

MICRO ECONOMICS

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UNIT – 1 INTRODUCTION

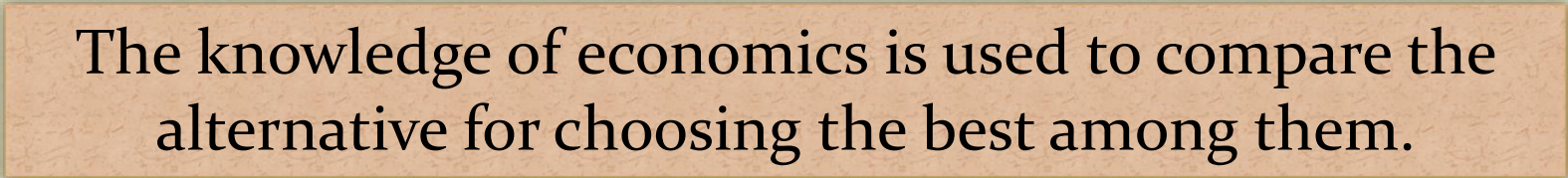
- Economics – Scope and Subject matter.
- Distinction between economics & business economics.
- Tool required – Functional relationship, Schedules, Graph , Concept of Slope and its measurement - etc.
- Resources – Scarcity and Efficiency .

INTRODUCTION

- Economics is the science that deals with production , exchange and consumption of various commodities in economic system.



Why to study economics ?



The knowledge of economics is used to compare the alternative for choosing the best among them.

alternative for choosing the best among them.

INTRODUCTION

- ❑ Emergence of economics (2 major factor)
 1. The existence of **unlimited human wants**.
 2. The **scarcity of available resources**.
- ❑ Economics deals with how the numerous human wants are to be satisfied with limited resources .
- ❑ It does not only covers the decision making behaviour of Individual but also the macro variables of economics like Public finance , International trade etc.

Definition of Economics

Economics was derived from two Greek words-

oikos (a household)

Nemein (to manage)

Which would mean “ **managing an household** ” using the limited resources in most satisfactory manner.

Definitions of Economics

Different Economist have explained **different meanings & Subject matter of economics.**

1. Definition related to **wealth.**
(**Classical economist view**)

2. Definition related to **welfare.**

3. Scientific definition or **scarcity** definition.

4. Definition related to **growth.**

➤ Definition related to wealth

- Propounded by Adam Smith, J.B. Say, Seneior, Walker.
- Adam Smith (Father of economics) in his book “**An ENQUIRY INTO THE NATURE AND CAUSES OF WEALTH OF NATIONS**” in 1776 in which
- He explained economics as “the great object of political economy of every country is to increase the riches and power of that country”
- F.A. Walker says that “Economics is the body of knowledge which is related to wealth”
- Seneior “the subject treated by political economics is not happiness but wealth.
- J.B.Say “Economics is science which deals in treat of wealth.

Definition related to **wealth**

- Criticism – All definitions are only in terms of wealth not in terms of human welfare .

However wealth is considered only to be a mean to end ,
the end being the human welfare

Hence wealth definition was rejected and emphasis was
shifted from wealth to welfare .

➤ Definition related to welfare

- Propounded by Marshall , Pigou , Cannon.
- Alfred Marshall (1842-1924) wrote a book “PRINCIPLES of ECONOMICS” in which he defined Political economy or economics is a study of mankind in the ordinary business of life .
- Marshall makes distinction between two things
Material things (as book, rice)
Immaterial things (as skill)

In his definition Marshall considered only the material things that are capable of promoting welfare of people.

Definition related to **welfare**

Criticism – Marshall considered only material things but immaterial things such as

Service of a doctor, a teacher and so on also promote welfare of the people.

Marshall definition is based on the concept of welfare but there is no clear definition of welfare .

The welfare of an individual or nation is dependent not only on the stock of wealth possessed but also on political , social & cultural activities of people.

Scientific definition or **Scarcity** centred definition

- Propounded by L.Robbins , P. Wickseed , G.J.Stigler
- Robbins in his famous book “ **Nature and significance of economic Science**”, he argued that Economics studies the problem which have arisen due to the law scarcity of resources .
- 4 basic proportions of Robbins definition-
 - Human wants are unlimited
 - Resources are limited to satisfy human wants
 - The scarce means at our disposal are capable of being put to alternative uses
 - Wants can be put into different categories on the basis of their intensity.

Scientific definition or **Scarcity** centred definition

Criticism –

- a) Robbins does not make any distinction between goods conducive to human welfare & goods that are not conducive to human welfare . (eg production of rice & production of alcoholic drinks)
- b) In economics we also study about macro economic aspect like how national income is generated but Robbins has reduced economics merely to theory of resource allocation .
- c) Robbins definition does not cover the theory of economic growth and development .

Definition related to **growth**

- Propounded by prof. paul samuelson .
- Prof. Paul samuelson defined Economics as
**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 among various people and group of society.**

Definition related to **growth**

- The major implications of this definition
 - a) Samuelson has made his definition dynamic by including the element of time in it, therefore it covers the theory of economic growth.
 - b) Samuelson stressed the problem of scarcity of means in relation to unlimited ends . Not only the means are scarce , but they could also be put to alternative uses.
 - c) The definition covers various aspects like production , consumption and distribution.

So above all definition growth definition appears to be most satisfactory.

SCOPE OF ECONOMICS

- Scope means province or field of study.
- According to Keynes following aspects are covered under the scope of the scope of economics :-
 - i. **Subject matter** of Economics
 - ii. **Nature** of Economics
 - iii. **Limitations** of Economics.

Scope of Economics

Subject matter

Traditional approach

- Consumption
- Production
- Exchange
- Distribution
- Public Finance

Modern approach

- Micro economics
- Macro economics

Nature

Science

- Positive Science
- Normative Science

Art

Limitations

SUBJECT MATTER OF ECONOMICS

- **Traditional approach-** Economics can be studied under 5 major divisions:
 1. **Consumption**:- Consumption is the force that direct and guides all productive activities. Consumption is defined as “Destruction of utility”. consumption , can be included in the study Utility, Law of Utility , Consumer surplus , Consumption savings etc.
 2. **Production** :- It is an activity which results in the creation of wealth. By production we mean “creation of utility”

Traditional approach

3. **Exchange** :- Transfer of wealth from one person to another is called exchange.

Price determination , Market , Money , Banking , Insurance and Trade are included under study of exchange.

4. **Distribution** :- All wealth that is created in the society finds its way to the final deposition with the individual through certain channel or source of income . This process is called distribution .

Traditional approach

The four factors of production are to be rewarded for their services rendered in the process of production .

The process of determining Rent, Wage ,Interest and Profit is called distribution.

5. **Public Finance**:- It studies how the government gets money and how it spends it , thus in public finance we study about public revenue , public expenditure , taxes , Public debts & the problems related to financial administration .

Modern approach

- The study of economics is divided into
 1. Micro economics :- is derived from Greek word 'Micros' meaning small .

In micro economics focus is on individual economic unit Such as Individual consumer , or an individual business firm, or an individual factor owner.

Scope covered by Micro economics are –

Theory of product pricing

Theory of Factor pricing

Theory of Economic welfare

Modern approach

2. Macro economics :- It is derived from Greek word 'Makros' which means large .

It studies the aggregates and average related to the whole economy , such as aggregate demand and supply , national income , general price level , total employment etc.

Nature of economics

- **Economics :- A science and an Art**
 - a) **Economics is a science** :- Systematic body of knowledge that traces the relationship between cause and effect.
 - b) **Economics a social science** :- behaviour of men in groups
 - c) **Economics is also an art** :- A science teaches us know and an Art teaches us do . Applying this definition we find that economics offers us practical guidance in the solution solutions of economic problems.

POSITIVE AND NORATIVE SCIENCE

1. **Positive Science :-** It only describes what it is and normative science prescribes what it ought to be .
2. **Normative Science :-** It makes distinction between good and bad . It prescribes what should be done and promote human welfare .

A positive statement is based on facts.

A normative statement involves ethical values.

LIMITATIONS OF ECONOMICS

1. Economics studies only the activities of real persons ,not fictitious or imaginary persons .
2. Economics studies only the activities of those human beings who are members of a society .
3. Economics studies only the activities of those human beings which are related to wealth .
4. An activity which needs to fall within the scope of economics , It should be measured in terms of money because measuring rod of economics is money .
5. The laws of economics are not completely true .

METHODOLOGY OF ECONOMICS

- Economics as a science adopt 2 methods for the discovery of its laws and principles as :-
 1. **Deductive method** :- Here, we descend from general to particular .
 2. **Inductive method** :- This method mount up from particular to general i.e. We begin from observation of particular facts and then proceed with the reasoning founded on experience so as formulate laws and theorem on the basis of observed facts.

DISTINCTION BETWEEN ECONOMICS AND BUSINESS ECONOMICS

1. The traditional economics has both **micro and macro aspects** whereas business economics essentially **micro in character**.
2. Economics is both **Positive and Normative science** but business/ managerial economics is essentially **Normative in nature** .
3. Economics deals mainly with **the theoretical aspects only** whereas business economics deals with **the practical aspects** .

Cont.....

4. Under Economics we study only the economics aspect of problems but

Under business economics , we have to study both the economic and non economic aspect of problem .

5. Economics studies principles underlying rent, wages , interest , and profit

but In Business economics , we study mainly the principles of profit only.

6. The scope of business economics is limited & not so wide as that of Economics.

TOOLS REQUIRED – Functional relationship , Schedules , Graph , Concept of Slope and its measurement .

- Economists have developed a number of basic concepts that are useful when we want to describe how an economy works....
- Three main **modes of investigation** are
 1. Empirical Investigation
 2. Theoretical
 3. historical.

- Empirical Investigation:- observation and recording of the specific phenomena of concern

When the observations take the form of showing how a numerical economic variable changes over time, we call them time series data. examples of time series data as you study economics—for GDP growth, employment, and other economic variables.

Math Review: Graphing Empirical Data

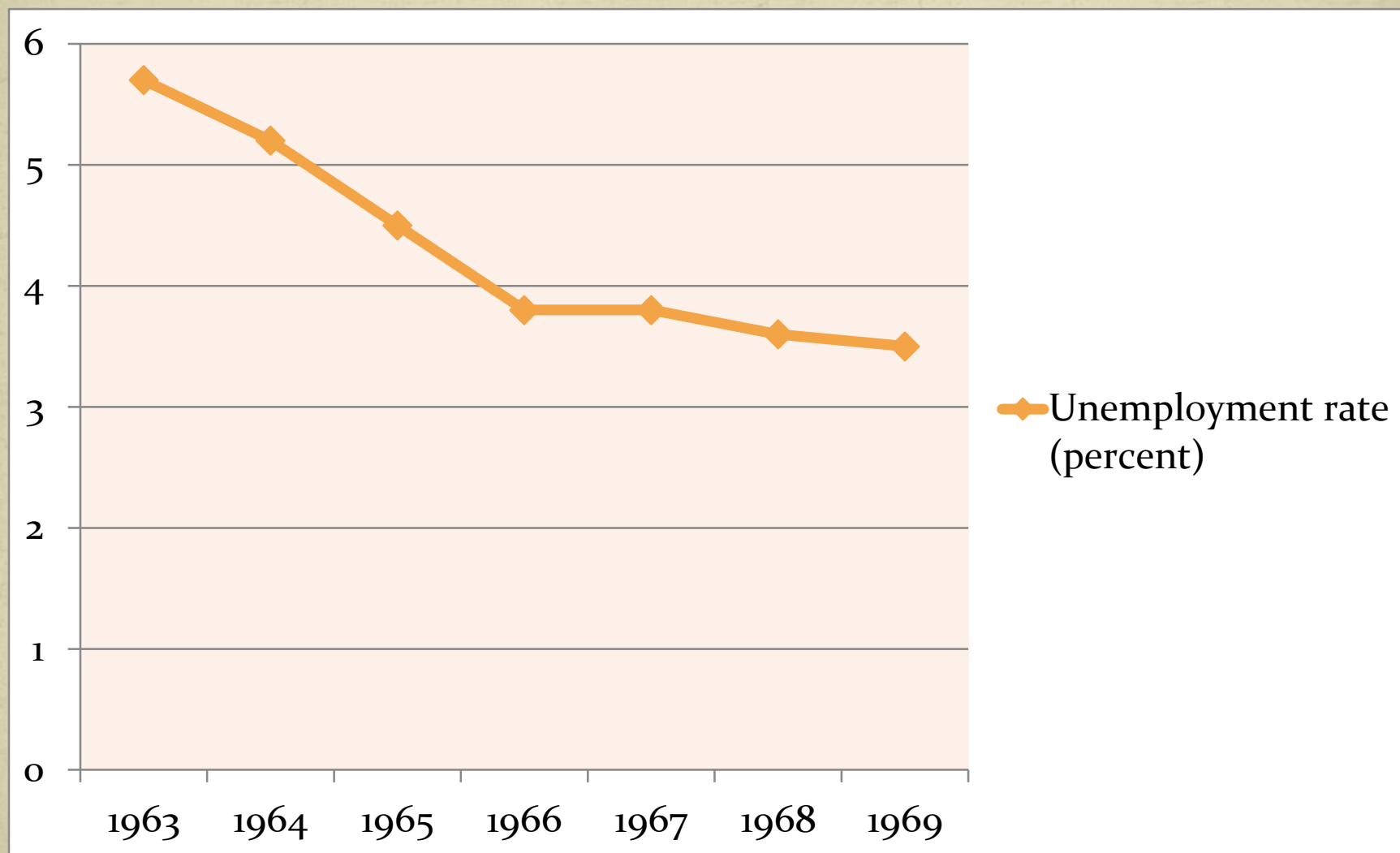
The Phillips curve, originally derived by economist A.W. Phillips using British data, played a very important role in U.S. economic theorizing and policymaking, especially during the 1960s.

- Table 1

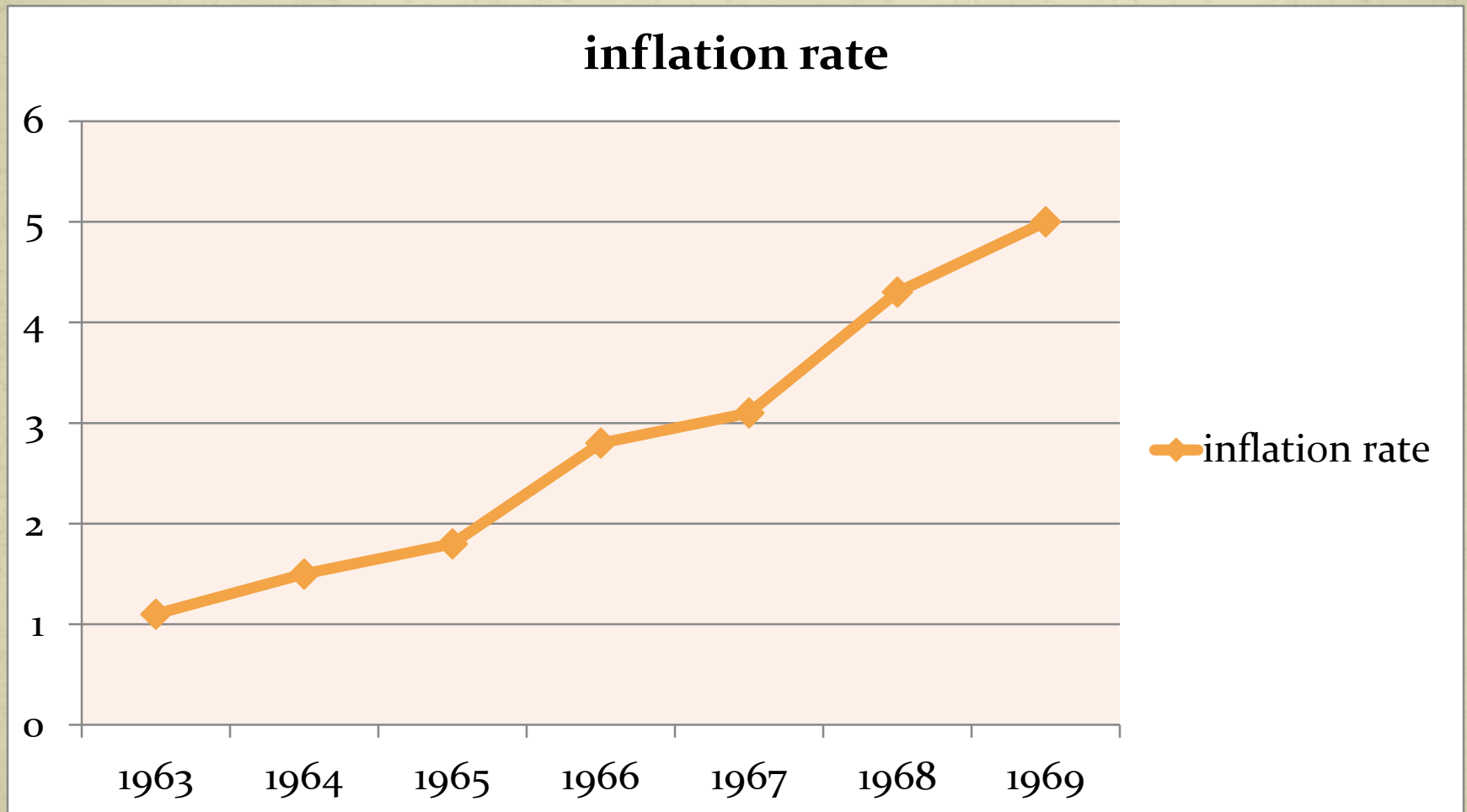
Year	Inflation (percent per year)	Unemployment Rate Year (percent)
1963	5.7	1.1
1964	5.2	1.5
1965	4.5	1.8
1966	3.8	2.8
1967	3.8	3.1
1968	3.6	4.3
1969	3.5	5

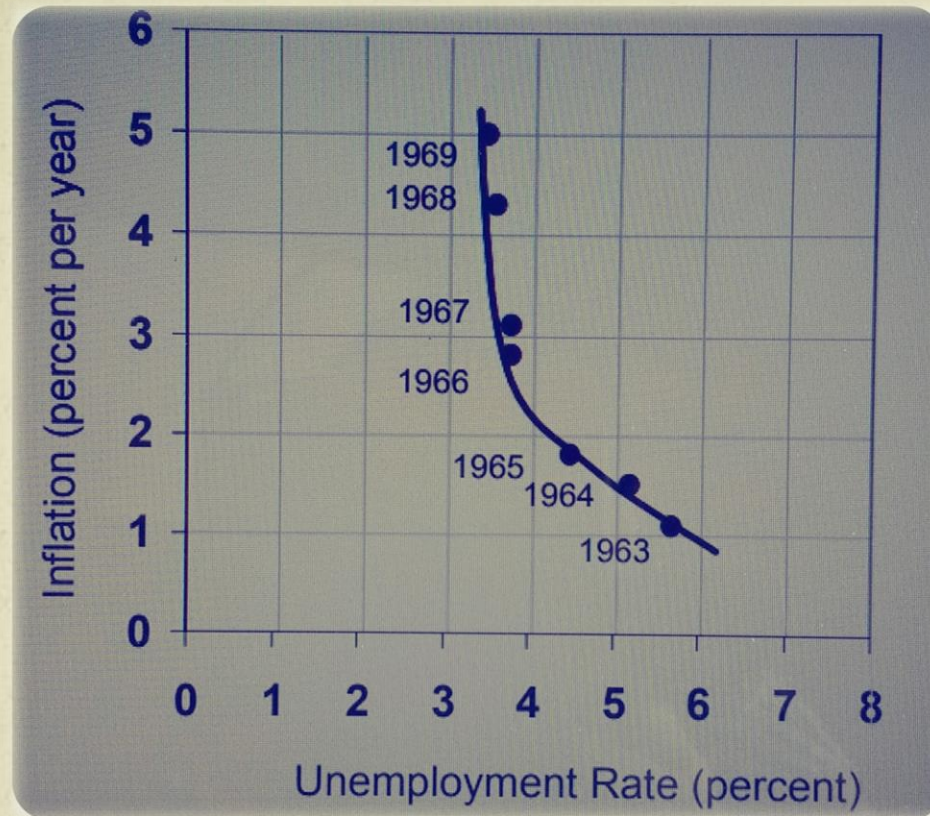
We can interpret this data in visual form, by plotting each series separately on a time series graph.

Unemployment rate 1963-1969



Inflation rate 1963-1969





The Empirical Relation between Unemployment and Inflation . 1963-1969

- Negative (or inverse) relationship: the relationship between two variables if an increase in one is associated with a decrease in the other.
- Positive (or direct) relationship: the relationship between two variables when an increase in one is associated with an increase in the other.

Empirical investigation creates the foundation for relevant macroeconomic analysis.

2. Theoretical Investigation :- analysis based in abstract thought .

3. Historical Investigation :- study of past events.

Basic tools :-

Lines and curves – The functional relationship between the variables may be linear or non-linear.

A line or curve is nothing but locus of various points

A line depicts the relationship between the variables.

Slope – The slope indicates change in one variable due to change in other variable.

Slope is defined as the amount of change in the variable measured on the vertical or Y-axis as per unit change in the variable measured on the horizontal or X-axis.

Expressed as - $\Delta Y / \Delta X$

Graph & Diagram :- A graph or a diagram present the relationship between two or more sets of data or variables that are related to one another .

the use of graph provides a better understanding of the generalization.

RESOURCES – SCARCITY AND EFFICIENCY PRODUCTION POSSIBILITY FRONTIER

Economic Tradeoffs

As individuals, and as members of a larger society, people make choices about
what should be produced,
how it should be produced, and
for whom it should be produced.

Abundance and Scarcity

Abundance: resources are abundant to the extent that they exist in plentiful supply for meeting various goals.

Scarcity: resources are scarce to the extent that they are not sufficient to allow all goals to be accomplished at once .

- production possibilities frontier (PPF): a curve showing the maximum amounts of two outputs that society could produce from given resources, over a given time period .
- the quantity of “butter” measured on the horizontal axis, or X axis.
- The quantity of “guns” is measured on the vertical axis, or Y axis.

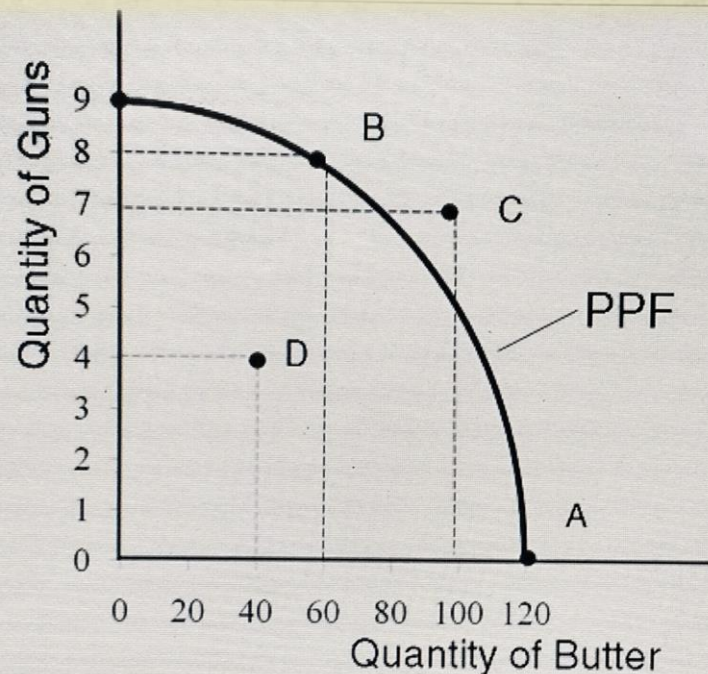


Figure 5. Society's Production Possibilities Frontier
As you select different points along the PPF you see that the more you get of one good, the less you can have of another.

Every point on the graph represents a pair of quantities:
one quantity of guns and another of butter.

The points on the PPF curve illustrate the maximum quantities of guns and butter that the society could produce.

For example, point A, where the curve intersects the horizontal axis, shows that this society can produce 120 units of butter if it does not produce any guns.

Moving up and to the left,

point B illustrates production, over the year, of 60 units of butter and 8 units of guns.

If the society produces no butter, how many guns can it produce

THANK YOU