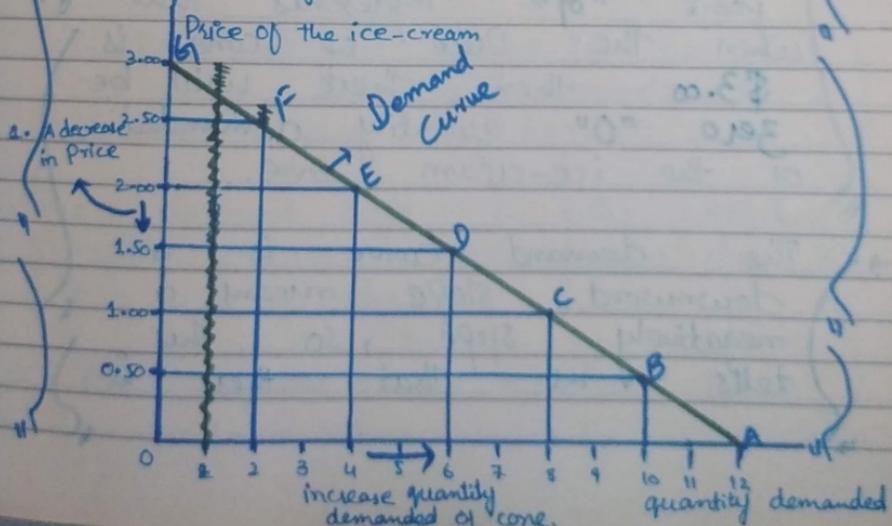
Price of ice cream cone	Quantity of cones demanded
\$ 0.00	12
0.50	10
1.00	8
1.50	6
2.00	4
2.50	2
3.00	0

The Demand schedule above explains us about that when the price of the cone was/is \$ 0.00 , so the quantity demanded is 12 cones and when the Price of cone increases to \$ 0.50 then the Cone demanded is 10 and when the Price of Cone start increasing then the quantity demanded of the cone

Cone Start decreasing this shows us that the price of a cone and the quantity demanded of the cone are in inverse relationship and when  $P \uparrow$  then  $D \downarrow$  and vice versa, this simply explains the law of demand.

## → Demand Curve

The demand curve is a graph of the relationship between the price of a good and the quantity demanded. E.g. Ahmed's demand curve is as following.



## Explanations

→ The Point "A" on the demand curve point out that when the ice-cream cone is free then its demand is 12 cones and when the price of the ice-cream cone starts increasing means at Point "B" the price of the cone is \$0.50 so then the quantity demanded of the ice-cream cone will be 2 and Point "G" represents that when the price of cone is \$3.00 then there will be zero "0" quantity demanded of the ice-cream cone.

→ The demand curve is a downward slope means a negatively slope, so this tells us that there is

inverse relationship between the price of the ice-cream cone and the quantity demanded of the cone are in inverse relationship

$$P \uparrow \Rightarrow D \downarrow \text{ or } P \downarrow \Rightarrow D \uparrow$$

When we combine all the points means A to G then we will get a curve which is known as a demand curve.

### Market Demand Versus Individual Demand

Market demand refers to the sum of all individual demands for a particular good or service.

The demand curve in the previous graph shows individual's demand for a product

The quantity demanded in a

market is the sum of the quantities demanded by all the buyers at each price. Thus the market demand curve is found by adding horizontally the individual demand curves.

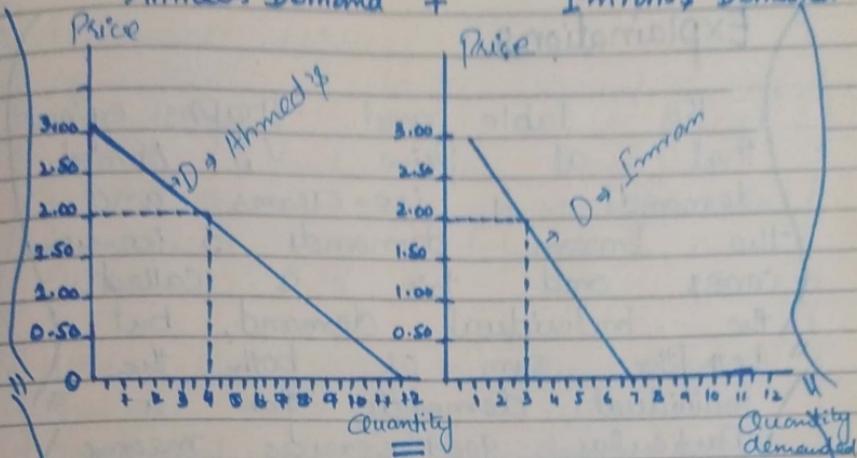
At the price of \$ 2.00, Ahmed demands 4 and Imran demands 3 ice-cream cones. The quantity demanded in the market at this price is 7 cones.

Price of ice-cream	Ahmed	Imran	Market
\$ 0.00	12	7	19 cones
0.50	10	6	16
1.00	8	5	13
1.50	6	4	10
2.00	4	3	7
2.50	2	2	4
3.00	0	1	1

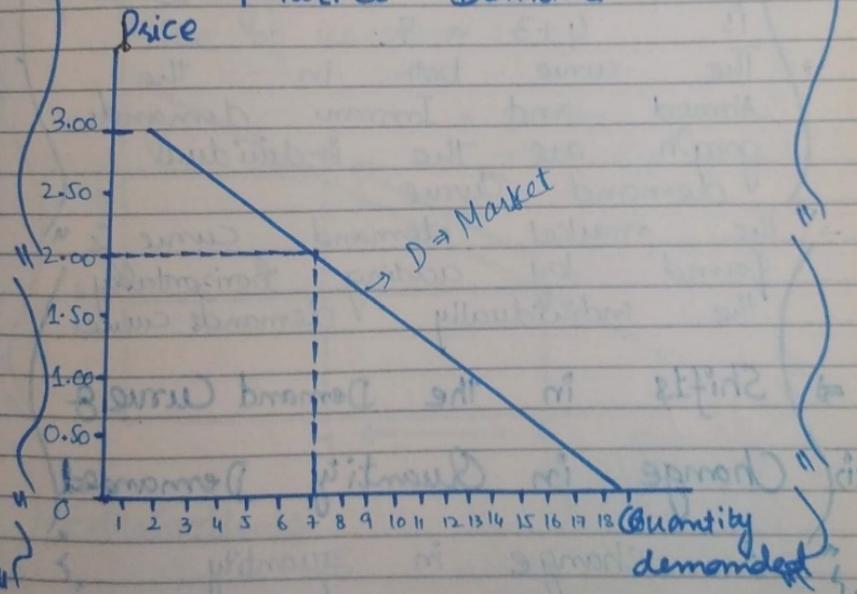
So when we convert it into graphs we get

Ahmed's Demand +

Inyam's Demand



Market Demand



## Explanation

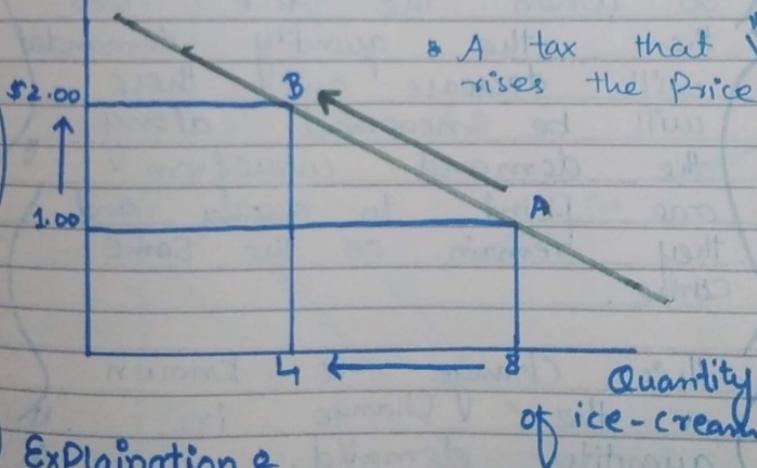
- The table and graphs explain that at Price 2 Ahmed demands 4 ice-creams and Imran demands 3 ice-cream cones and this is called the individual demand, but both / the sum of both the individual demands for a particular good / services means for an ice-cream cones market demand when is  $4+3 = 7$ .
- The curve both in the Ahmed and Imran demands graph are the individual demand curve.
- The market demand curve is found by adding horizontally the individually demands curves.
- ⇒ Shifts in the Demand Curves

(i) Change in Quantity Demanded  
What change in quantity?

demanded refers to a change in the specific quantity of a product that buyers are willing and able to pay. This change in quantity demanded is caused by a change in price.

When the price of the product changes then there will be movement along the demand curve

Graphically  
Price of icecream



Explanation 8

The above graph

Shows that when the price of ice-cream cone is \$1.00 then the quantity demanded of the ice-cream is 8 but, when the price of ice-cream rises due to a tax that rises the price of ice-cream cones, and then at price \$2.00 the quantity demand is 4 ice-cream cones and there will be a movement along the demand curve.

So when the price rises then the quantity demanded will decrease and there will be movement along the demand curve from one point to another and remain on the same curve.

This change is known as the change in quantity demand.

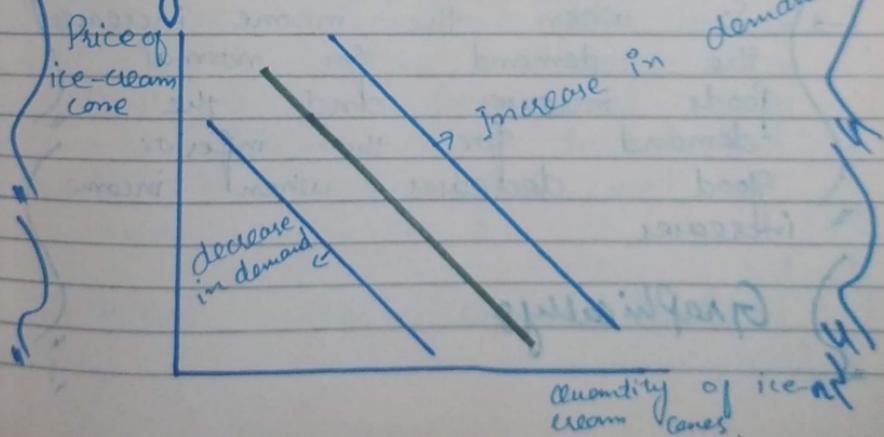
## Shift in the Demand curve

Whenever there is a change in demand other than due to price then there will be a shift in demand curve upward or downward.

The factors which changes the demand are :-

- (i) Consumers income
- (ii) Prices of Related goods
- (iii) Change in Expectations
- (iv) Number of buyers
- (v) Taste Change.

## Change in Demand &



## Explanation

So, When the income of the consumer increases so this demand also increases and then the demand curve will shift upward and when the income of consumer decreases hit demand also decreases go the demand curve will shift downward.

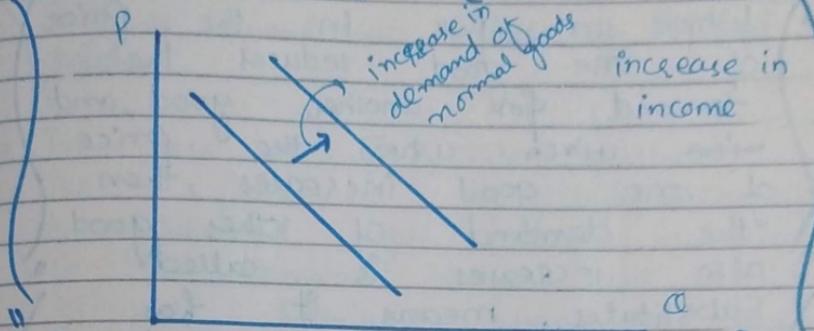
## (ii) → Consumer income &

Here we will discuss when the income changes what is its impact on normal and inferior goods.

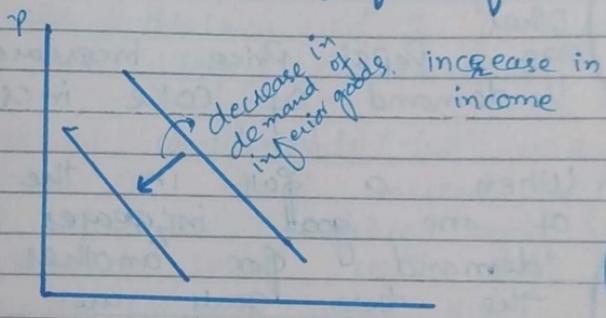
So when the income increases the demand for normal goods increases and the demand for inferior goods decreases when income increases.

## Graphically

Consumer income (Normal Good)



Consumer income (Inferior good)



Similarly when the ~~price~~ Income of the consumers decrease then the demand for normal good will decrease and the demand for the inferior good will be increase.

Prices of the Related Goods

When a fall in the price of one good reduces the demand for another good, and vice versa when the price of one good increases, then the demand of other good also increases is called

Substitutes, means it has a positive impact on each other.

e.g. Pepsi Price increase the demand of Coke increases.

When a fall in the price of one good increases the demand for another good, the two goods are called complements.

(OR) When the price of one good increases and then the demand of another good decreases, means it has negative impact on each other.

This is only for those commodities which are used together  
e.g. Tea and Biscuits  
(ii) Petrol and cars.

$\Rightarrow$  Shift of demand due to Price of Related goods.

(i) In case of Substitute (+), when the price of Pepsi increases the demand for Coke increases so the demand curve will shift upward. Similarly when the price of Pepsi decreases the demand of Coke also decreases, so the demand curve will shift downward.

(ii) In case of Compliments (-ive), when the price of Petrol increases, the demand for car decreases and the demand curve will shift downward. Similarly when the price of Petrol decreases, the demand of car will increase, so the demand curve will shift upward.

(iii) Taste

Taste can shift the demand curve as when we want to change from tea to coffee for its taste then

the demand curve for upward  
and caprice will shift downward.

#### iv) Expectations

Means when the buyers expects the price of the good to go down in the future, they hold off buying it today, so due to which its demand shifts for that good for today downward.

#### v) Number of buyers

Number of buyers can also effect the demand curve, when the number of buyers for a particular good are many then its demand will shift upward and vice versa.

#### Supply

Quantity supplied is the amount of a good that sellers

are willing and able to sell.

It is the amount of commodity which is sent in market for sale at a given price.

### Law of Supply

Law of supply states that the quantity supplied of a good rises when the price of the good rises, with other things remains same.

$$\begin{array}{ccc} P \uparrow & \Rightarrow & S \uparrow \\ P \downarrow & \Rightarrow & S \downarrow \end{array} \text{ with other things remains same.}$$

Supply Price and Quantity Supplied

### Supply Schedule

The supply schedule is a table that shows the relationship b/w the Price of the good and the quantity supplied e.g. Ahmed's Supply Chart

Price of ice-cream	Quantity of the ice-cream supplied
\$0.00	0
0.50	0
1.00	1
1.50	2
2.00	3
2.50	4
3.00	5

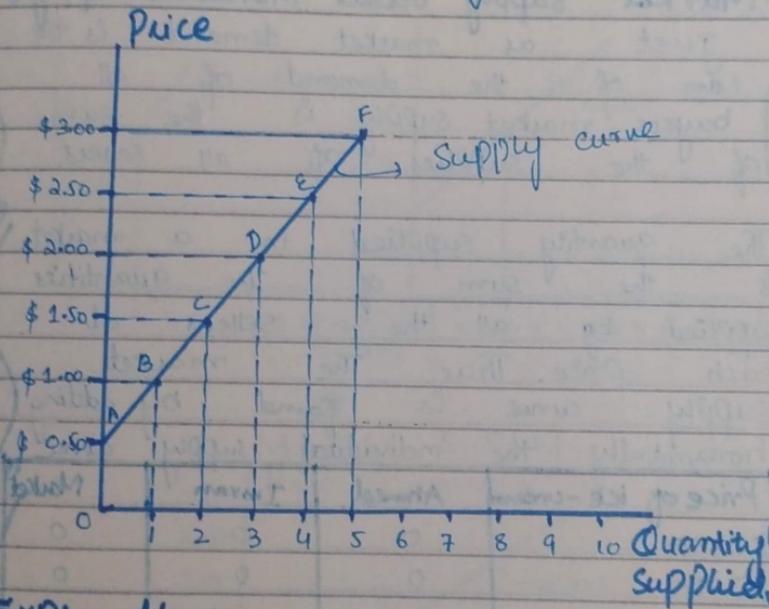
### Explanation 8

The supply schedule explains that when the price is \$ "0" and \$ 0.50 the supply is 0 and when the price increases the supply also increase as like when the price of the ice-cream is \$ 3.00 then the supply will be 5. So this shows that there is direct relationship b/w the price and the quantity demanded of the ice-cream cones. This explains

the phenomena of Supply

### Supply curves

The supply curve is the graph of the relationship b/w the price of a good and quantity of the good supplied.



### Explanations

Here when the price of a commodity increases so the quantity supplied also

increases showing the positive relationships.

In most cases, the supply curve is drawn as a slope rising upward from left to right

→ Supply curve versus individual curve.

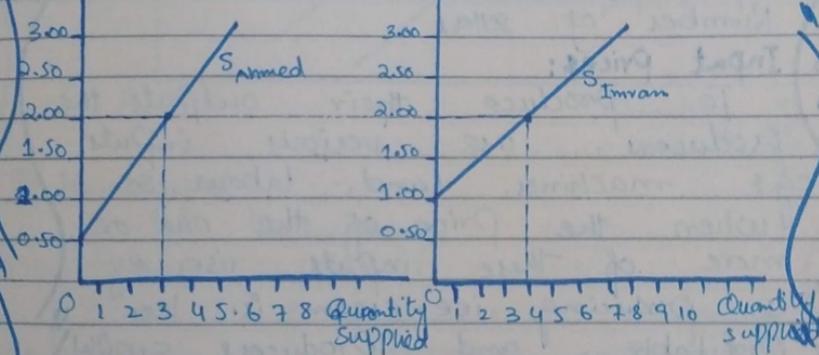
→ Market supply versus individual supply & just as market demand is the sum of the demands of all buyers, market supply is the sum of the supplies of all sellers.

→ The quantity supplied in a market is the sum of the quantities supplied by all the sellers at each price. Thus the market supply curve is found by adding horizontally the individual supply curve

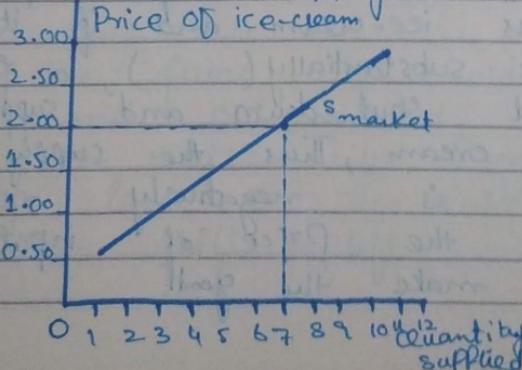
Price of ice-cream	Ahmed	Imran	Market
\$0.00	0	0	0
0.50	0	0	0
1.00	1	+ 0.50 = 0.50	1.50
1.50	2	2	4
2.00	3	4	7
2.50	4	6	10
3.00	5	8	13

At a price of two \$2.00 Ahmed supplies 3 icecream cones and Imran supplies 4 ice-cream cones. So the quantity supplied in the market at this price is 7 cones.

Ahmed's Supply Price



+  
Market Supply  
Price of ice-cream



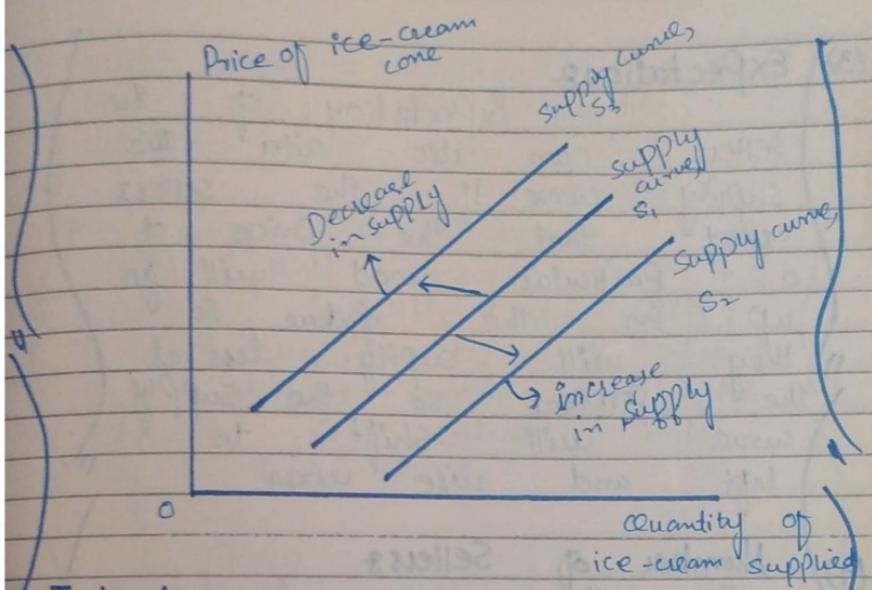
## → Shifts in the Supply curves

The factors that shift the supply curve are as follows.

- (1) Input prices.
- (2) Technology.
- (3) Expectations.
- (4) Number of sellers.

### i) Input prices:

→ To produce their outputs the producers use various inputs e.g. machines, land, labour, so when the price of the one or more of these inputs rises e.g. so producing ice-cream is less profitable, and producers supply less ice-cream. So if the input prices rises, a firm producer less ice-cream, and if its prices rises substantially ( ), a firm might shut down and supply no ice cream, Thus the supply of good is negatively related to the price of inputs used to make the good.



## Technology &

Technology can also alter the supply curve.

If the firms uses modern technology and modern methods of production the supply will increase and the supply curve will shift to Right.

→ And if the firms uses old technology and old method of production so they will produce less so the supply curve will shift to left.

### (3) Expectations

Expectations of the

sellers can also alter the supply curve. If the sellers expect that the price of a particular good will go up in the future so they will supply less at the present, so the supply curve will shift left and vice versa.

### (4) Number of Sellers

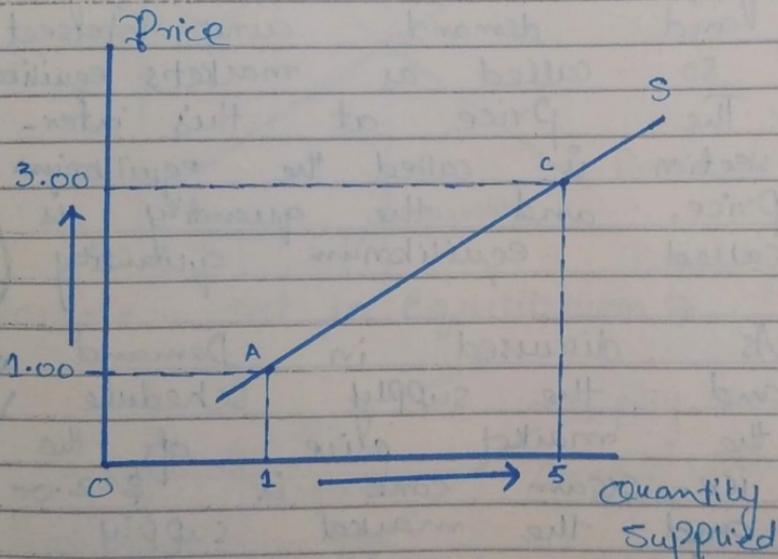
If there are less number of sellers so the supply curve will be less so the supply curve will shift left and similarly if there are many numbers of sellers so the supply curve will be greater and will shift to Right

### Change in quantity supplied

Movement along the supply curve.

Caused by a change in anything that alters the quantity supplied at each price.

There is difference b/w shift and change in the quantity supplied. The shift is caused by the factor that studied earlier and the change is caused only by the Price.



A rise in the price of ice-cream cones results in a movement along the supply curve.