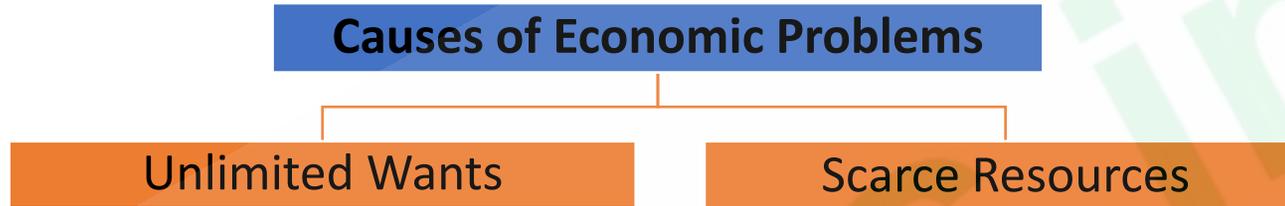


Basic Concept of Economics and introduction to Micro Economics

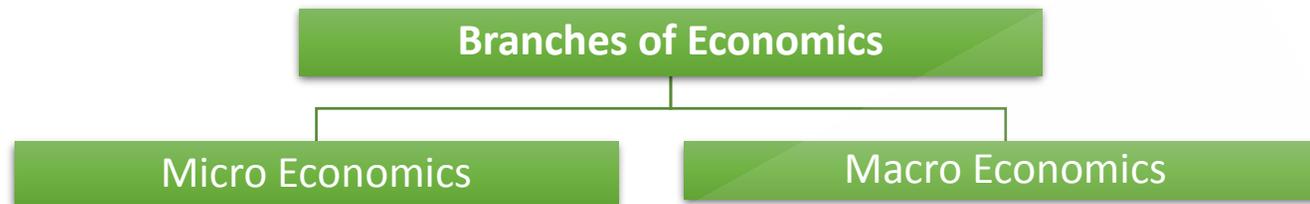
- The term '**Economics**' owes its origin to the **Greek** words **Oikos** meaning **household** and **nomos** meaning **management** = '**Household Management**'.
- **Economics General Definition:** The study of how individuals, Governments, Business and Other Organizations make choices that effect the allocation and distribution of scarce resources.



➤ **Definitions of Economics:**

Type of Definition	Wealth Definitions	Welfare Definitions	Scarcity Definitions	Growth Definitions
Parameters	(Science of Wealth) Given by Classical Economists	(Science of Material Well-Being) Given by Neo Classical Economists	(Science of Choice Making)	(Science of Dynamic Growth and Development)
Definitions/ Statements	1. "Economics is a science which inquiry into the nature and causes of the wealth of the nations": Adam Smith (Father of Economics) 2. "Science which deals with wealth": J.B. Say	1. "Economics is the study of man in the ordinary business of life": Alfred Marshall 2. "The range of our inquiry becomes restricted to that part of social welfare that can be brought directly or indirectly into relation with the measuring rod of money": A.C. Pigou	"Economics is the science which studies human behaviour as a relationship between ends and scarce means which have alternate uses": Lionel Robbins	1. "Economics is the study of how men and society choose, with or without the use of money, to employ scarce productive resources which could have alternative uses, to produce various commodities over time and distribute them for consumption now and in the future amongst various people and groups of society": Paul A. Samuelson. 2. Economics is the "study of how in a civilized society one

				obtains the share of what other people have produced and of how the total product of society changes and is determined.”: Henry Smith. 3. “Economics is what Economists do.”: Jacob Viner
Features	1. Creation of wealth is very important problem 2. Problems of poverty and unemployment can be solved with the help of money.	1. Study of wealth and man both 2. Social Welfare	1. Economics is a science. 2. Unlimited ends (i.e. Unlimited wants) 3. Scarce means. 4. Alternative use of means or choice.	
Criticism	1. Ignored creation of immaterial wealth like services of doctors and CAs. 2. Ignored Social welfare.	1. Ignored creation of immaterial wealth like services of doctors and CAs. 2. Very difficult to state the word ‘welfare’.	1. Concept of welfare not explicitly mentioned. 2. The definition makes economics a human science instead of social science. 3. Narrow definition, doesn’t talk about growth & development. 4. Rational decision making requires that one’s choice be consistent with one’s goals. 5. Failed to explain what is good or bad for society’s welfare and what should be done to attain good ends.	



Difference Between Micro and Macro Economics

Basis	Micro Economics	Macro Economics (Aggregate Economics)
Term derived from	Greek word ' mikros ', meaning " small "	Greek word ' makros ' meaning " large "
Popular Definition	"Microeconomics is the study of particular firms, particular households, individual price, wages, income, individual industries and particular commodities.": Prof. Boulding	"Macroeconomics examines the forest and not the trees. Thus, it analysis and establishes the functional relationship between large aggregates": Mc Connel
Also called	Price Theory	Income Theory
Study of	Individual economic units	Economics as a whole and its aggregates
Deals with	Individual income, individual prices and individual output etc.	National Price level, national output etc.
Tools	Main tools are demand and supply of a particular commodity .	Main tools are aggregate demand and aggregate supply of the economy as a whole.
Central Problem	Price determination of commodities or factors of production.	Determination of level of income and employment
Prices	Price determined under this are called ' relative prices '.	Price determined under this are called ' absolute price '.
Type of Analysis	It is a partial equilibrium analysis .	It is a general equilibrium analysis .
Scope	It is narrow in scope.	It is wider in scope
Examples	1. Lockout in TELCO 2. Finding the Causes of TATA NANO	1. Per Capita Income 2. Unemployment Level in country

Is Economics a Science or an Art?

Economics is a Science because:	Economics is an Art because:
<ol style="list-style-type: none"> 1. It has cause and effect relationship for e.g. Law of demand. 2. It is capable of measurement in terms of money. 3. It has its own methodology of study (induction and deduction) 4. It forecasts the future market condition with help of various statistical and non-statistical tools. <p>But Economics is not a perfect science because:</p> <ol style="list-style-type: none"> 1. It doesn't have uniform opinion about a particular event. 2. The subject matter of economics is 'Human Behaviour' which is highly unpredictable. 3. Money, which is measurement of economy, is itself a dependent variable. 4. It is not possible to make correct predictions about the behaviour of economic variable. 	<p>It provides practical solution of various economic problems we face in our day to day life.</p> <div style="text-align: center;">  </div>
<p><u>Conclusion:</u></p> <p>Economics is both a science and an art. It is science in its methodology and art in its application</p>	

Economics as Positive Science or Normative Science

Basis	Economics as a Positive Science	Economics as a Normative Science
<i>(Definition/ Related Important Statements)</i>	Seeks to understand behaviour without making judgement about outcomes. “Economics is neutral between ends.”: Robbins	Analyses outcomes of economic behaviour, evaluate them as good or bad, and sometimes prescribes a course of action.
<i>Advocated by:</i>	Adam Smith, Robbins etc.	Marshall, Pigou, Hicks etc.
<i>Based on</i>	Causes and effects of facts.	Ethics.
<i>Deals with</i>	Actual or realistic situation and how an economic problem is solved.	Idealistic situation and how an economic problem should be solved.
<i>Value Judgements</i>	Are not given.	Are given.
<i>Examples by statements</i>	Disposable income has declined by 15% over the past four years: Positive Economic Statement.	The minimum wage should be raised by 20%.: Normative Economic Statement

Note: Thus, Economics is both positive science and normative science.

Methods of Study Economics

Deductive Method

Inductive Method

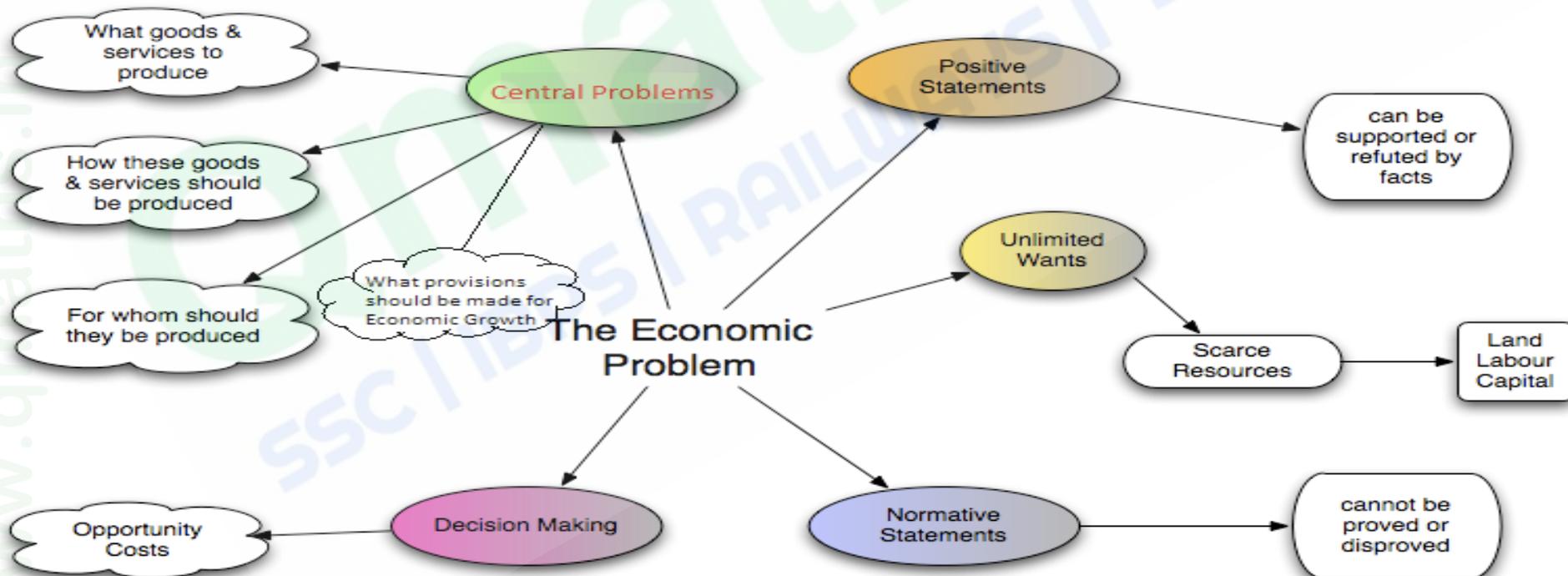
Differences between Deduction and Induction Method

Basis	Deduction Method	Induction Method
What is this?	Deduction method is the process of reasoning from general to particular or universal to individual . This method is called abstract, hypothetical or a priori because it is based on abstract reasoning and not on actual facts.	Induction method is the process of reasoning from particular to general or from individual to the universal . The generalizations are based on observation of individual instances.
How it work?	Conclusions and generalisations are drawn based on certain fundamental assumptions or accepted axioms or truths which have been established and handed down from generations to generations.	Conclusions are drawn based on collection and analysis of facts relevant to the inquiry.
Process of reasoning	From general to particular	From particular to general
Advocated by	Classical economists	Modern economists
Suitability	More suitable when facts and data are not available.	More suitable when facts and data are available.
Merits	It is simple method. It leads to definite and clear conclusion. It is free from bias. It is helpful in comprehending economic objectives.	Conclusions drawn by this method are more real. People's attention is paid to the complexities of economics features. Its approach is dynamic. Precise, exact and measurable conclusions.
Demerits	Correct conclusions cannot be drawn for wants of real facts. It is not easy to prove the conclusion drawn by this method. Many of assumptions are unrealistic. It is static approach.	Scope of tis examination is limited. It is complex method. There is possibility of bias under this method. Hurried conclusion can be drawn.
Example	Inverse relationship between price and demand. Direct relationship between price and supply.	Relationship between income and consumption. Factors determine Investment and savings.
<p>“Induction and deduction are both needed for scientific thought as the right and left foot are both needed for walking”: Alfred Marshall</p>		

Central Problems of Economics

Human wants are unlimited and productive resources are scarce. An economy without scarcity is not found in the real world. **All wants cannot be satisfied with the scarce productive resources**, so problem of use of scarce resource arise. This is generally called **‘the central economic problem’**. The central economic problem may be of four types:

What to produce	How to produce	For whom to produce	What provision should be made for economic Growth
Human wants are unlimited and resources are limited. To satisfy human wants, the question arises, “what goods are to be produced and in what quantity these goods to be produced”.	This problem is related to the choice of technique for producing a commodity. An economy has to choose between Labour Intensive and Capital Intensive Techniques . (A labour surplus economy will choose labour intensive technique and a capital surplus economy will choose capital-intensive technique.)	Problem of “for whom to produce” means how the national product i.e., national income is to be distributed among the factors of production that helped to produce it. This determine the distribution of goods among the various individuals in the society.	A society would not like to use all its scarce resources for current consumption only. It has to decide how much saving and investment should be made for future progress. Increase in the current level of consumption provides slower economic growth in the future. Larger production of capital goods would lead to higher production in future.

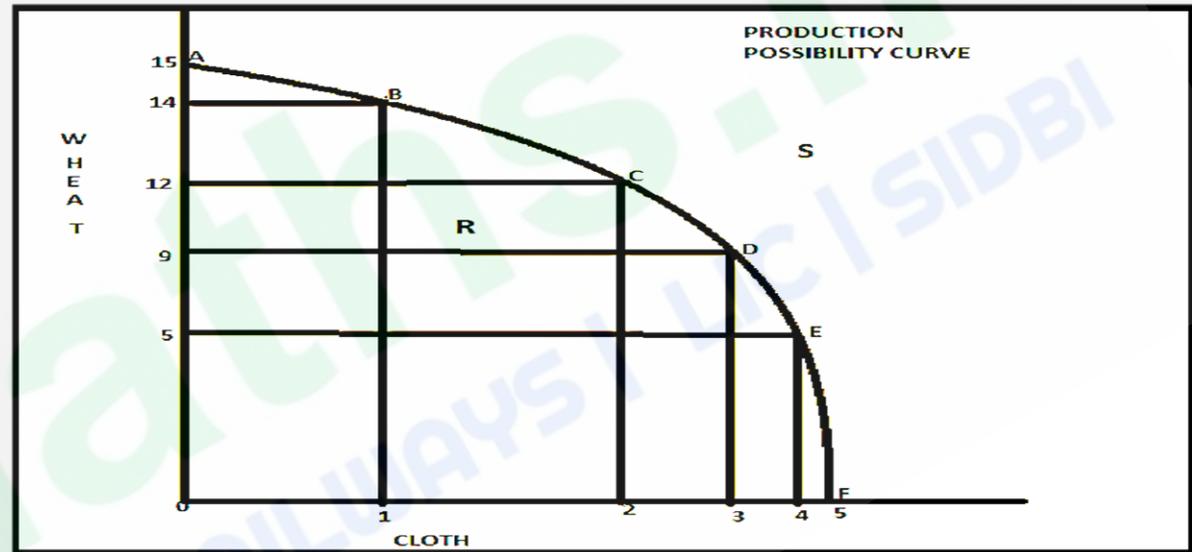


Production Possibility Curve (PPC) (Also known as Production Possibility Frontier (PPF) and Transformation Curve)

Production Possibility Curve may be defined as a curve which shows the various combinations of two goods that can be produced in any economy with a given amount of resources and technology.

To understand PPC, let us assume that there are two types of goods-wheat and cloth which are to be produced. We also assume that (1) there is a given amount of productive resources and they remain fixed, (2) resources are neither unemployed nor underemployed and (3) technology does not change. It is also assumed that the resources of economy can be alternatively used in both the commodities. Now consider the following table and Graph:

Production Possibilities	Cloth	Wheat	Increasing Opportunity cost
A	0	15	-
B	1	14	1
C	2	12	2
D	3	9	3
E	4	5	4
F	5	0	5



From the above table and figure, it is clear that when production of cloth increases then production of food decreases and it will give concave shape to PPC because opportunity cost is increasing.

PPC and Productive Efficiency

All points on PPC curve like A, B, C, D, E and F show that goods and services produced at least cost and no resources are wasted and the economy is **'Productively Efficient'**

Opportunity Cost and PPC

Opportunity cost may be defined as the value of the next best alternative. It is also called **'Foregone cost'** and **'Trade off'**. In the context of PPC since there are only two goods, therefore opportunity cost of producing one good is in terms of sacrifice made of the other good. PPC is downward sloping because more production of one good is associated with less of the other good.

Shape of PPC

Concave to the Origin due to Increasing marginal opportunity cost.

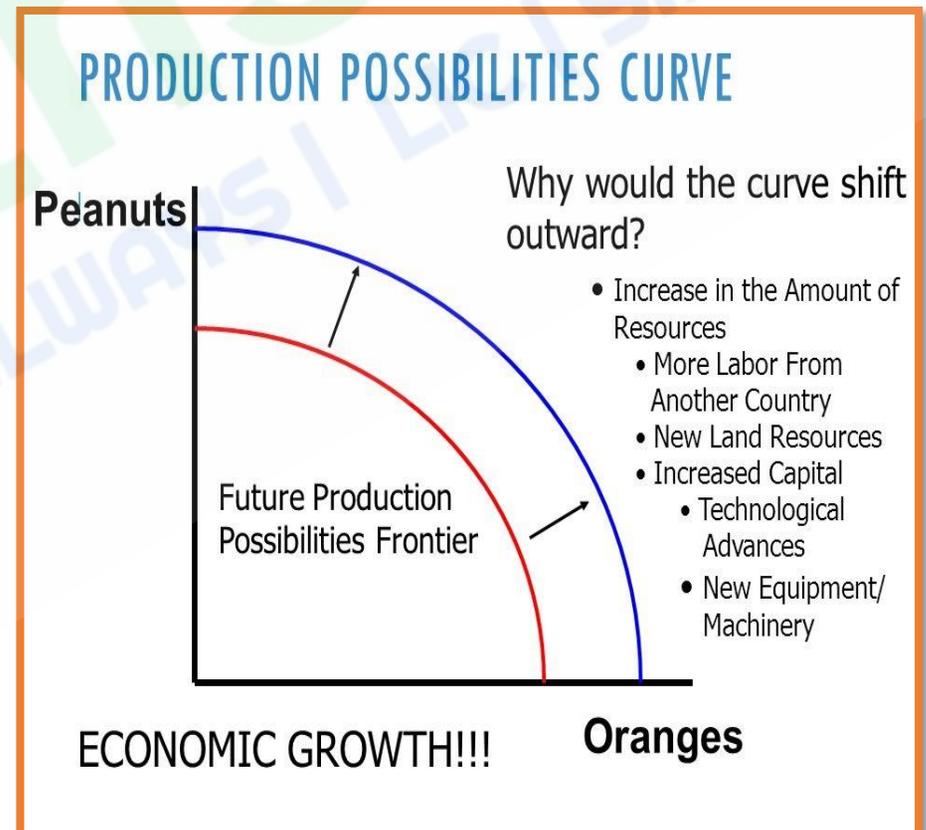
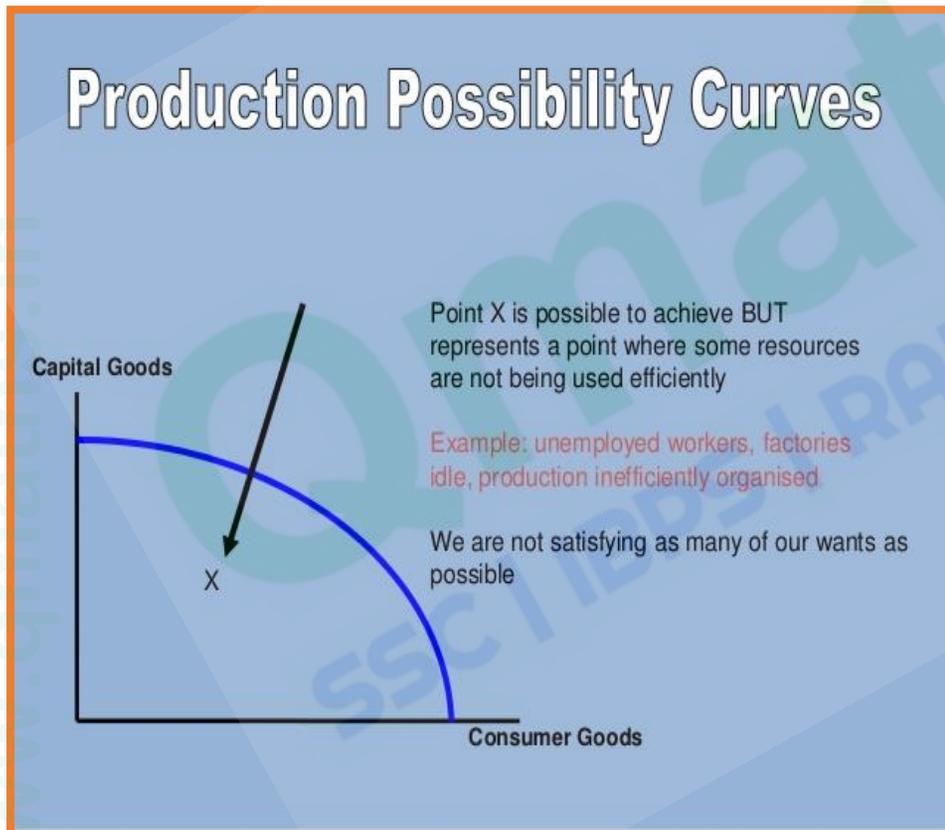
The increasing marginal opportunity cost means that for additional unit of a good, the sacrifice of unit of other good goes on increasing. Principle of increasing opportunity cost that make the PPC concave to the origin or make bowed-out shape. **PPC may be straight line if opportunity cost is constant.** Actually, PPC is negative sloped not due to increasing opportunity cost **but due to 'scarcity'** because at any point of time we have limited resources.

Unemployment and PPC

When an economy produces on PPC, it means that there is no unemployment and all the resources are being used efficiently. But if an economy operates inside the PPC then there is unemployment or underemployment and/or inefficient use of resources.

Economic Growth and shift in PPC

When an economy produces at PPC curve it is 'productively efficient'. But there is also scope of progress and one PPC can **shift to another PPC on the right, it indicates Economic Growth.**



Economic Systems

It refers to the mode of production, exchange and distribution of goods and services in a society and the role which Government plays in economic activities. Based on these we divide all the economies into three broad classifications which are:

Economic Systems	Capitalist Economy	Socialist Economy	Mixed Economy
Characteristics			
Definition	An economic system in which individuals own and operates all factors of production.	An economic system in which government own and operates all factors of production.	An economic system in which both individuals and government own and operate factors of production.
Also known as	Market Economy Free Enterprise Capitalism Private Enterprise System	Socialist Economy (Erstwhile USSR) Communist Economy (China Pre-1985) Centralised Economy Centrally Planned Economy Non-Market Economy	
Role of Government	Little and no role of government	Decides all economic activities	Government creates laws and regulates business activities.
Freedom of Choice	Consumers and Producers have freedom of choice.	No freedom of choice.	Limited freedom of choice given government controls.
Ownership of natural resources	Private Sector	State/Public Sector	Both public and Private Sector
Price Determination	Price mechanism system determines price	Government sets price	Price mechanism system but regulated by government.
Main Features	<ol style="list-style-type: none"> 1. Right to Private Property 2. Freedom of Enterprise 3. Freedom of choice by consumer 4. Profit Motive 5. Competition 6. Price Mechanism 	<ol style="list-style-type: none"> 1. Collective ownership of means of production 2. Centrally planned economy 3. Economic equalities. 4. Social welfare 5. Lack of competition 6. Elimination of exploitation 	<ol style="list-style-type: none"> 1. Coexistence of both private and public sectors 2. Planned Economy 3. Balanced regional development 4. Dual system of pricing

	7. Inequalities of Income		
Merits	<ol style="list-style-type: none"> 1. New varieties of goods 2. High standard of living 3. Benefits of Price mechanism 4. Maximum efficiency of production 5. Liberty and freedom 6. Maximum satisfaction of consumers 7. Right to private property 8. Initiative and enterprises 9. Growth of business 	<ol style="list-style-type: none"> 1. Equitable distribution and equal opportunity 2. Better utilisation of resources 3. Wastage avoided through economic planning 4. Economic stability 5. Co-operative mentality and avoids class war 6. Ensures right to work and minimum standard of living 7. Protected from the exploitation 	<ol style="list-style-type: none"> 1. Merits of both capitalism and socialism 2. Protects individual's freedom 3. Role of price mechanism 4. Reducing the inequalities and class struggle 5. Centrally planned economy 6. Useful for underdeveloped countries 7. Rapid and balanced economic development
Demerits	<ol style="list-style-type: none"> 1. Rich and poor class 2. Welfare ignored 3. Economic instability 4. Wastage of money on advertisements etc. 5. Employer-employee class conflict 6. Strikes and lock-outs 7. Resources used for luxuries 8. Formation of monopolies 9. Insecurity of employment 	<ol style="list-style-type: none"> 1. Predominance of bureaucracy, corruption and favouritism 2. Restriction on freedom 3. No right of private property 4. Absence of profit earning and No incentive for hard work 5. State monopolies become uncontrollable 6. No proper allocation of resources 7. No freedom of choice 8. Pure socialism is not practicable 	<ol style="list-style-type: none"> 1. Difficult to adjust the private and public sector 2. Excessive control and heavy taxes 3. Discourage to private sector 4. Problem of favouritism and officialdom <p>5. According to Schumpeter, mixed economy is 'Capitalism in the oxygen tent'.</p>
Examples	USA in around 1800	Erstwhile USSR & Pre-1985 China	Most of the economies in the world (including India) at present are examples of Mixed Economies.