Basic Fundamental Economic

3rd Year Economic and Prospect Analysis
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What is Economics in General?

- Economics is the science of scarcity.
- Scarcity is the condition in which our wants are greater than our limited resources.
- Since we are unable to have everything we desire, we must make choices on how we will use our resources.
- In economics we will study the choices of individuals, firms, and governments.

Economics is the study of __choices__.

Examples:

You must choose between buying jeans or buying shoes.
Businesses must choose how many people to hire
Governments must choose how much to spend on welfare.

Economics Defined

Economics-Social science concerned with the efficient use of limited resources to achieve maximum satisfaction of economic wants.

(Study of how individuals and societies deal with_scarcity_)

Micro vs. Macro

MICROeconomics-

Study of small economic units such as individuals, firms, and industries (competitive markets, labor markets, personal decision making, etc.)

MACROeconomics-

Study of the large economy as a whole or in its basic subdivisions (National Economic Growth, Government Spending, Inflation, Unemployment, etc.)

How is Economics used?

- **Economists use the scientific method to make generalizations and abstractions to develop theories. This is called theoretical economics.**
- **These theories are then applied to fix problems or meet economic goals. This is called policy economics.**

Positive vs. Normative

Positive Statements- Based on facts. Avoids value judgements (what is).

Normative Statements- Includes value judgements (what ought to be).

Marginal Analysis

In economics the term marginal = additional

“Thinking on the margin”, or MARGINAL ANALYSIS involves making decisions based on the additional benefit vs. the additional cost.

For Example:

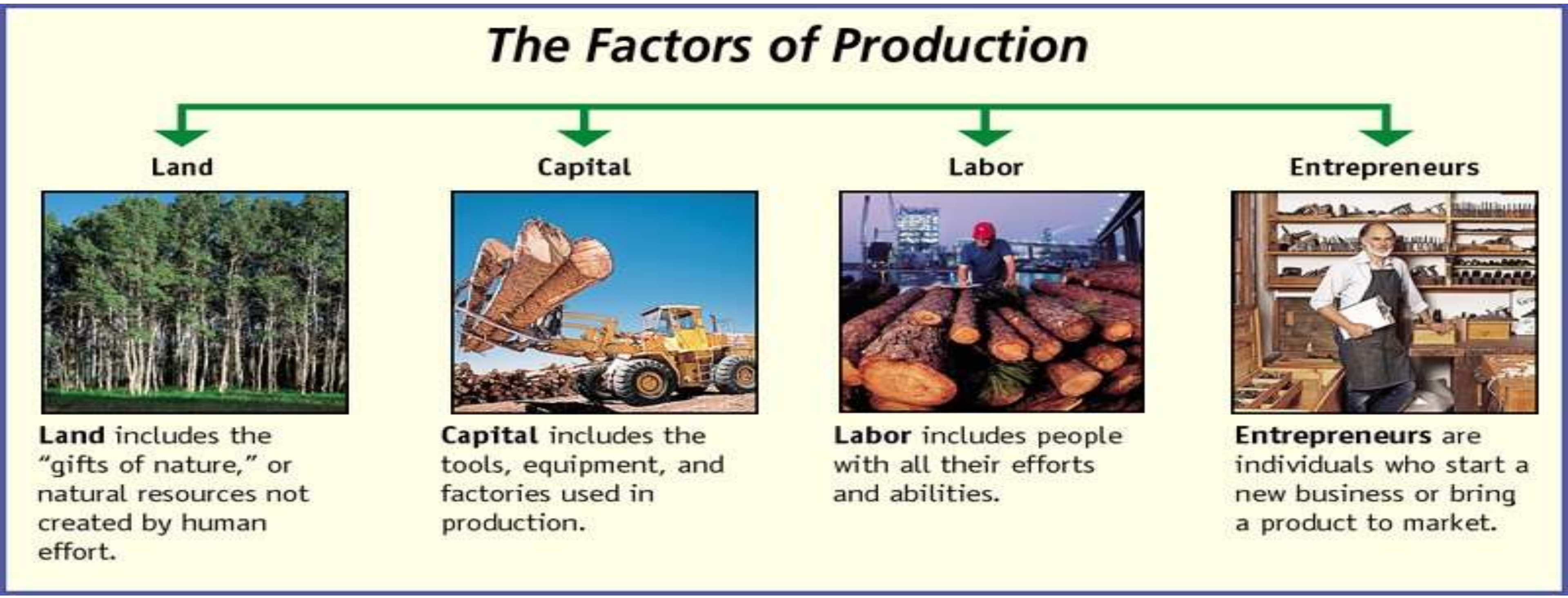
You have been shopping at the mall for a half hour, the additional benefit of shopping for an additional half-hour might outweigh the additional cost (the opportunity cost).

After three hours, the additional benefit from staying an additional half-hour would likely be less than the additional cost.

5 Key Economic Assumptions

1. **Society's wants are unlimited, but ALL resources are limited (scarcity).**
2. **Due to scarcity, choices must be made. Every choice has a cost (a trade-off).**
3. **Everyone's goal is to make choices that maximize their satisfaction. Everyone acts in their own "self-interest."**
4. **Everyone acts rationally by comparing the marginal costs and marginal benefits of every choice**
5. **Real-life situations can be explained and analyzed through simplified models and graphs.**

The Factors of Production



- **Land** refers to everything on Earth that is in its natural state, or Earth's natural resources.
- **Labor** refers to all the people who work in the economy.
- **Capital** includes money needed to start and operate a business. At a national
  level, capital includes **infrastructure**, such as roads, ports, sanitation facilities,
  and utilities.
- **Entrepreneurship** refers to the skills of people who are willing to risk their time and money to run a business.

FUNDAMENTAL CONCEPTS OF ECONOMICS

1. **Opportunity Cost:** The **benefit** of the next best alternative which had been **sacrificed** due to the choice of the best alternative is known as opportunity cost of the best alternative. **It tells us the gain from the proposed use of input.**

   Eg- Opportunity cost of funds employed in one's own business is the amt of interest which cud have been earned had these funds been invested in the next best channel of investment.

2. Incremental Reasoning: It's the most important concept in economics. Incremental principle is applied to business decisions which involves a large increase in total cost & total revenue. Incremental cost is defined **as"change in total cost as a result of change in the level of output.** Incremental revenue is **change in total revenue resulting from change in the level of output. It tells us gain arising from the change in activity.**

3. The Discounting Principle. Discounting factor determines the **present value** of future inflow of cash. Its based on the fundamental fact that a rupee now is worth more than a rupee earned a year after. PV= FV*PVFn,i

4. Time Perspective. Aim of the firm is to make profit in the long run. There is a difference between long & short run. In short run all of the inputs(called fixed inputs) **cannot be altered**, while in the long run all the inputs can be changed(i.e. there are no fixed inputs). A decision should take into account both the short run & long run effects on revenues & costs to maintain a right balance b/w short & long run perspectives.

5. Risk & Uncertainty. In real world, uncertainty influences the estimation of costs & revenues & hence the decision of the firm. Since future conditions are not perfectly predictable, there is always a sense of risk & uncertainty about outcome of decisions. When a firm is operating in a market along with other firms there is generally an element of uncertainty regarding the actions & reactions of the competitors. **Other uncertain factors can be shifts in consumers choices, changes in govt policies, national international political scenario.**

Concepts of Economics

1. Utility: Utility refers to the amount of satisfaction which a consumer gets by consuming the various units of commodity.

2. Marginal Utility: Addition made to the total utility by consuming 1 more unit of a commodity. MU= change in total utility/ change in quantity of good X.

3. Law of Diminishing Marginal Utility: "For any individual consumer the value that he attaches to successive units of a particular commodity will diminish slowly as his total consumption of that commodity increases, the consumption of all other goods being constant".

Assumptions of the Law:

1. Various units of goods are homogeneous.
2. There is no time gap b/w consumption of different units.
3. Tastes, preferences & fashion remain unchanged.

4. Consumer's Equilibrium. The quantity of good X where marginal utility of X equals price of good X.

Mux=Px.

5. Income Effect. Change in consumption of the good due to the change in income of the consumer.

6. Price Effect. Change in the consumption of the good due to change in the price of the good.

7. Micro Economics. Studies the **behavior of individual decision making units like consumers, firms**(regulates under Company's Act). It includes i) **Product Pricing** which includes Theory of Demand & Supply, ii) **Factor Pricing** which includes wages, rent, interest & profit.

8. Macro Economics. Studies the aggregate of all economic units. **It includes theory of growth & employment, theory of Inflation & Price Level, theory of Income & theory of Distribution.**

Eg- Automobile industry includes firms like Maruti Suzuki India Ltd, Hindustan Motors, Hyundia Motors India Ltd, Tata Motors etc.

Textbooks:

-O'Sullivan, A.,Sheffrin, S.,& Perez, S., (2019). Survey of Economics: Principles, Applications, and Tools, 8th Edition, Boston: Pearson Education (Older editions are OK; the digital versionis much cheaper).-Krugman, P., Wells, R.,& Graddy, K.,(2016). Essentials of Economics, 4th Edition, New York: Worth Publishers (3rdedition is fine but 1stand 2ndare outdated).Recommended

References books:

-O'Sullivan, A., Sheffrin, S., & Perez, S.,(2017). Economics: Principles, Applications, and Tools, 8th Edition, Boston: PearsonEducation. (Contains all the chaptersfrom the compulsory textbook plus some material that will not be covered in class, but it is usually cheaper).-Hubbard, G., & O’Brien, A.,(2019). Economics, 7th Edition, Boston: Pearson Education. -Parkin, M., (2019). Economics, 13th Edition, Boston: Pearson Education. -Acemoglu, D., Laibson, D., & List, J.,(2018). Economics, 2nd Edition, Boston: Pearson Education. -Samuelson, P., &Nordhaus, W.,(2009). Economics, 19thEdition, Boston: McGraw-Hill Higher Education. -Mankiw, G., (2018). Principles of Economics, 8th Edition, Boston: CengageLearning.