

# FOUNDATION COURSE IN MANAGERIAL ECONOMICS

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Lecture 1: Principles of Economics

# What is economics all about?

- Scarcity of resources
- Trade off
- And how people make choices

# Principles of how people make decisions

- PRINCIPLE #1: People Face Tradeoffs
  - Efficiency vs Equality
- PRINCIPLE #2: The Cost of Something Is What You Give Up to Get It
  - The **opportunity cost** of any item is whatever must be given up to obtain it
- PRINCIPLE #3: Rational People Think at the Margin
- PRINCIPLE #4: People Respond to Incentives

# Principles of how people interact

- PRINCIPLE #5: Trade Can Make Everyone Better Off
- PRINCIPLE #6: Markets Are Usually A Good Way to Organize Economic Activity
- PRINCIPLE #7: Governments Can Sometimes Improve Market Outcomes
  - When markets fail – e.g. externalities, public goods, equity etc

# Principles of how the economy works as a whole

- PRINCIPLE #8: A Country's Standard of Living Depends on Its Ability to Produce Goods & Services
- PRINCIPLE #9: Prices Rise When the Government Prints Too Much Money
- PRINCIPLE #10: Society Faces a Short-run Tradeoff Between Inflation and Unemployment

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Lecture 2: Introduction to Demand & Supply  
framework

# Demand & Supply

- What is a competitive market?
- What is demand curve and how is it determined?
- What are the factors affecting demand?
- What is supply curve and how is it determined?
- What are the factors affecting supply?
- What is market equilibrium and how is price determined in the market?

# Assumption

- We assume a competitive market where
  - Many buyers and sellers
  - All goods are perfect substitutes
  - Buyers and sellers can easily enter or exit the market
  - Everyone is a price taker



# Demand

- Quantity demanded of any good is the amount of that good that the consumers are willing to purchase at a certain price
- **Law of Demand:** Other things remaining the same the quantity demanded of any good would fall when prices rise

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Lecture 3: Price and non price determinants of  
demand

# Determinants of demand

- *Other things remaining same*, demand curve is relationship between price and quantity of a particular good that the consumers are willing to buy.
- These *other things* are the non-price determinants of demand, or, demand curve shifters

# Non price determinants of demand

1. Number of buyers
2. Income
  - a. Normal good => Demand for normal good increases with income
  - b. Inferior good => Demand for inferior good falls with rise in income
3. Prices of related goods
  - a. Substitutes => Demand Increases with increase in price of substitute
  - b. Complements => Demand increases with fall in price of substitutes
4. Tastes and preferences
5. Expectations

# Example

- What happens to demand for ebooks in the following scenarios:
  - Price of e-reader falls
  - Price of e-books falls
  - Price of books fall

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Lecture 4: Supply curve and its determinants

# Supply

- *Other things remaining same*, supply curve is relationship between price and quantity of a particular good that the producers are willing to supply.
- These *other things* are the non-price determinants of supply which shift the supply curve
- **Law of supply**: Other things remaining same the quantity supplied of a good rises when the price of the good rises and vice versa.

# Market Supply versus Individual Supply

- Market supply or the quantity supplied in the market is the sum of all individual quantities supplied by the sellers at each price.
- So in a market of three sellers A, B and C, if at Rs30 per cone of ice cream, A is willing to supply 10 Kgs of ice cream, B 20 Kgs and C 30 Kgs, then market supply at price of Rs10 is 60Kgs



# Non price Determinants of Supply

- Input prices
- Technology
- Number of sellers
- Expectations

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# Example: Supply of e-books

1. E-book retailers reduce the price of e-books
2. A fall in the cost of software to produce e-books
3. A rise in the price of paperbacks

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Lecture 5: Market equilibrium

# Supply and Demand together

- **Market equilibrium** is reached where demand equals supply, i.e. intersection of the demand and supply curves
- **Surplus** – when quantity supplied in the market becomes more than the quantity demanded
- **Shortage** – when quantity demanded in the market is more than what producers are willing to supply
- Price acts as signal in the market

# Disruptions in the market for any good

- Non price determinants of demand and supply can affect the market
- How to determine the effect of any event?
  - Does the event affect the demand or the supply side in the market?
  - What is happening to the demand/supply curves?
  - How does the change impact the market equilibrium?

# Examples:

## 1. Market - diesel cars

- Event – hike in petrol prices
- Shifts the demand curve

## 2. Market – cars

- Event – many new car manufacturers have entered the markets
- Shifts the supply curve

## 3. What happens when the events happen together?

# Summary of Week1

- We have introduced the concept of perfectly competitive markets – many buyers and sellers and all are price takers
- The demand supply framework to understand equilibrium in the competitive market
- Law of demand and the demand curve
- Law of supply and the supply curve
- Price and non price determinants of demand and supply
- The intersection of demand and supply determines the market equilibrium
- How price corrects shortages and surpluses
- Any disturbance in the market may be explained through the demand supply model
- Price acts as a signal