

# Entrepreneurship

## Lecture # 4



Saltanat Kondybayeva, PhD

Topic 4.

# The basic agents of economic activity

# PLAN

- 1. The role of an agent in economy**
- 2. Households**
- 3. Firms (Producers)**
- 4. Government and Central Bank**
- 5. Circular Flow Model**

# The role of an agent in economy

an **agent** is an actor and more specifically a decision maker in a model of some aspect of the economy. Typically, every agent makes decisions by solving a well or ill-defined optimization or choice problem.



# Economic Agents

- Economic agents are participants in the economy that engage in specialization, production, exchange, and consumption. There are two economic agents:
  1. Producers
  2. Consumers
- Government is also consider as economic agent.

# The main types of agents in the economy

- **Households**
- **Firms**
- **Governments**
- **Central Banks**

# Households

All those people living under one roof are considered a household.

Households do two fundamental things vital to the economy.

1. Demand goods and services from product markets
2. Supply labor, capital, land, and entrepreneurial ability to resource markets.

Economists think of each household acting as a single decision-maker.

# Role of Households

- **Act as a producer**
- **Act as a consumer**
- **Act as a tax-payer**
- **Act as a professional**
- **Act as a saver**



# Firms

A firm is a business organization, such as a corporation, limited liability company or partnership, that sells goods or services to make a profit.

The title "firm" is typically associated with business organizations that practice law, but the term can be used for a wide variety or business operation units, such as accounting. "Firm" is often used interchangeably with "business" or "enterprise."

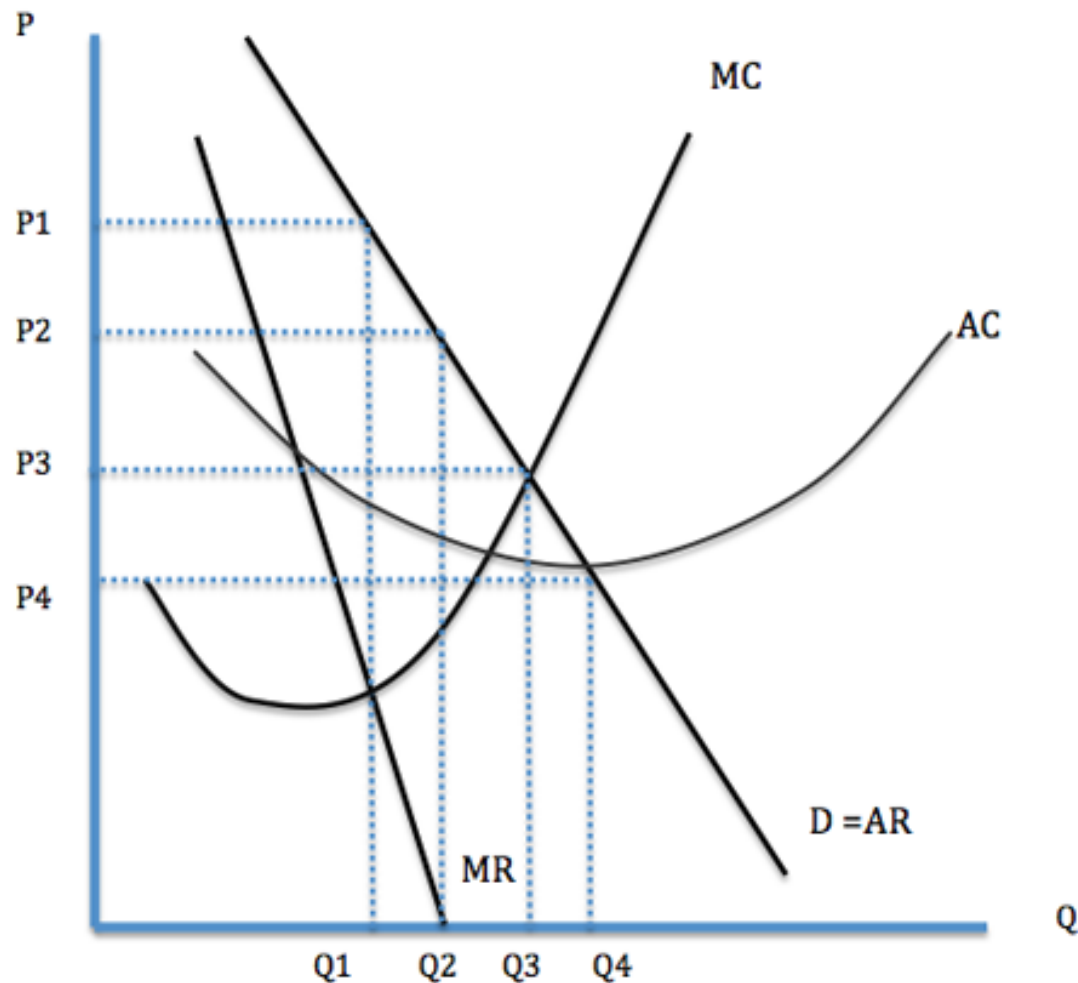
# Firms use four different basic types of resources in productive activities:

- Natural resources: taken directly from nature without previous transformation (land, air, water, wood, etc.).
- Capital: funds needed to invest in tools, machinery, equipment, technology.
- Human resources: physical and intellectual capabilities of the workers.
- Entrepreneurship: the innovative ideas that shape the business model.

# The main objectives of firms are:

- Profit maximisation
- Sales maximisation
- Increased market share/market dominance
- Social/environmental concerns
- Profit satisficing
- Co-operatives

# Diagram showing different objectives of firms



- Q1 = Profit maximisation (MR=MC)
- Q2 = Revenue Maximisation (MR=0)
- Q3 = Marginal cost pricing (P=MC) – allocative efficiency
- Q4 = Sales maximisation – maximum sales while still making normal profit (AR=ATC)

# Government

A group of people that governs a community or unit. It sets and administers public policy and exercises executive, political and sovereign power through customs, institutions, and laws within a state. A government can be classified into many types- democracy, republic, monarchy, aristocracy, and dictatorship are just a few.

# The economic functions of a government

- Protection of private property and maintaining law and order / national defence.
- Raising taxes.
- Providing public services not provided in a free market (e.g. health care, street lighting)
- Regulation of markets, e.g. regulations on environment / labour markets / monopoly.
- Macro-economic management, e.g. use of fiscal and monetary policy to control business cycle – recession and inflation.
- Reducing inequality / poverty.

# Economics of Government Intervention

Government intervenes in the market for two reasons

## Efficiency

Making the optimum use of scarce resources

Addressing market failures to create Pareto improvements

Non-political: doesn't make value judgement on what is right

## Equity

An 'efficient' distribution may involve considerable inequalities

Redistributing resources to offset inequality

Political: involves democratic judgement on what is 'fair'

<b>Basis</b>	<b>Central Bank</b>	<b>Commercial Banks</b>
<b>Meaning</b>	Central Bank is the banker of all the banks. It is an apex body.	Commercial banks operate under the control of Central Bank. It is an individual unit.
<b>Control on money supply</b>	Central Bank controls the flow of credit within the economy.	Commercial banks create credit within the economy.
<b>Objective</b>	The objective of Central Bank is social welfare.	The objective of commercial banks are profit maximisation.
<b>Function</b>	It is the banker to the government.	Commercial banks are bankers of the common public.
<b>Custody of foreign exchange</b>	Central Bank is the custodian of nation's foreign exchange reserve.	A commercial bank is not the custodian of foreign exchange reserve.
<b>Currency issue</b>	Central Bank has the authority to issue currency.	A commercial bank does not have such rights.



# Central Bank

A central bank or monetary authority is a monopolized and often nationalized institution given privileged control over the production and distribution of money and credit.

In modern economies, the central bank is usually responsible for the formulation of monetary policy and the regulation of member banks.

# Monetary policy tools

- First, they set a [reserve requirement](#). That tells their network of private [banks](#) how much cash to have on hand each night. That controls how much banks can lend.
- Second, they use [open market operations](#) to buy and sell securities from member banks. It changes the amount of cash on hand without changing the reserve requirement.
- Third, they set targets on [interest rates](#) they charge their member banks. That guides rates for loans, mortgages, and bonds. Raising interest rates slows growth, preventing [inflation](#). That's known as a [contractionary monetary policy](#).

# GOVERNMENT'S BANK

Exchequer Account and National loans fund

**LENDER OF THE  
LAST RESORT**

**ISSUING OF  
CURRENCIES AND COINS**

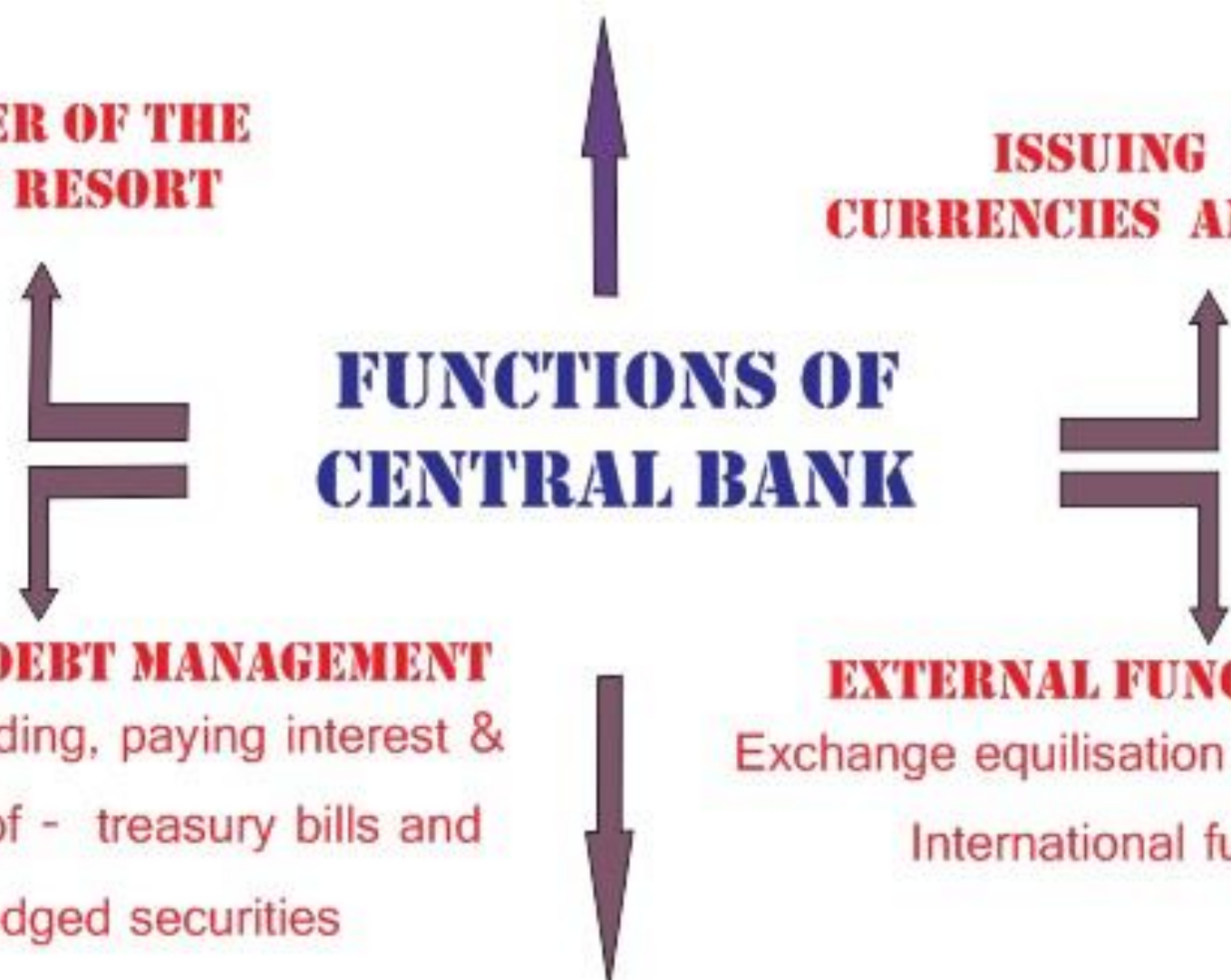
## **FUNCTIONS OF CENTRAL BANK**

**NATIONAL DEBT MANAGEMENT**

Issuing, recording, paying interest &  
redemption of - treasury bills and  
Guilt edged securities

**EXTERNAL FUNCTIONS**  
Exchange equilisation account and  
International funds

**BANKERS BANK**



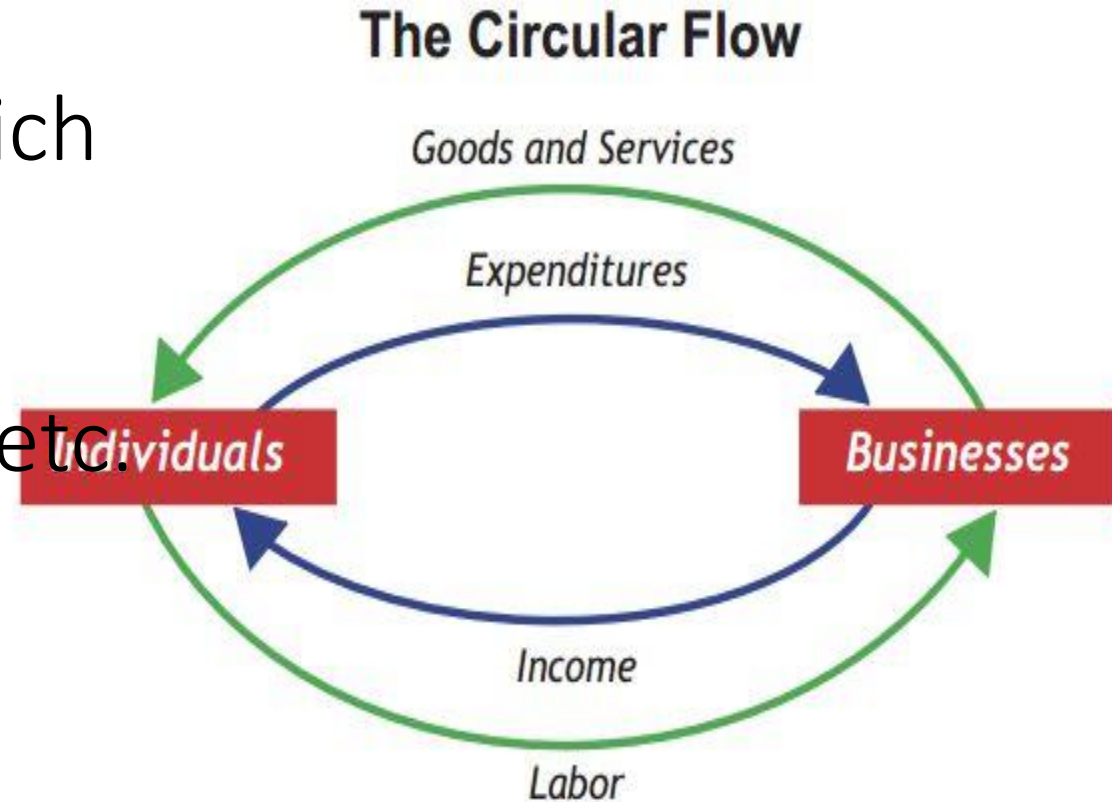
## Circular flow

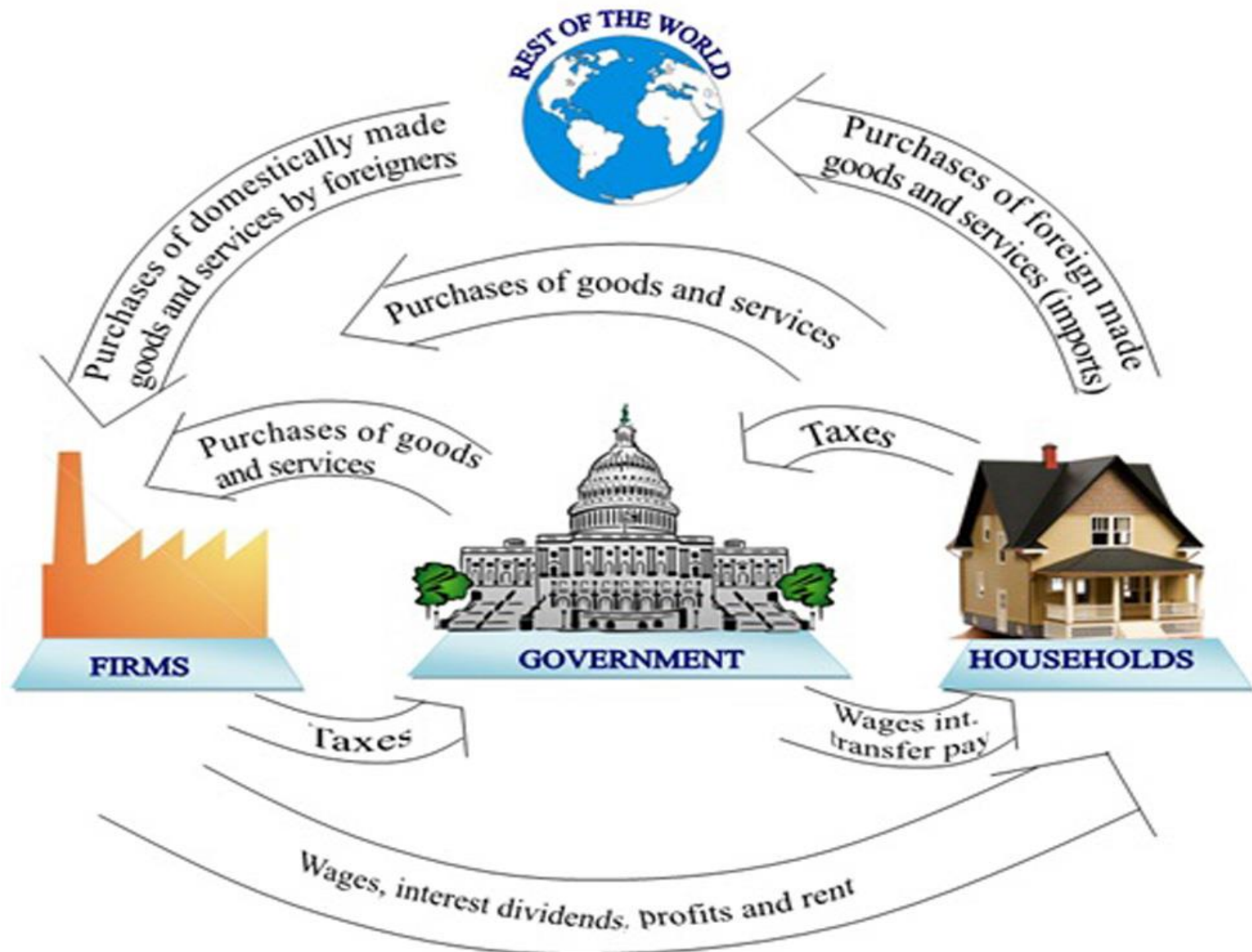
In a market economy households provide resources and labor and purchase goods and services while firms provide goods and services and purchase resources and labor. You can view the relationship between households and firms as a "circular flow"

# Market System – Circular Flow



The **circular flow of income** or **circular flow** is a model of the economy in which the major exchanges are represented as flows of money, goods and services, etc. between economic agents. The flows of money and goods exchanged in a closed circuit correspond in value, but run in the opposite direction.





# Types of Circular Flow Model

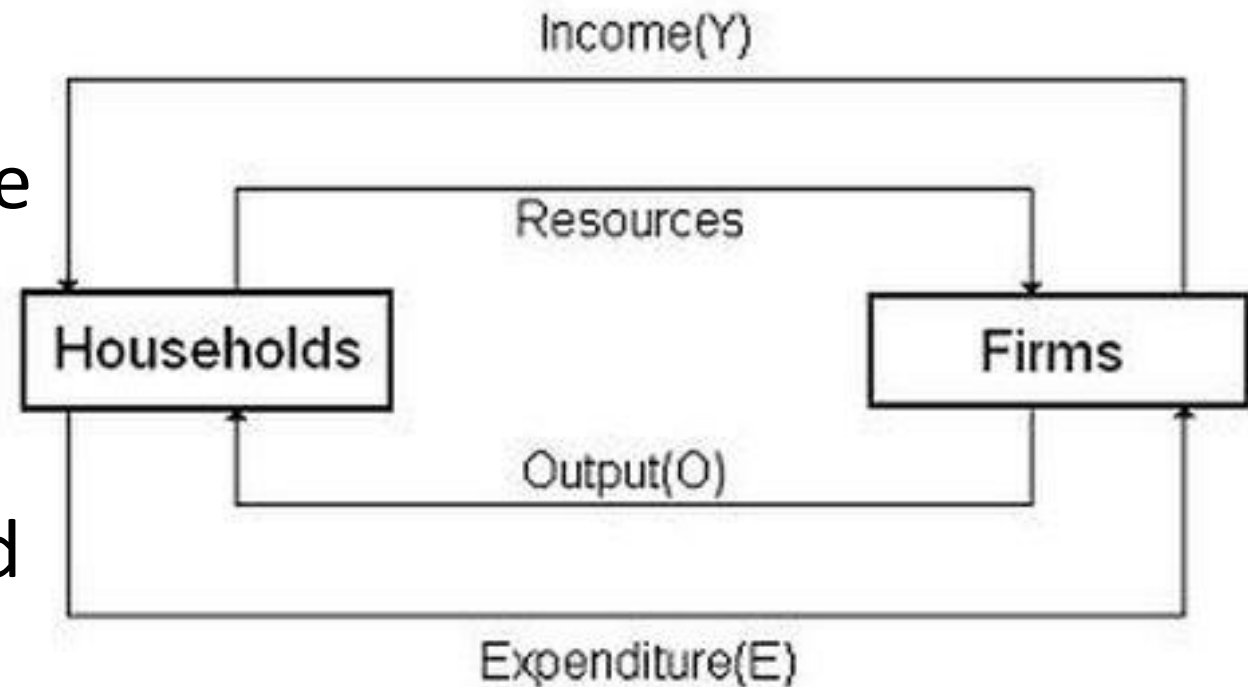
- **Two sector model**
- **Three sector model**
- **Four sector model**
- **Five sector model**



# Two sector model

In the basic circular flow of income, or two sector circular flow of income model, the state of equilibrium is defined as a situation in which there is no tendency for the levels of income (Y), expenditure (E) and output (O) to change, that is:

$$Y = E = O$$



# This basic circular flow of income model consists of six assumptions

- The economy consists of two sectors: households and firms.
- Households spend all of their income (Y) on goods and services or consumption (C). There is no saving (S).
- All output (O) produced by firms is purchased by households through their expenditure (E).
- There is no financial sector.
- There is no government sector.
- There is no foreign sector

# Significance of study of circular flow of income

- Measurement of National Income - National income is an estimation of aggregation of any of economic activity of the circular flow. It is either the income of all the factors of production or the expenditure of various sectors of economy. However, aggregate amount of each of the activity is identical to each other.
- Knowledge of Interdependence - Circular flow of income signifies the interdependence of each of activity upon one another. If there is no consumption, there will be no demand and expenditure which in fact restricts the amount of production and income.
- Unending Nature of Economic Activities - It signifies that production, income and expenditure are of unending nature, therefore, economic activities in an economy can never come to a halt. National income is also bound to rise in future.
- Injections and Leakages