CHAPTER 1

Introduction To Micro Economics

ECONOMICS MEANING

The term or word 'Economics' comes from the Ancient Greek *oikonomikos (oikos* means "households"; and, *nomos means* "management", "custom" or "law"). Thus, the term 'Economics' means 'management of households'. The subject was earlier known as 'Political Economy', is renamed as 'Economics', in the late 19th century by Alfred Marshall.

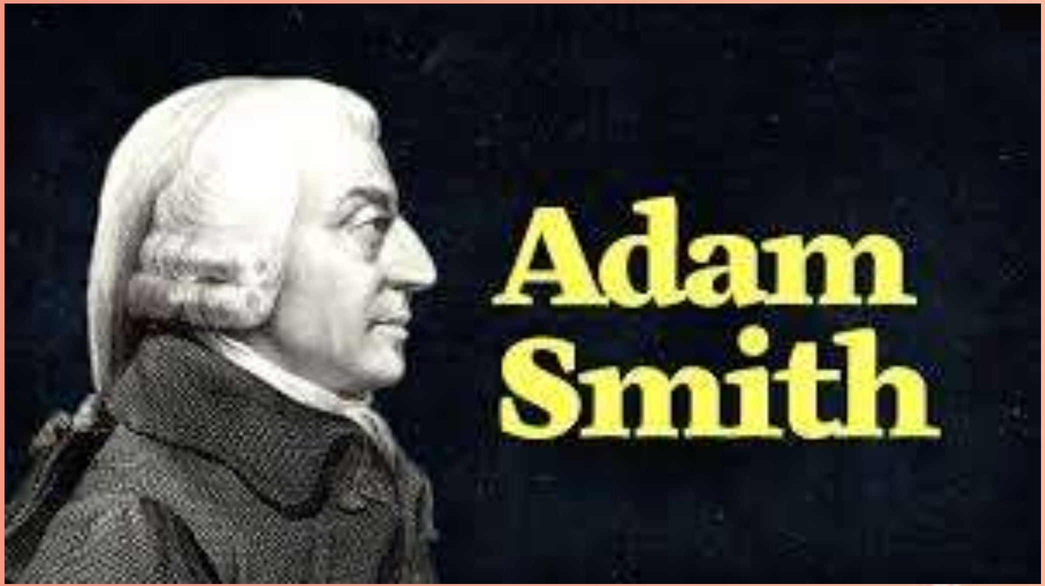
ECONOMICS ITS NATURE

This nature is understood by studying the various definitions given by the notable economists

They are:

01. Smith's Wealth Definition,
representing the Classical era;
02. Marshall's Welfare Definition,
representing the Neo-Classical era;
03. Robbins' Scarcity Definition,
representing the New Age;
04. Samuelson's Growth Definition,
representing the Modern Age.

WEALTH DEFINITION



Adam Smith (1723-1790), in his book "An Inquiry into Nature and Causes of Wealth of Nations" (1776) defines "Economics as the science of wealth".

He explains

How a nation's wealth is created and increased. He considers that the individual in the society wants to promote his own gain and in this process, he is guided and led by an

"*invisible hand*".

He **states that every man is motivated by his self interest is means that each person works for his own good.**

Smith favours the introduction of

“division of labour”

to increase the quantum of output. Severe competition in factories and society helps in bettering the product. Supply force is very active and a commodity is made available to the consumers at the lowest price

The publication of Adam Smith's

"The Wealth of Nations" in 1776, has been described as "the effective birth of economics as a separate discipline".

CRITICISM

- **For Smith, Economics consists of 'wealth getting' activities and 'wealth-spending' activities.**

- **An undue emphasis is given to material wealth. Wealth is treated to be an end in itself.**

- **This view leads him to ignore human welfare as an essential part of Economics.**

- **Smith gives his definition when religious and spiritual values are held high. *Ruskin and Carlyle* regard Economics as a '*dismal science'*, as it teaches selfishness which is against ethics.**

WELFARE DEFINITION

WELFARE DEFINITION

Alfred Marshall (1842-1924) in his book "Principles of Economics" (1890)
defines Economics

"Political Economy" or Economics is a study of mankind in the ordinary business of life; it examines that part of individual and social action which is most closely connected with the attainment and with the use of the material requisites of well-being. us, it is on one side a study of wealth; and on the other, and more
important side, a part of the study of man."

IMPORTANT FEATURES

MARSHALL'S DEFINITION ARE:

- **Economics does not treat wealth as the be-all and end-all of economic activities. Man promotes primarily welfare and not wealth.**

- **The science of Economics contains the concerns of ordinary people who are moved by love and not merely guided or directed by the desire to get maximum monetary benefit.**

- **Economics is a social science. It studies people in the society who influence one another.**

CRITICISM

- **Marshall regards only material things.**
  He does not consider immaterial things, such as the services of a doctor, a teacher and so on. They also promote people's welfare.

- **In the theory of wages, Marshall ignores**
  The amount of money that goes as reward for the services of 'immaterial' services.

- **Marshall's definition is based on the concept of welfare. But it is not clearly defined. Welfare varies from person to person, country to country and one period to another.**

SCARCITY DEFINITION

Lionel Robbins published a book "An Essay on the Nature and Significance of Economic Science" in 1932.

According to him,

"Economics is a science which studies human behaviour as a relationship between ends and scarce means which have alternative uses"

FEATURES OF ROBBINS

- **Ends refer to human wants**. Human beings have unlimited number of wants.
- **On the other hand, resources or means** that go to satisfy the unlimited humanwants are limited or scarce in supply. The scarcity of a commodity is to be considered only in relation to its demand.
- **Further, the scarce means are capable** of having alternative uses. Hence, an individual grades his wants and satisfies first his most urgent want

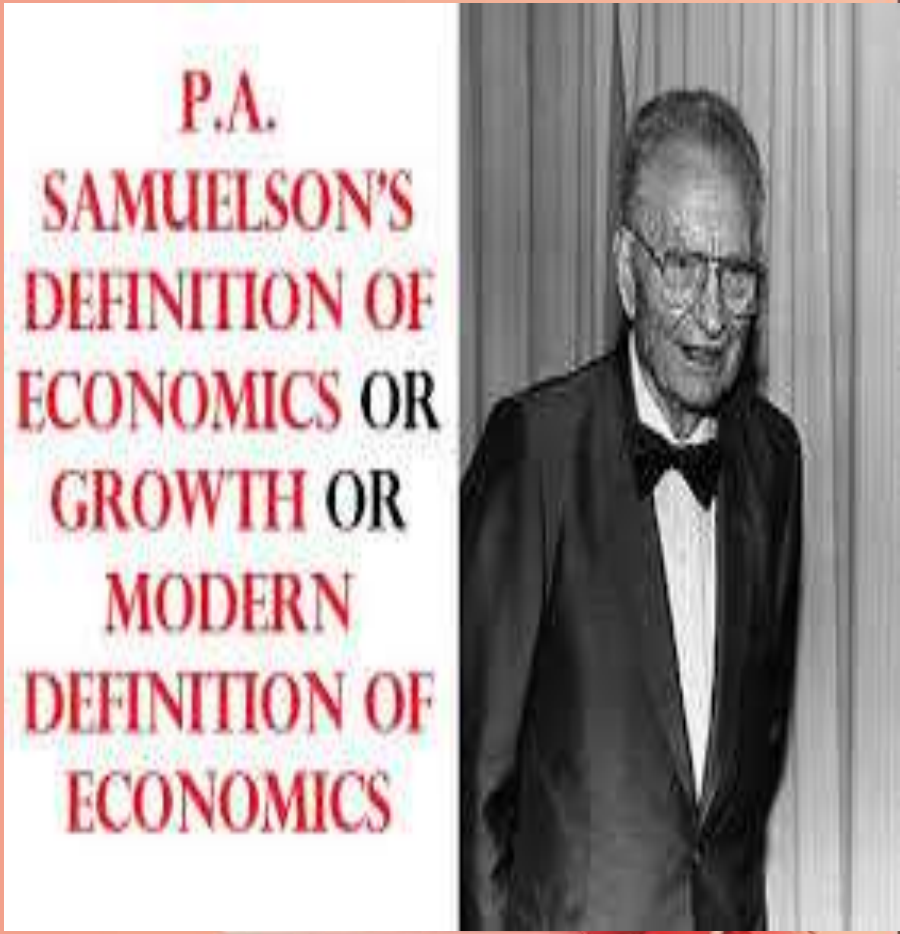
CRITICISM

- ❖**Robbins does not make any distinction** between goods conducive to human welfare and goods that are not
- ❖ **Economics deals not only with the** micro-economic aspects of resource allocation and the determination of the price of a commodity, but also with the macro-economic aspects like how national income is generated.
- ❖**Robbins' definition does not cover** the theory of economic growth and development

GROWTH DEFINITION

Paul Samuelson defines Economics as

“The study of how menand 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 in the future among various people and groups of society.”



FEATURES

Like Robbins,

- **Samuelson states that the means are scarce** in relation to unlimited ends and that such means could be put to alternative uses.
- **Samuelson makes his definition** dynamic by including the element of time in it. Therefore, his denition covers the theory of economic growth.
- **Samuelson's definition is applicable** also in a barter economy, where money is not used.
- **His definition covers various aspects** like production, distribution and consumption.
- **Samuelson treats Economics as a** social science, whereas Robbins regards it as a science of individual behaviour.

SCOPE OF ECONOMICS

- **Its subject Matter**
- **Economics is an Art and a Science**
- **Positive Science and Normative Science**

Scope of Economics

- Microeconomics *versus* macroeconomics
  - Micro - individuals or groups of individuals
  - Macro - broad aggregates at economy level
- Positive *versus* normative economics
  - Positive - "what is", or "what would happen if"
  - Normative - "what should be"
- Alternative economic systems
  - Capitalism and socialism
  - U.S. has mixed economic system

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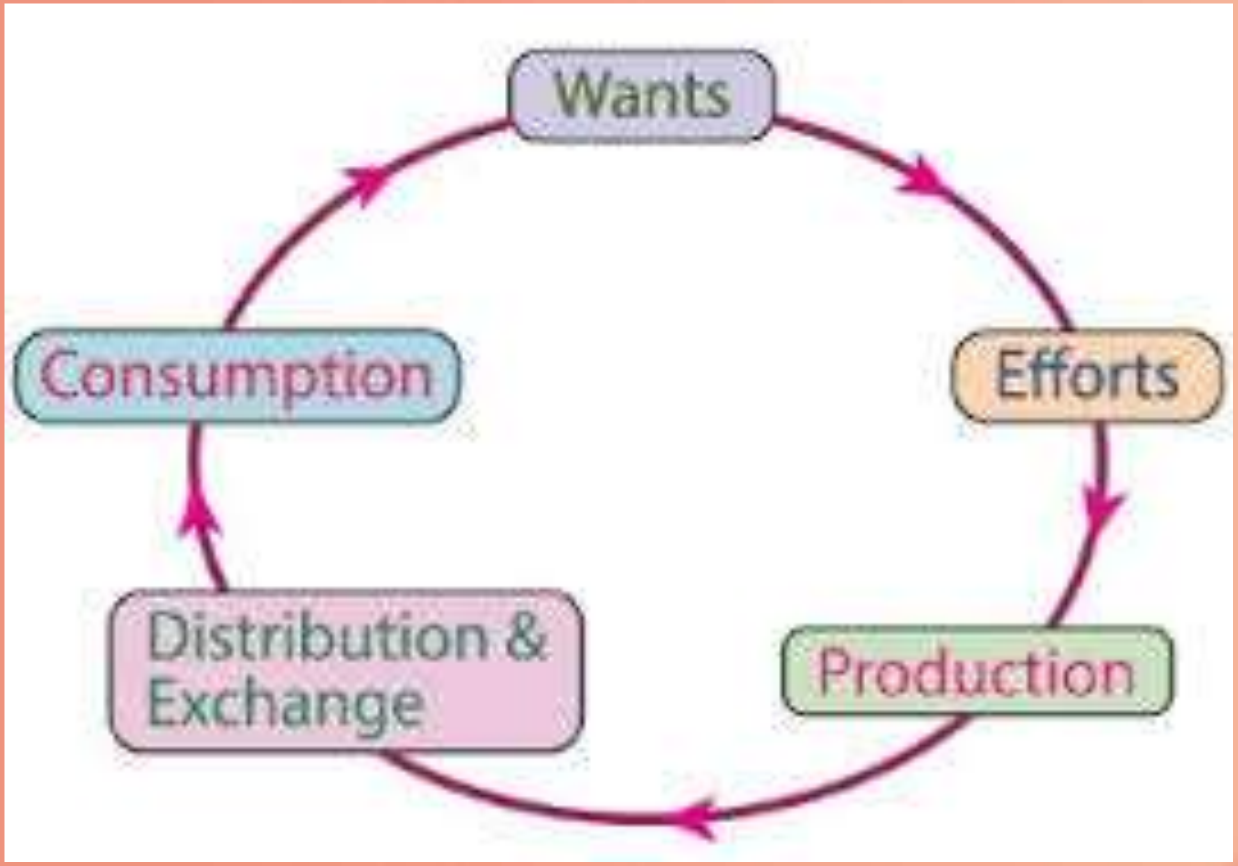
SUBJECT MATTER OF ECONOMICS



Subject matter of economics

The basics subject matter of economics is

- The economy
- The coordination process
- The effects of scarcity
- The science of choice
- Human behavior
- Human beings as to how they coordinate wants and desires, given the decision making mechanisms, social customs and political realties of society

Economics Is A Science As Well As An Art

- When economics study the facts it is said to be positive science, when suggestions are made to change the facts to achieve the desired results, it is said to be normative science. And when practical steps are taken to put the suggestion in practice, we see economics as an art.
- For exp, Govt provides incentive to private sector to boost production or
- Labor economics etc.

Normative versus Positive

- Positive economic statement
  - Assertion about economic reality
  - Supported or rejected by reference to the facts
- Normative economic statement
  - Opinions
  - Cannot be shown to be true or false by reference to the facts

Basic Concepts in Economics

Classification of Goods

- **Free goods** are those goods that exist in lenty that can be used as much as we like
- **Economic goods**,are scarce and can be had only on payment.

- Durable & perishable Goods

Durable goods are those goods that can be used more than one's over a period of time.

Perishable goods are those goods which can be used only one's.

PUBLIC VS PRIVATE GOODS

- PUBLIC GOODS

  A good available to everyone to consume, Regardless of who pays and who doesn't.

  - Spillover benefits;
  - Non -rival in consumption and non- excludable;

  E.g:National defence,Law enforcement.

- PRIVATE GOODS

  A good consumed by a single person or Household;

  - No spillover benefits;
  - Rival in consumption and excludable;

  E.g:food and drink

- Intangible: Intangible things are For example The intangible things are converted and stored into tangible items such as recording a music piece into a pen-drive.are marketed as a good.
- Heterogeneous: Services vary across For example, music, consulting physicians etc.
- Inseparable from their makers: For example labour and labourer are inseparable
- Perishable: For example it is useless to possess a ticket for a cricket-match once the match is over.It cannot be stored and it has no valuein- exchange.

UTILITY

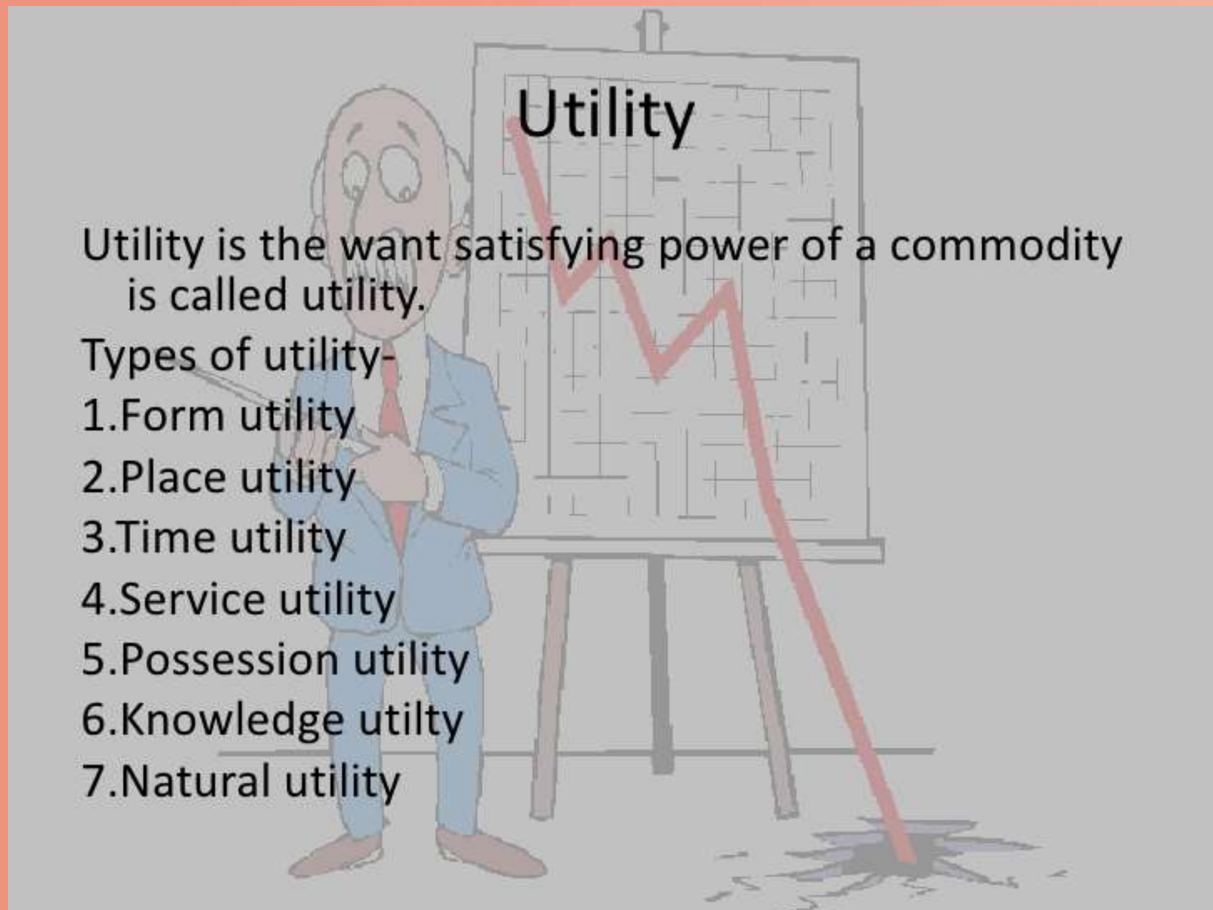
Meaning

'Utility' means 'usefulness'. In Economics, utility is the want satisfying power of a commodity or a service. It is in the goods and
services for an individual consumer at a particular time and at a particular place.

CHARACTERISTICS OF UTILITY

- Utility is psychological.
- Utility is not equivalent to
- Utility is not the same as pleasure.
- Utility is personal and relative.
- Utility is the function of the intensity of human wants
- Utility is a subjective concept
- Utility has no ethical or moral significance.

TYPES OF UTILITY



PRICE

Price is the value of the good expressed in terms of money. Price of a good is fixed by the forces of demand for and supply of the good. Price determines what goods are to be produced and in what quantities. It also decides how the goods are to be produced.

MARKET

Generally, market means a place where commodities are bought and sold.
But, in Economics, it represents
where buyers and sellers enter into an exchange of goods and services over a price.

COST

Cost refers to the expenses incurred to produce or acquire a given quantum of a good. Together with revenue, it determines the profit gained or the loss incurred by a firm.

REVENUE

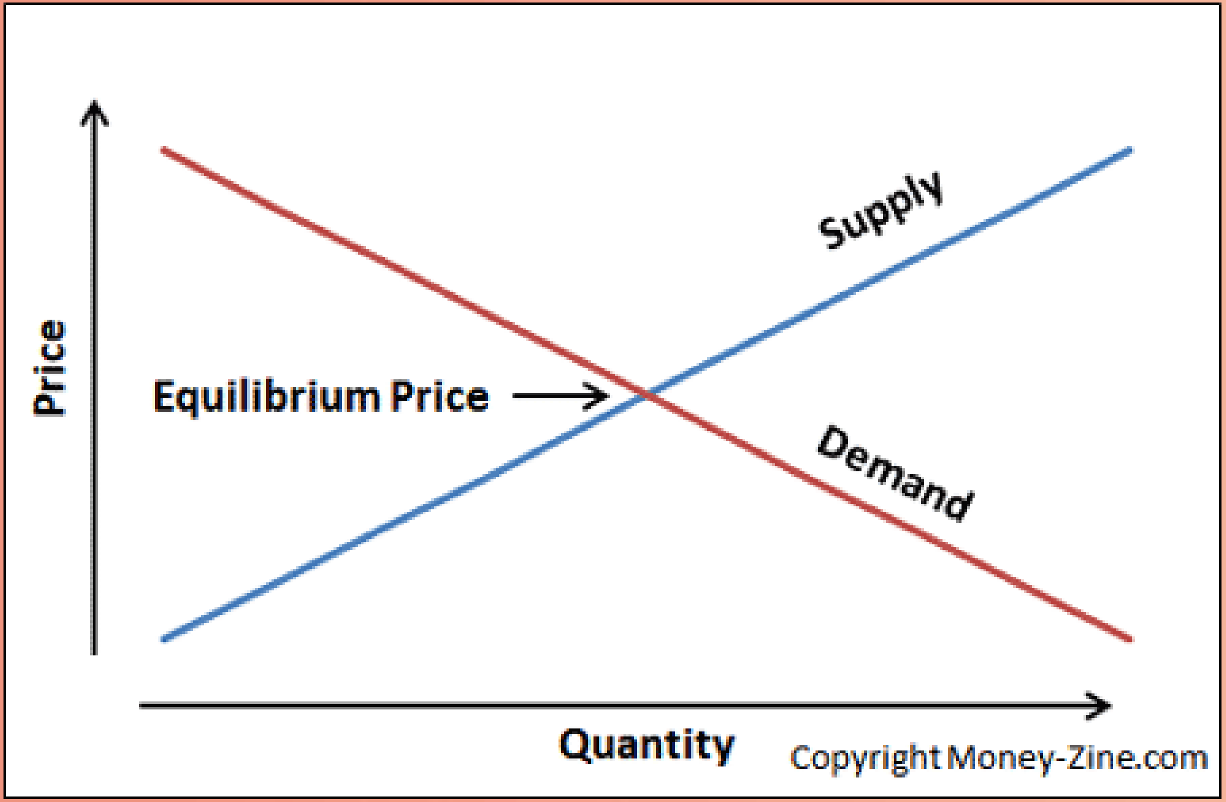
Revenue is income obtained from the sale of goods and services. Total Revenue(TR) represents the money obtained from the sale of all the units of a good. Thus, $TR = P \times Q$, where TR is Total Revenue; P is the price per unit of the good; and, Q is the Total Quantity of the goods sold.

EQUILIBRIUM

Stable Equilibrium

Particular Equilibrium

EQUILIBRIUM DIAGRAM



INCOME

Income represents the amount of monetary or other returns, either earned or unearned small or big, accruing over a period of time to an economic unit. Nominal income refers to income, expressed in terms of money. It is termed as the *money income.*

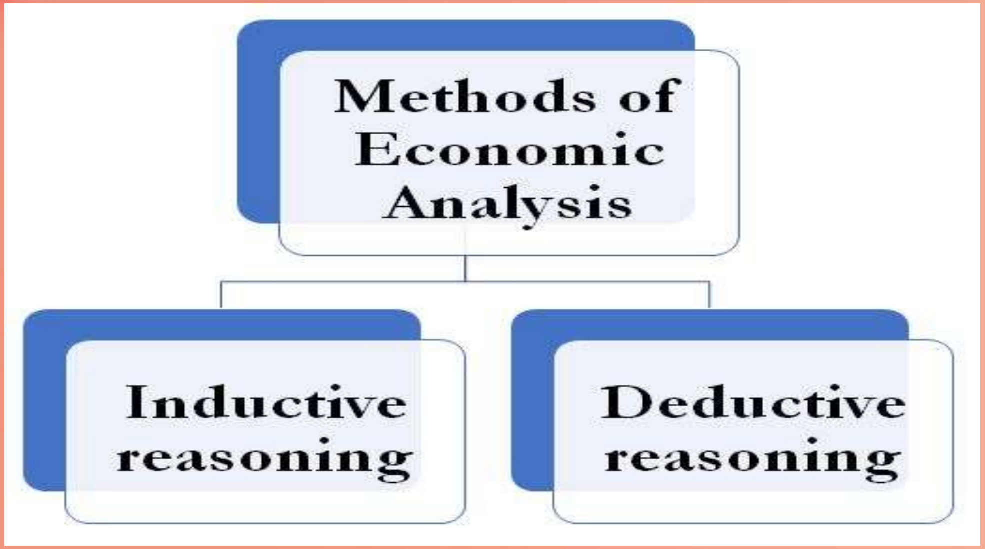
Real income is the amount of goods **that can be purchased with money as income.**
It is the purchasing power of income which is based on the rate of infation.

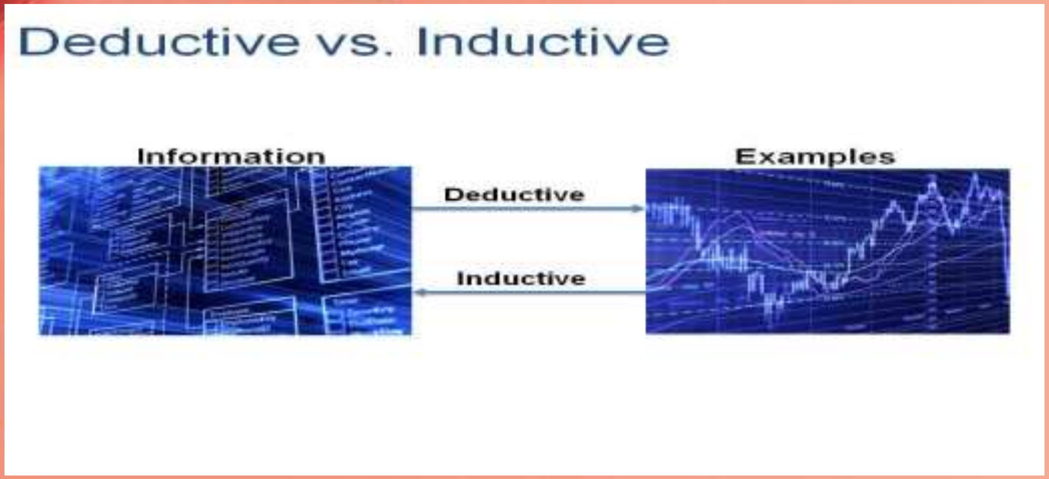
TYPES

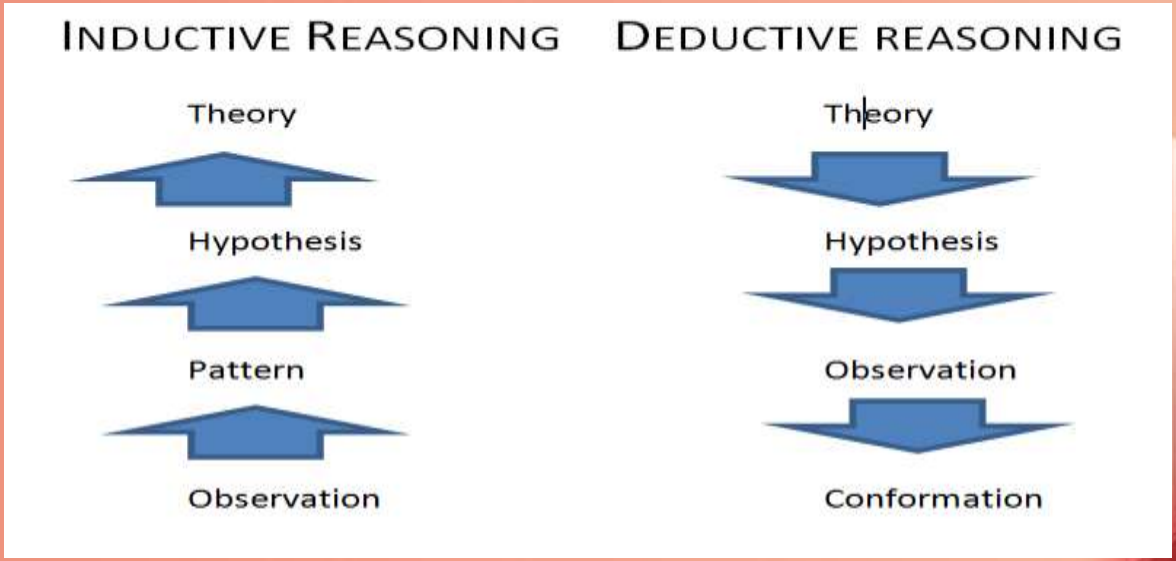
MONEY INCOME

REAL INCOME

METHODS OF ECONOMICS




Deductive vs. Inductive
Information
Examples
Deductive
Inductive


INDUCTIVE REASONING
Theory
Hypothesis
Pattern
Observation
DEDUCTIVE REASONING
Theory
Hypothesis
Observation
Conformation

ENGEL'S LAW

"The proportion of total expenditure incurred on food items declines as total expenditure [which is proxy for income] goes on increasing."

NATURE OF ECONOMIC LAWS

❖In Economic science, the laws function with cause and effect.

Economic laws are not as precise and certain as the laws in the physical sciences in Economics makes the Economic laws hypothetical.

Since money is used as the measuring rod, laws in economics are more exact, precise and accurate than the other social sciences.

DIVISION IN ECONOMICS

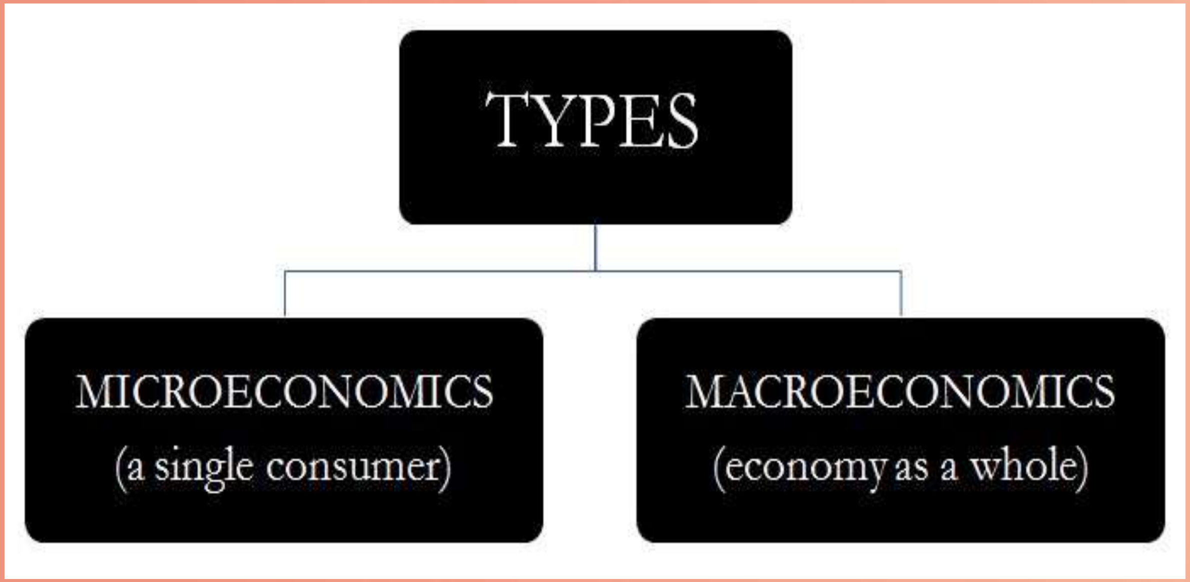
Traditional Approach

Economics is studied under 5 major divisions:

1) Consumption: Satisfaction of human wants through the use of goods and services
2) Production: Creation of utility or producing things for satisfying human wants
3) Exchange: The process of buying and selling constitutes exchange
4) Distribution: The process of determining rent, wage, interest and profit
5) Public Finance: Study of public revenue and public expenditure

TYPES

Economics can be studied under the two broad categories- Macroeconomics and Microeconomics



MICRO VS MACRO ECONOMICS

Micro Economics	Macro Economics
1. It is that branch of economics which deals with the economic decision-making of individual economic agents such as the producer, the consumer etc.	1. It is that branch of economics which deals with aggregates and averages of the entire economy. E.g., aggregate output, national income, aggregate savings and investment, etc.
2. It takes into account small components of the whole economy.	2. It takes into consideration the economy of the country as a whole.
3. It deals with the process of price determination in case of individual products and factors of production.	3. It deals with general price-level in any economy.
4. It is known as price theory	4. It is also known as the income theory.
5. It is concerned with the optimization goals of individual consumers and producers	5. It is concerned with the optimization of the growth process of the entire economy.

The Development Economics deals with features of developed nations, obstacles for development, Economic and Non-economic factors

Public finance is concerned with the income or revenue raising and expenditure incurring activities of the public authorities and with the adjustment of the one with the other

Every country is having links with the other countries through foreign capital, investment (foreign direct investment) and international trade.

Health Economics is an area of applied economics. It covers health indicators, preventive and curative measures, medical research and education,

Environmental Economics which analyses the inter relationship between economy and environment.

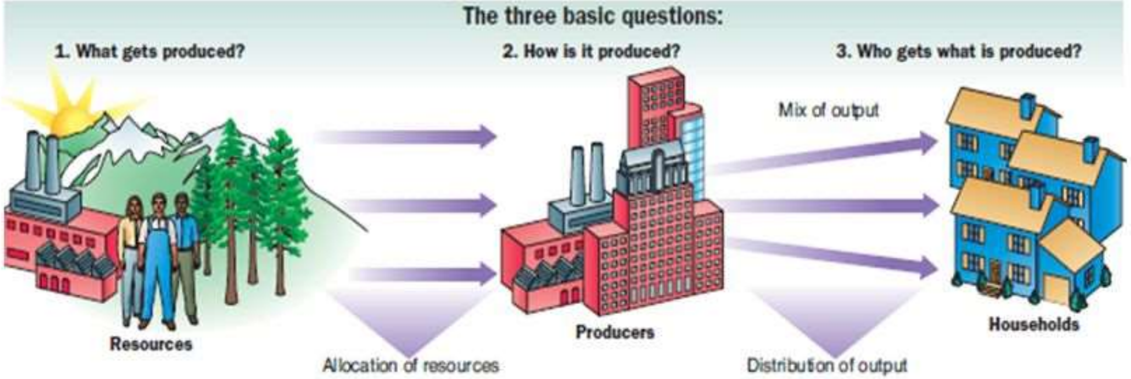

The basic economic problem
Human wants are unlimited but resources are scarce
WHAT PRODUCTS?
CHOICES
Who FOR?
Me!
Me!
Me!
HUMAN WANTS
UNLIMITED!
RESOURCES
SCARCE!


How to produce?
What to produce?
For whom to produce?
Three Basic Economic Problems of Society
UniversalTeacher.com

Three Basic Economic Questions

Every society must answer three basic economic questions because of scarcity.

What will be produced?
How will it be produced?
Who will get what is produced?



Societies answer these questions differently, leading to a variety of economic systems.

PRODUCTION POSSIBILITY CURVE (PPC)

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The problem of choice between relatively scarce commodities due to limited productive resources with the society can be illustrated with the help of a geometric device, is known as production possibility curve.

ASSUMPTIONS

❖The time period does not change.
It remains the same throughout the curve.

❖Techniques of production are fixed.

❖ There is full employment in the economy.

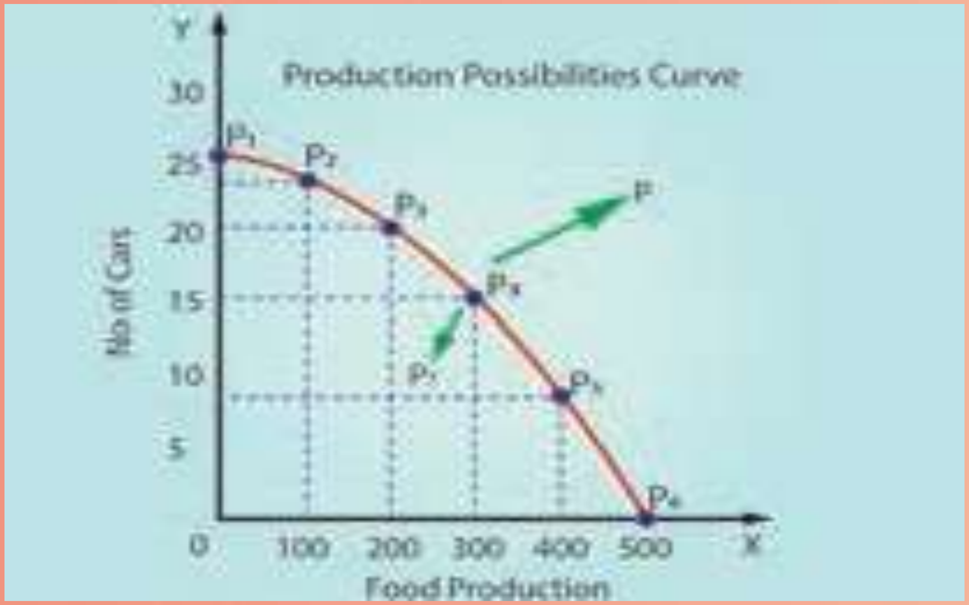
❖Only two goods can be produced from the given resources.
❖Resources of production are fully mobile.

❖The factors of production are given in quantity and quality

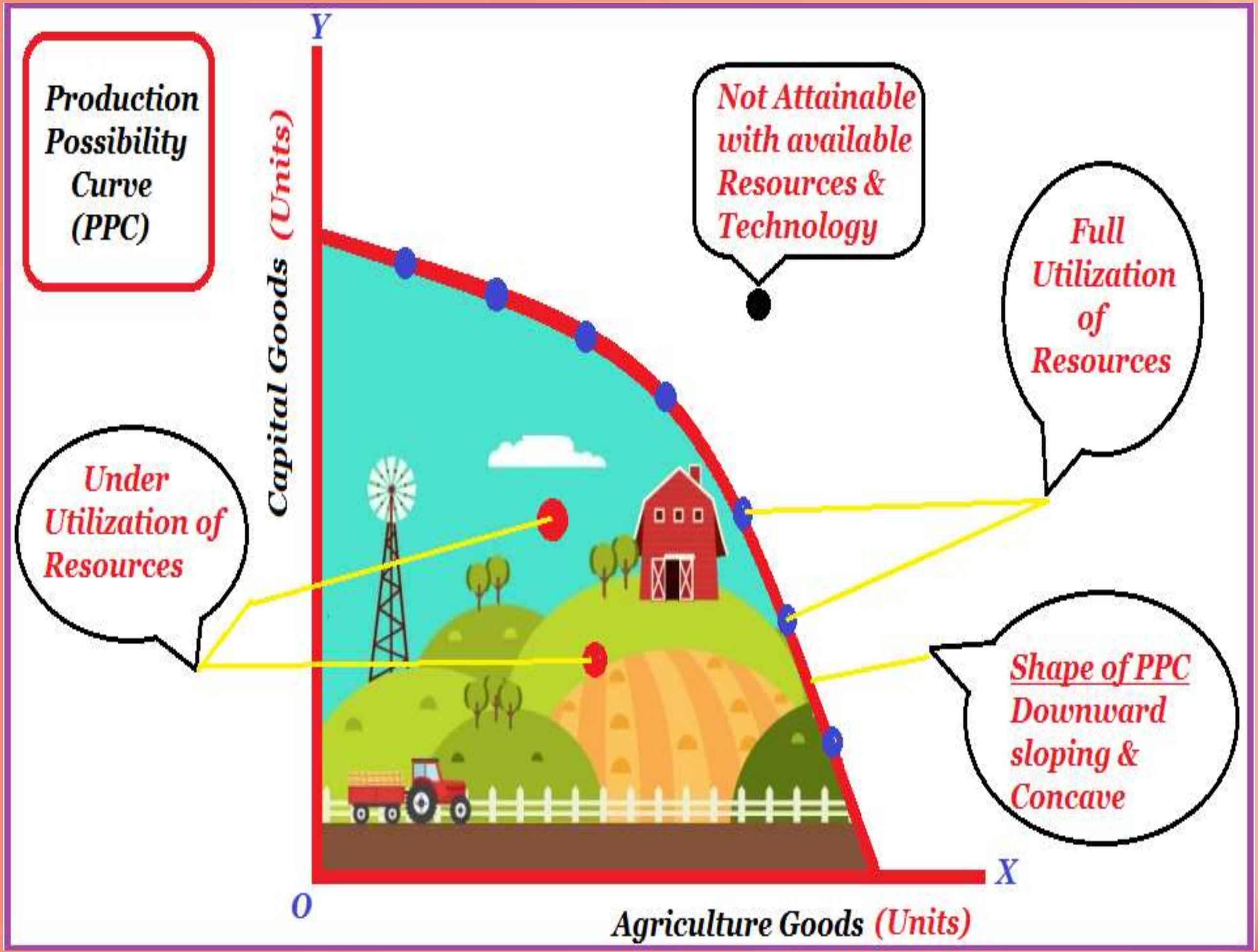
❖The law of diminishing returns operates in production.

Production possibilities	Quantity of food production in tons	No of car production
I	0	25
II	100	23
III	200	20
IV	300	15
V	400	8
VI	500	0

This schedule suggests that if all resources are thrown into the production of food, a maximum of 500 tons of food can be produced, given the existing technology. If on the other hand, all resources are instead used for producing cars, 25 cars can be produced. In between these two extreme possibilities exist. If we are willing to give up some food, we can have some cars.



We can obtain a production possibility curve by drawing production possibilities schedule graphically. The quantity of food is shown on x-axis and the number of cars is shown on y-axis, the different six production possibilities are being shown as point P1 P2 P3 P4 P5 & P6


Production Possibility Curve (PPC)
Y
Capital Goods (Units)
Not Attainable with available Resources & Technology
Full Utilization of Resources
Under Utilization of Resources
Shape of PPC
Downward sloping & Concave
X
O
Agriculture Goods (Units)

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Thank You!