

# Economics for Business Environment

## *Unit 1*

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# Lecture Outline

- ① Module Introduction
- ② Introduction to Economics
- ③ What is economics about?
- ④ Conclusion

# Module Outline

- Mark P. Taylor and N. Gregory Mankiw (2017), Economics, 4<sup>th</sup> edition, Cengage Learning.
- Moodle
- News (Financial Times, Economist, BBC, etc.)
- Assessment: Coursework 40%, Exam 60%

## Module Outcome

- Understand the global nature of business
- Show understanding of the economic basis for business
- Demonstrate an understanding of the markets within which a business operates
- Identify the impact of Government policy on business
- Show awareness of current issues and their impact on the strategy, behaviour and management of business

# Module Structure

- Duration: 11 weeks
- Lecture 1 per week
- Seminar 1 per week
- Written assignment: 1500 word essay/report.  
Due date: tbc
- Exam: week 13 (tbc)

## General Comments

- Read the textbook
- Start thinking like economists.
- “Everything in life is a trade off.”
- Try to understand concepts and ways of thinking.
- Develop economic intuition.

## How to Pass

- Come to the lectures.
- Use the available resources (slides, book, seminars, etc.)
- Ask **anything** you do not understand.
- Participate in the lectures and in the seminars.
- You are expected to invest around 200 hours in this module. Out of which only about 40% will be delivered to you. The rest is your own work. **STUDY.**

# Moodle

- Everything that you need (and more) is there (including me and the module representatives).
- Lecture slides for every week (constantly revised).
- Seminar questions and answers.
- Any announcement regarding the module.

Questions?

101LON

Economics for Business Environment  
*Introduction to Economics*

# What we will learn today

## *What is Economics?*

- Study what activities are beneficial for the individual or the society.
- Economics and the Economy are different things.

## *What is the Economy?*

- **Actors**: Consumers, firms, corporations, countries, organizations, markets.
- **Behaviour**: Decision making process.
- **Outcomes**: Profit/loss, rent/return, etc.

# What we will learn today

## *Why study Economics?*

- Essential Tool for every day decisions, e.g. purchase something or allocate time watching Netflix instead of studying.
- They allow us to analyze data, make informed decisions and form expectations for the future.

# Main Issue

- What is economics about?
- The central economic issue
- The difference between micro & macro economics
- Economic Systems
- Explain the key ideas that define the economic way of thinking

## What we will learn today

What is the main issue in economics?

### Answer

**Scarcity:** The difference between limited, ie scarce, resources and theoretically limitless wants. In other words, our inability to satisfy all our wants is called scarcity.

- All economic questions arise because we want more than we can get.

# Scarcity

- Because of scarcity, we have to make choices.
- The choices we make depend on the *incentives* we face.
- An incentive is a reward that encourages an action or a penalty that discourages an action.

# Scarcity

- People want to maximise their utility (consume goods).
- Firms maximise their profit. Firms need inputs/resources to produce goods (labour, capital, land, raw materials)
- The issue is how to efficiently allocate resources in production.

# Fundamental Questions

- What to produce?
  - It changes over time as advances in technology allow us to produce more. Transitions of primary (agriculture), to secondary (manufacturing) to tertiary sector (services).
- How to produce?
  - Factors of production: Land, Labour, Capital, Entrepreneurship
- Who buys the goods/services?
  - Income. Land earns rent. Labour earns wages. Capital earns interest. Entrepreneurship earns profit.

# The Economic Way of Thinking

- Every choice involves a sacrifice, *trade-off*
- You choose to buy coffee instead of tea.
- You choose to watch Game of Thrones instead of studying.
- People make rational choices by comparing benefits and costs.
- Benefit is what you gain from something.
- Cost is what you must give up to get something.

# Rational Choice

- How do people make choices?

## Key Concept/Assumption

**Rational Choice:** We assume that every individual has some preferences and will always choose *rationally* the action that will maximise their utility.

- A rational choice is one that compares costs and benefits and achieves the greatest benefit over cost for the person making the choice.
- The idea of rational choice provides an answer to the first question: What goods and services will be produced and in what quantities?

## Trade-off

The economic way of thinking places scarcity and its implication, choice, at centre stage.

- All choices have a price: Opportunity Cost.

### Key Concept

**Opportunity Cost** : The "opportunity cost" of a resource, refers to the value of the next-highest-valued alternative use of that resource, *Concise Encyclopedia of Economics*

# Opportunity Cost

Opportunity cost has two components:

- What is your opportunity cost of going to a concert?
  - 1 The things you can't afford to buy if you purchase the ticket.
  - 2 The things you can't do with your time spent at the concert.

Class Exercise: Think some examples.

## Example

| Occupation        | Median  | Cost             | Estim.  |
|-------------------|---------|------------------|---------|
| Lorry driver      | £23,000 | Tuition fees     | £9,000  |
| Postal worker     | £18,500 | Living expenses  | £12,000 |
| Tube driver       | £42,000 | Salary from job  | £29,000 |
| Refuse collector  | £18,000 | TOTAL (per year) | £50,000 |
| Electrician       | £23,500 |                  |         |
| Plumber           | £21,000 |                  |         |
| Accountant        | £27,000 |                  |         |
| HR manager        | £32,500 |                  |         |
| Investment Banker | £59,000 |                  |         |
| Lecturer          | £34,500 |                  |         |

Table: Opportunity cost of going to university

# Production Possibilities Frontier

- How does the economy produce?
- Do we use the resources in an efficient way?
- The production possibilities frontier (PPF) is the boundary between those combinations of goods and services that can be produced and those that cannot.
- For simplicity, we focus on two goods, *ceteris paribus*.

## Example

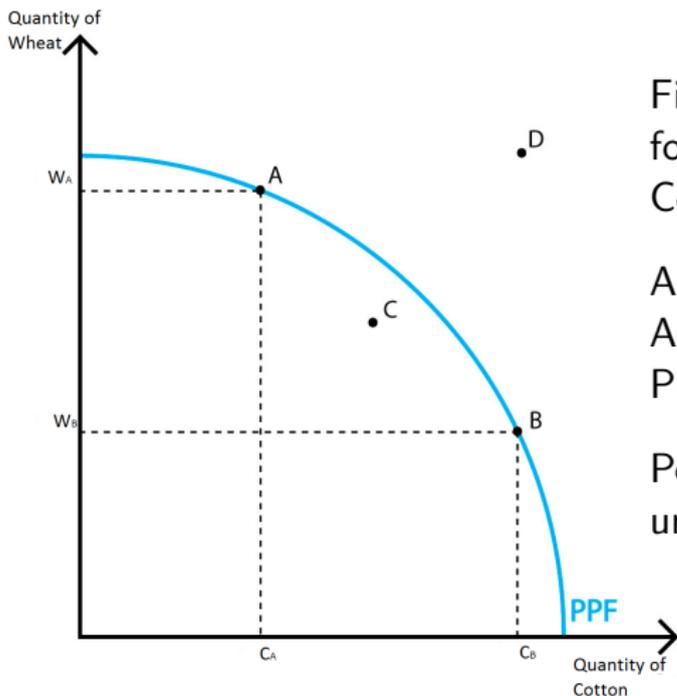


Figure on the left shows the PPF for two goods: Wheat and Cotton.

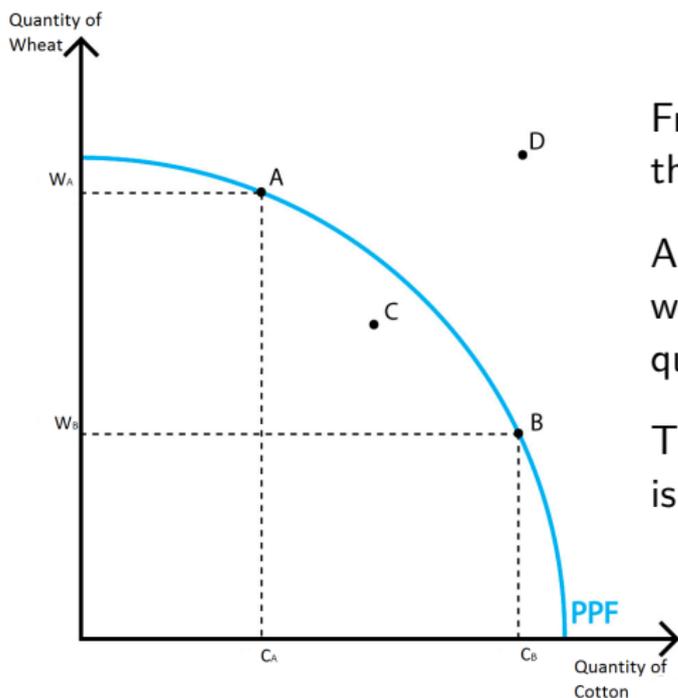
Any point on the frontier such as A and B and any point inside the PPF such as C are attainable.

Points outside the PPF are unattainable.

## Production Efficiency

- We achieve production efficiency if we cannot produce more of one good without producing less of some other good.
- Points on the frontier are efficient.
- Any point inside the frontier, such as C, is inefficient.
- It is possible to produce more of one good without producing less of the other good. At C, resources are either unemployed or misallocated.

## PPF and Opportunity Cost

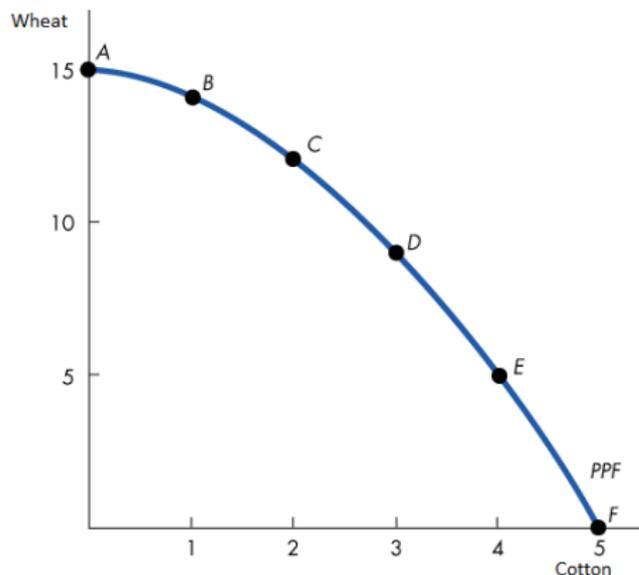


From the PPF we can understand the concept of *opportunity cost*.

As we move down along the PPF, we produce more Cotton but the quantity of Wheat decreases.

The opportunity cost of a wheat is the cotton forgone.

## PPF and Opportunity Cost



Moving from D to E, the quantity of Cotton produced increases by 1 ton.

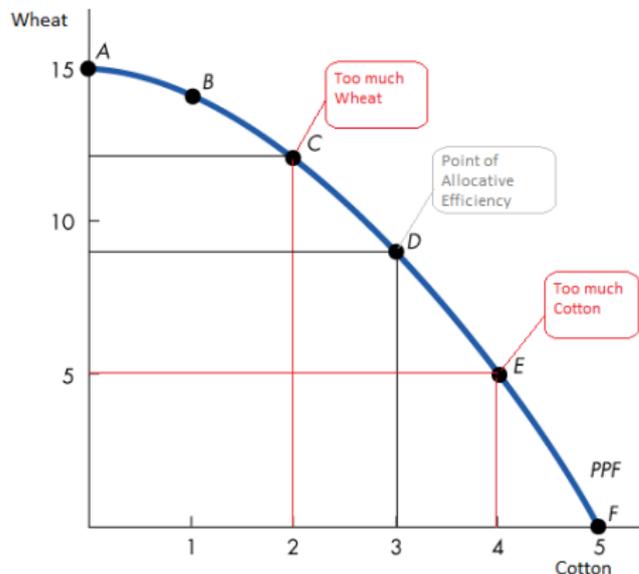
The quantity of wheat produced decreases by 5 tons.

The opportunity cost of producing the 4<sup>th</sup> ton of cotton is 5 tons wheat. One ton of cotton costs 5 tons of wheat.

## Efficient Use of Resources

- We are producing at a point **on** the PPF.
- When we cannot produce more of any one good without giving up some other good, we have achieved *production efficiency*.
- When we cannot produce more of any one good without giving up some other good that we value more highly, we have achieved *allocative efficiency*.
- We are producing **at** the point on the PPF that we prefer above all other points.

## PPF and Opportunity Cost



Moving from D to E, the quantity of Cotton produced increases by 1 ton.

The quantity of wheat produced decreases by 5 tons.

The opportunity cost of producing the 4<sup>th</sup> ton of cotton is 5 tons wheat. One ton of cotton costs 5 tons of wheat.

# Economic Growth

The expansion of production possibilities and increase in the standard of living is called economic growth. Two key factors influence economic growth:

- 1 **Technological change** is the development of new goods and of better ways of producing goods and services.
  - 2 **Capital accumulation** is the growth of capital resources, which includes human capital.
- Economic growth is not free. We sacrifice resources in research and development.
  - The opportunity cost of economic growth is less current consumption.

## Micro- vs Macro- economics

- ***Microeconomics*** is the part of economics that studies the decisions of the individuals (distribution of resources)
- It allows us to explain what we expect to happen if some conditions change. For example, what will happen to the market of coffee if a natural disaster destroys a large part of the harvest.

## Micro- vs Macro- economics

- **Macroeconomics** is the part of economics that studies how the aggregate economy behaves.
- It allows us to explain how national income changes, inflation, unemployment, finance, international trade etc. For example, what will happen to national income if the government increases public spending.

# Economic Systems

What is the role of the government in the economy?

- Free Market:
  - Market not government decides: laissez-faire capitalism.
  - Firms & consumers direct their choices.
- Command Economy:
  - Also known as "Planned Economy"
  - Government decides: what, how, for whom
  - Government directs firms, and workers.
- Mixed Economy:
  - Firms & consumers direct some choices/ interests
  - Government directs other choices & interests
  - Government regulates firms

# Economic Systems

## Examples

- Free Market: *Capitalism*. One of the few examples is the US during the 19<sup>th</sup> century.
- Command Economy: *Communism*. The communist Soviet Union, Cuba today, North Korea.
- Mixed Market: *Socialism*. Most countries today belong to this type.

## Next time

- To help our analysis we talk about markets
- Markets are the theoretical place where buyers and sellers of a good or a service meet and interact with each other.
- Exchange goods/services

# Markets

- Every market consists of two sides: Demand and Supply.
- Demand refers to how much of a good is desired by buyers at a given price level.
- Supply refers to how much of a good is offered by sellers at a given price level.

## What We Learned Today

- Main issue in Economics is the scarcity of resources.
- We need economics to find efficient ways to allocate resources.
- Every decision we make involves a sacrifice.
- Opportunity cost.
- Government involvement

## Conclusion

- Review today's lesson
- Read Part 1 of the book (Including all boxes and case studies)
- Search online for more sources.
- Ask questions in seminar if anything is unclear
- Do self-test questions at the end of the chapters and online