

A Report on Economics for Managers



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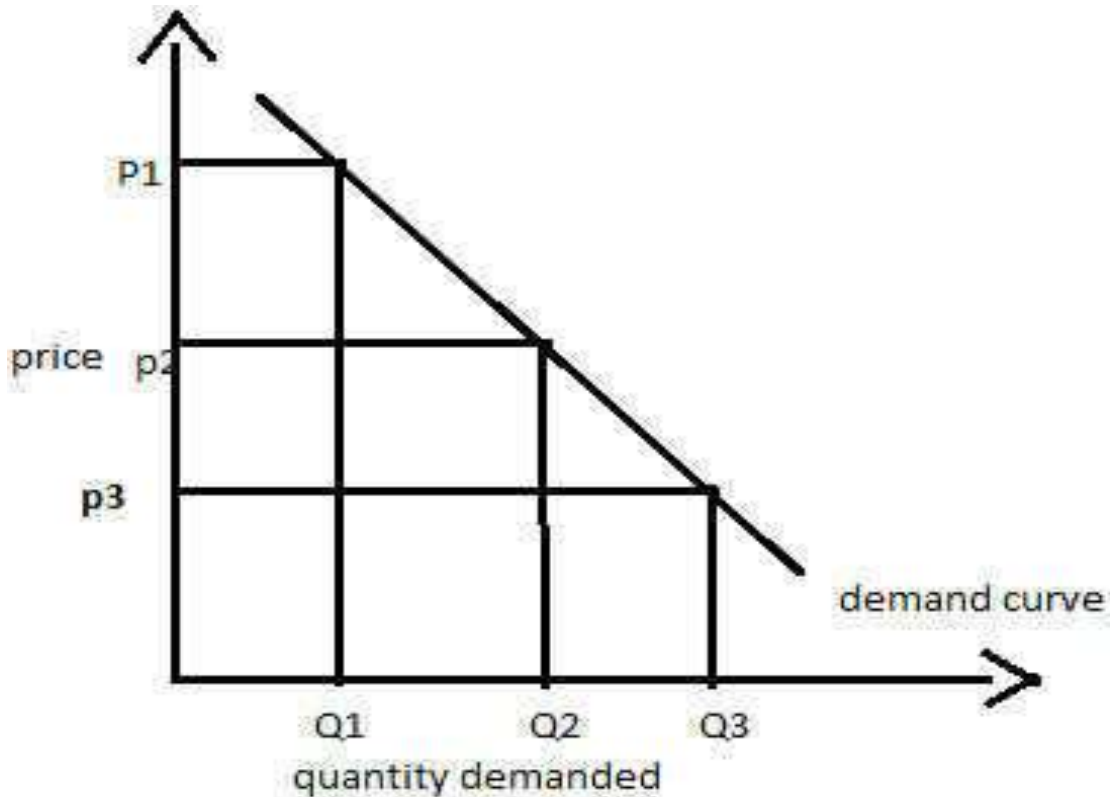
Task 1.

There has been a steady increase in the cost of food in Australia (Groenewegen, 2014). Cost of food has increased by 0.30 percent in June 2018 over the cost in the same month of the previous year (Moon, 2016). The food inflation is maintaining an average of 5.35% from 1973 to 2018. All time high was 20.60% in the fourth quarter of 1973 and all time low was -3.20% in the second quarter of 2012 (Groenewegen, 2014). Main drivers for such increase are as follows:

- *increase in oil price which shoots up the shipping cost.
- *The changes in the climatic conditions.
- *More demand for meat. More grains are required to feed the animals for the meat.
- *Organizations like WTO have reduced the subsidies for the farmers (Cohen and Winn, 2007).

1.a. Application of Law of demand in food just as it applies to all other goods and services:

In this context, it is clearly discussed as how Law of Demand applies to food products: Generally the Law of Demand states that price and quantity demanded of any goods and services are inversely related to each other assuming that the other factors remain constant (Alhabeeb and J., 2012).



The above diagram depicts the demand curve which shows that when the price of a commodity increases from P_3 to P_2 , the quantity demanded comes down to Q_2 from Q_3 (Arnold, 2010).

The following are the assumptions:

- There is no change in the price of any related commodities.
- There is no change in the income of the consumer.
- There is no change in the size of the population.
- There is no change in the taste and preferences of the customer.
- There is no expectation with respect to any change in price in the future (Anjan, 2013).

The Law of Demand will not be applicable in the following situations (Cohen and Winn, 2007):

- *Inferior goods/Giffen goods
- *Goods/products having prestige value
- *Expectation of change in the price

- * Fear of scarcity
- * Goods that fulfill the basic necessities of life
- * expecting a change in income and fashion of the consumer.



The law of demand applies to food because there is both income and substitution effect that strengthens the requirements of each other (Doogan, 2013). When the price of a particular food increases, people switch on to equivalent food item or substitute products. For eg: when the price of food products increases, people may substitute home cooked food rather than going for restaurants (Economic Help, 2015). In the same way, the negative impact on the income will make people buy less of all food products. Thus both the concept sets a conclusion that the quantity demanded automatically decreases when the price increases.

1.b. Substitution effect that influences food prices:

When the price of a food item increases, people substitute such expensive foods with that of the other not so expensive foods. This shows that they substitute cheaper ones for the expensive ones. For example, the Australian Egg Corporation has warned in the earlier years that the price of eggs will rise by 50 to 60 cents a dozen. And as a result people opt for vegan diet (Cohen and Winn, 2007). Thus if the price of non-vegetarian food items increase, people may opt temporarily for vegetarian items.

The substitution effect is generally depicted by a graph where units of say Product A is on Y axis and Units of say Product B on Y axis (Economic Help, 2015). The demand curve is generally concave which means that the downward slope is initially high, then slight gets smaller as a result of increase of units of Product B along the Y axis. A consumer who is price sensitive will say for example will stop buying 4 units of Product A and replace the same with one unit of Product B (Economic Help, 2015). With the increase in such substitution, the quantity demanded of unit of Product B will gradually increase thereby smoothening the slope of the quantity demanded (Alhabeeb and J., 2012).

1.c. Income effect that influences food prices:

Food is one of the important requirements for the survival of a human being. So when there is an increase in the price of any food product, it apparently decreases people's income thereby reducing the quantity of food demanded (Kishtainy, 2012). People thus resort to cost cutting by various ways for example people may buy more of steaks instead of noodles. In the US, due to high priced food during certain times leads to a negative impact in the income and as such people will avoid going to restaurants thereby putting the restaurant owners in stake (Anjan, 2013). Most of the backward countries suffer during such situation of increase in food prices. During such situations, people either reduce their consumption of certain food products or in extremely backward countries, the rate of starvation increases (Cohen and Winn, 2007).

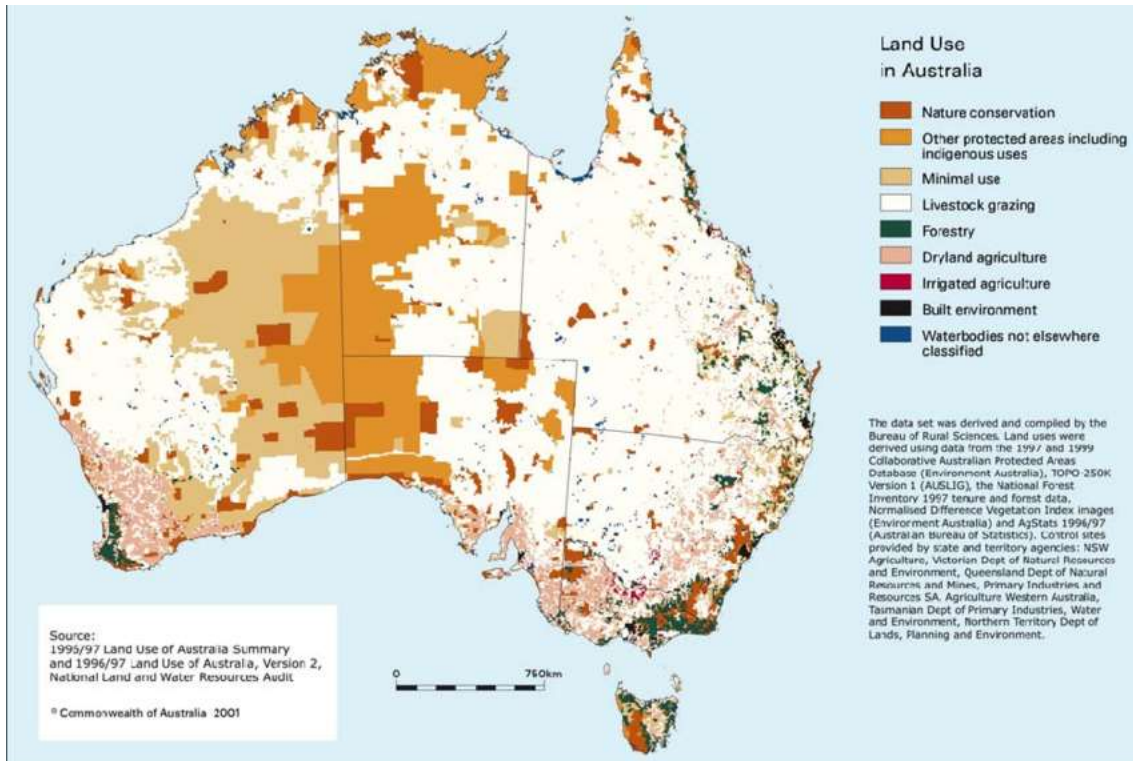
The purchasing power changes as a result of changes in the income pattern. The purchasing power increases due to decrease in price. Thus the concept of Marginal Propensity to consume explains how consumers generally spend based on their income. It is mentioned in Keynesian Economics which shows a comparison between production, an individual's income and their tendency to spend (Groenewegen, 2014).

This shows that irrespective of changes in the global market, the prices of food commodities will turn out to be volatile in the forthcoming days (Boyes and Melvin, 2010). Although the increased prices aggravates malnutrition, poverty and food

insecurity, measures are taken to do long term investment in agriculture to overcome all drawbacks and strengthen the reforms for an essential global food security.

Task 2.

2.a. Rising Land prices in the Metropolitan cities of Australia and its major drivers:

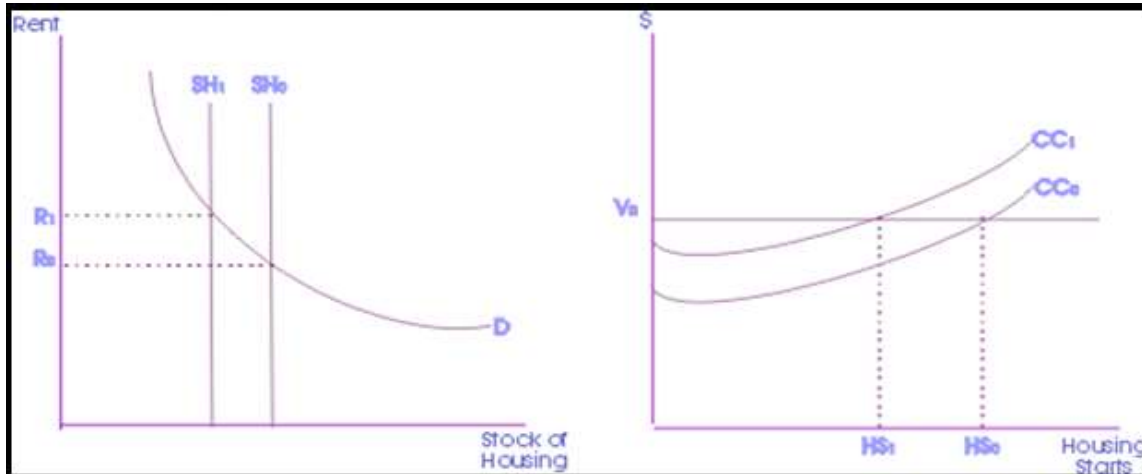


There is a tremendous change in the real estate market of Australia. According to HIA-Core Logic Residential Land Report 2018, the cost of the land holdings has increased by 2.2%. Sydney continued to be the most expensive market with a median lot priced at around \$450000 during the quarter (Financial Times, 2018). This led to increased sales of houses in Sydney for millions. The second most expensive is Melbourne, followed by Perth and Brisbane (Groenewegen, 2014).

One of the reasons for such increase is due to high investments from the foreign investors especially the Chinese. They always prefer Australia for their major investments and particularly, the real estate industry. Ms.Law has said that the buying enquiries from the

Chinese has increased by around 5.7% higher in March 2017 and around 22.3% higher in April 2017 (Boyes, 2011).

2.b. Diagram to support the above explanation:



The diagram shows the increase in the property prices in the Metropolitan Cities in Australia (Groenewegen, 2014). In the second diagram, we infer that the Reserve Bank of Australia has reduced its cash rate, which increased the construction cost from CC_0 to CC_1 (Moon, 2016). This as a result makes the land business development less profitable. Thus they have to be selective in choosing the land for development. The term survival of the fittest arises where some developers may leave the market unable to sustain the pressure. As a result, the quantity of supply of land automatically drops down from HS_0 to HS_1 (Doogan, 2013). The first diagram emphasizes the downward trend in the supply of a developed land from SH_0 to SH_1 . This eventually affects the price of the land available in the market and so the price of the land increases drastically (Groenewegen, 2014).

The RBA has maintained its cash rate at 1.5% irrespective of its weak inflation (Boyes, 2011). This is the reason for a steady growth of the economy as such. Irrespective of the housing credit growth declined to 5.5p.a%, the low interest rate is still managing to boost the Australian real estate industry (Fisher, 2007). Lending norms have become stringent for enforcing effective transactions. Major reports according to Foreign Investment

Review Board have put forward that in spite of the increase in the price of the land, there is 67% fall in the approvals for residential plots due to tighter lending norms amid the higher investor's appetite (Fisher, 2007).

2.c. Analysis of supply of land in Metropolitan cities to be perfectly inelastic

To know whether the supply of land in metropolitan cities is perfectly inelastic, it is necessary to understand the concept of price elasticity of demand (Doogan, 2013). It is nothing but the sensitivity of quantity demanded to that of various price alterations. The demand is said to be inelastic, if the price elasticity is less than one. The land which is supplied for development of a real estate property is taken as a quantity supplied at various price levels (Stengel, 2011). If it reflects an upward sloping curve, then it means that higher quantity is supplied at a higher price (Alhabeeb and J., 2012).

The Australian Government has brought stringent norms in its policies thereby restricting the availability of new land for development of housing. As a result it can be said that the supply of land is perfectly inelastic. The Government of Australia has to take measures for controlling the overall supply of land for real estate development in the country (Boyes and Melvin, 2010). To enhance further development, the Government can limit policies favouring the outer fringe of the city. Bob Birell, Monash University Professor has said that there was a continuous demand for detached housing in the outer areas of Melbourne's suburbs which was due to migration from overseas and interstate (Groenewegen, 2014).

With increase in prices of the land over the period, the median lot sizes of the plots are declining. As a result the sales volumes are also falling day by day (Alhabeeb and J., 2012). Thus the economists feel that it is not a healthier mix for enhancing the housing affordability in the country. Australia's growing population is said to have increased by 3, 88,000 in 2017, is seen to have a combination of more people and very less residential development (Cohen and Winn, 2007). If the current trend persists, then it would not be affordable for people to live in the country. Government's intervention is a key factor in the transformation of the country.

Task 3.

3.a. Australian Government's ban or planning to ban plastic shopping bags due to the rise of negative externalities:

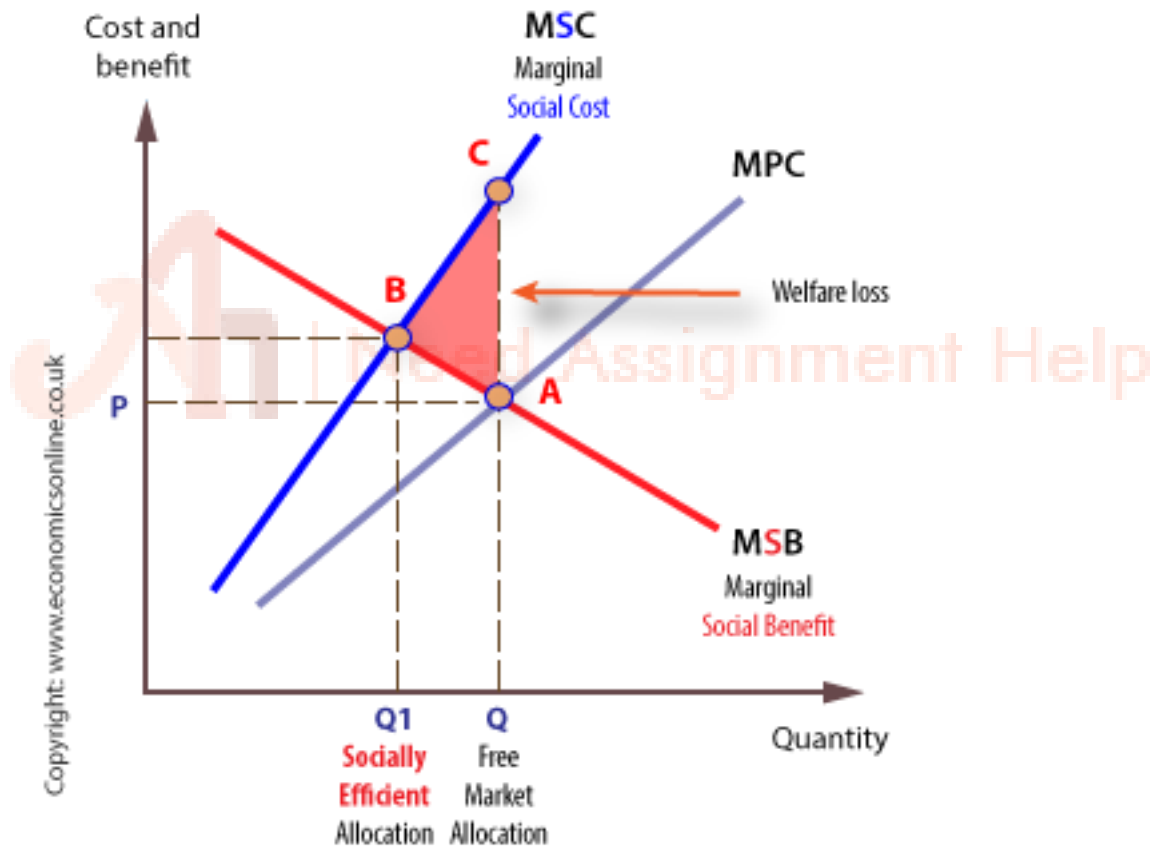


In any economic transaction, it is not only the producer and the consumer who are affected but there may also be a third party affected by the transaction (Arnold, 2010). The third party may be an individual or an organization. The spill over effects is called as externalities and a negative one is called as an external cost (Doogan, 2013). The massive usage of plastic bags and its production is as an example for bringing more negative externalities in the country (Economic Help, 2015). The plastic wastes inherent in the landfills poses a damage to the environment as such. Most of the industries emit the effluents in the nearby water bodies thereby making them unfit for use (Financial Times, 2018). The process of plastic incineration and harmful emission caused by it and the inefficiency on the management in failing to adopt effective recycling measures are examples for the negative externalities caused thereof (Moon, 2016). The companies are using heavy plastic bags because of the absence of any legislation for adopting an effective recycling infrastructure. The absence of proper market conditions for recycling input materials is also a major drawback. On an average, 130 kg of plastics are used in Australia every year. Out of which only 12% are recycled and up to 130000 tones are still dumped in the ocean and 85% of the Australian Sea birds are getting affected (Cohen and Winn, 2007).

Major awareness must be spread among the producers and consumers about the importance of plastic recycling (Groenewegen, 2014). The Government should also intervene to regulate its major policies with respect to the use of plastics. They can do so

by providing incentives for adopting the process of recycling plastics, which can in turn generate more job opportunities, major cost saving in the fuel and would yield long term sustainability (Economic Help, 2015). The Government can provide subsidies to promote research in the recycling industry. This is because the recycled materials can be used as an input for the manufacturing process. The Government can also encourage the use of eco friendly products thereby replacing plastics.

3.b. A Graph depicting the rise of welfare loss due to the usage of plastic containers:



MSC stands for Marginal Social Cost

MPC stands for Marginal Private Cost

MSB stands for Marginal Social Benefit (Cohen and Winn, 2007)

The above graph shows that welfare loss is an end result of consuming plastic bottles. Thus it can be said that negative externalities are due to the consumption of such plastic bottles (Alhabeeb and J., 2012). If $MSB=MSC$, then the market is said to be in an equilibrium position, that is no profit or no loss. The triangle marked in red color depicts the welfare loss (Economic Help, 2015). This is because of the divergence between MPC and MSB. From this, it is clearly inferred that the once a ban is imposed on the plastic bottles in Australia, it can gradually reduce the usage of such plastic bottles and also the market price will eventually come down. This will bring back the market to an equilibrium position. The welfare loss is also called as dead weight loss (Economic Help, 2015).

When a negative externality takes place in an unregulated market, the producers don't take the responsibility of the external costs as these are passed on to the society. While the factory pays for the electricity, materials etc, the people around the factory pays for medical expenses, poor quality of life etc due to usage of such plastics and the various plastic effluents in the surrounding areas (Cohen and Winn, 2007). The easier way to solve the negative externality is to tax the producer the actual amount of negative externality caused thereof (Boyes, 2011).

The latest records shows that the cost of living in Australia has rose to around 2% in the recent years. This has depicted as an epitome for the strong and steady rate of growth in its history in the last 3.5 years (Groenewegen, 2014). This has in turn reinforced immense pressure on the income earners.. Sydney which is referred as the most expensive city in Australia has risen to number 32 in the year's Cost of Living Index from 41 in the previous year (Groenewegen, 2014). Experts say that irrespective of the strongest growth in GDP and low inflation rates, the people are still struggling to cope with the cost of living. Australia is working towards introduction of reusable containers and the customers are encouraged to bring their own ones (Economic Help, 2015). The above reforms will contribute towards a healthy development of the country as such.

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