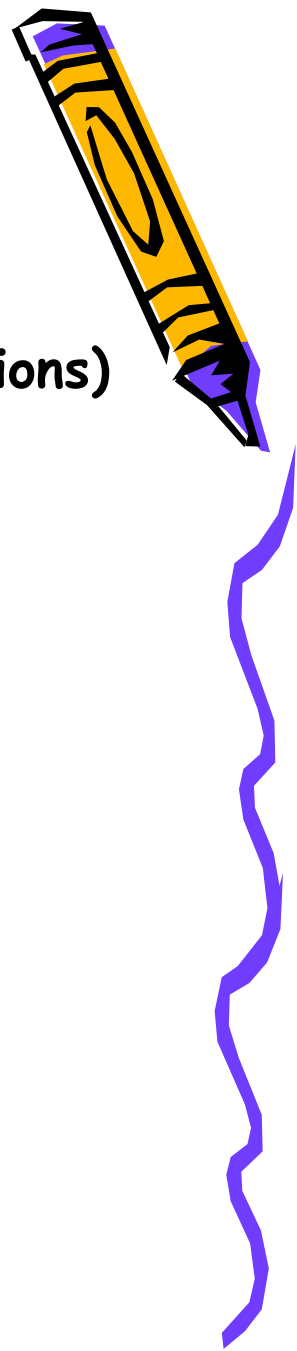


# WHAT IS ECONOMICS?

# CHAPTER 1



# Introduction to Economics



- 1. Origin of Economics
- 2. What Economics is all about? (Concepts & Definitions)
- 3. Significance/Advantages of Economics
- 4. Economic Theory
- 5. Economics as Science
- 6. Economic Laws
- 7. Economic Problems
- 8. Production Possibility Curve
- 9. Concept of Opportunity Cost
- 10. Microeconomics
- 11. Limitations of Economics



# 1. Origin of Economics

Our activities to generate income are termed as economic activities, which are responsible for the origin and development of Economics as a subject.

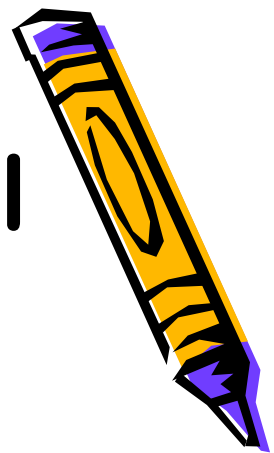
Originated as a *Science of Statecraft*. Emergence of *Political Economy*.

1776 : Adam Smith (Father of Economics) - *Science of Wealth*

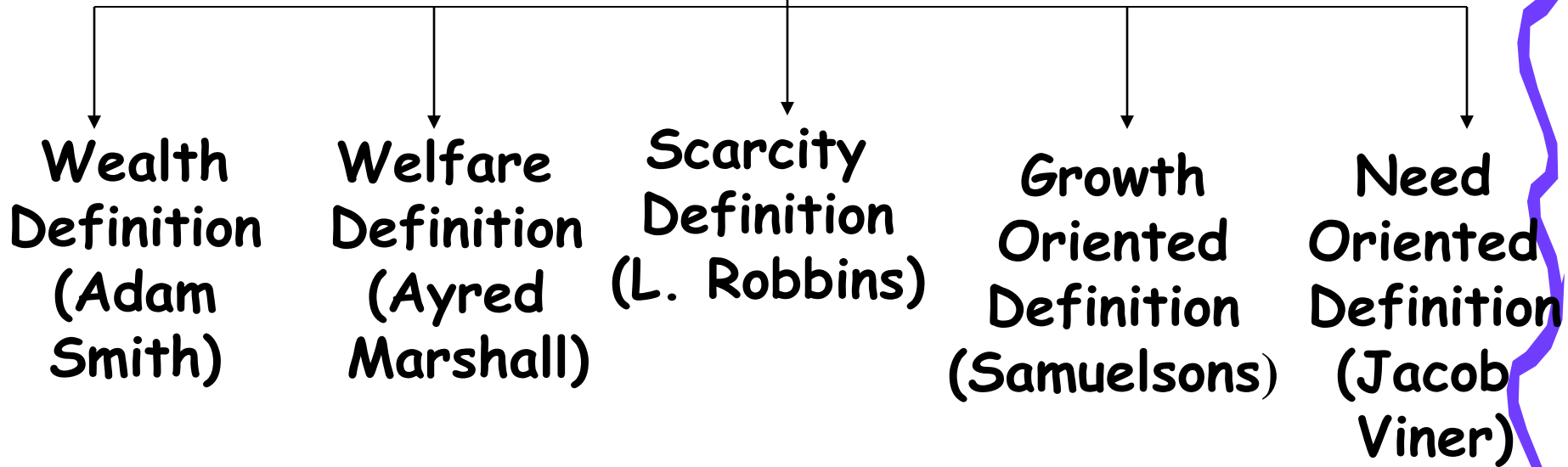
*Economy is concerned with the production, consumption, distribution and investment of goods and services.*



# 2. What Economics is all about?



## Stages & Definitions of Economics



- a. Wealth Concept : Adam Smith, who is generally regarded as father of economics, defined economics as " a science which enquires into the nature and cause of wealth of nation". He emphasized the production and growth of wealth as the subject matter of economics.

Characteristics :

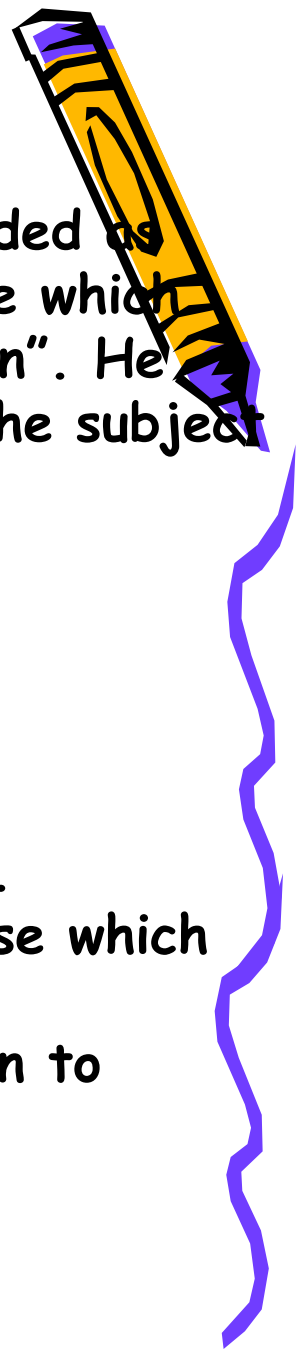
#Takes into account only material goods.

Criticism of Wealth Oriented Definition :

#Considered economics as a dismal or selfish science.

#Defined wealth in a very narrow and restricted sense which considers only material and tangible goods.

#Have given emphasis only to wealth and reduced man to secondary place in the study of economics.



b. Welfare Concept : According to A. Marshall "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 material requisites of well being. Thus, it is on one side a study of wealth; and on other; and more important side, a part of the study of man.

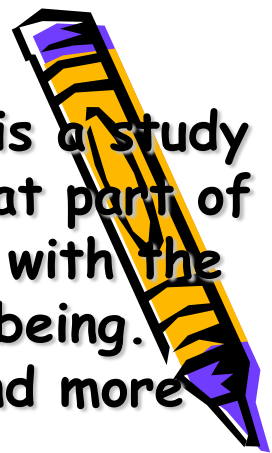
Characteristics of Welfare Definition:

# It is primarily the study of mankind.

# Takes into account ordinary business of life - It is not concerned with social, religious and political aspects of man's life.

# Emphasize on material welfare as the primary concern of economics i.e., that part of human welfare which is related to wealth.

# Limited the scope to activities amenable to measurement in terms of money.





## Criticisms of Welfare Oriented Definition :

# Criticized for treating economics as a social science rather than a human science, Thus welfare definition restricts the scope of economics to the study of persons living in organized communities only.

# Criticized because of the distinction made between economic and non-economic.

# Welfare in itself has a wide meaning which is not made clear in definition.

C. Scarcity Concept : According to Lionel Robbins: "Economics is the science which studies human behavior as a relationship between ends and scarce means which have alternate uses"



## Characteristics of Scarcity Oriented Definition:

- # Economics is a positive science.
- # Unlimited ends ( wants ).
- # Scarce means.
- # Alternative use of means.
- # Choice - study of human behavior.

## Superiority over Welfare Definition :

- # Tried to bring the economic problem which forms the foundation of economics as a social science.
- # The scarcity definition of economics is most universal in nature.
- # Has taken both sciences in account i.e. Social and Human.
- # It takes into account all human activities.
- # Consideration of neutral science was considered much logical.





## Criticism of Scarcity Oriented Definition :

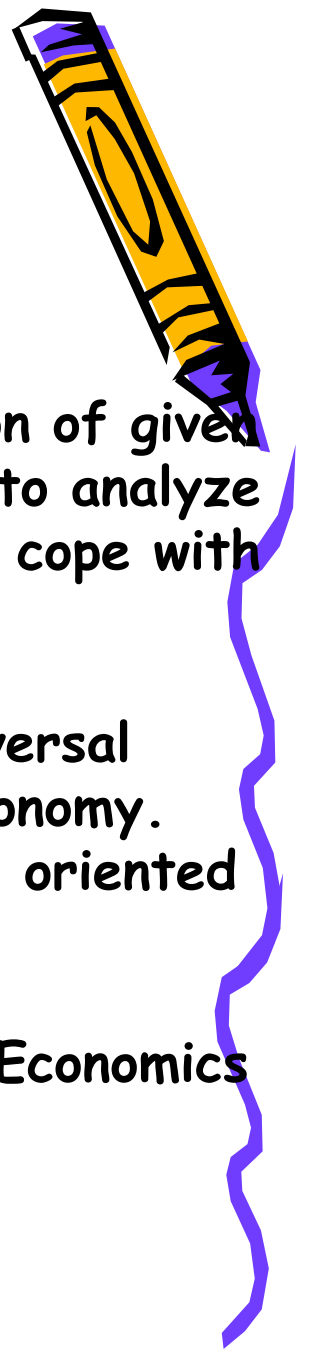
# His definition does not focus on many important economic issues of cyclical instability, unemployment, income determination and economic growth and development.

# Does not take into account the possibility of increase in resources over time.

# Has treated economics as a science only. But in fact it is both a science and an art.

D. Growth/Development Concept : According to Prof. Samuelson "Economics is the study of how men and society choose with or without the use of money, to employ the scarce productive resources which have alternative uses, to produce various commodities over time and distribute them for consumption now and in future among various people and groups of society.





## Characteristics of Growth Oriented Definition:

# The definition is not merely concerned with the allocation of given resources but also with the expansion of resources, tries to analyze how the expansion and growth of resources to be used to cope with increasing human wants.

# More dynamic approach.

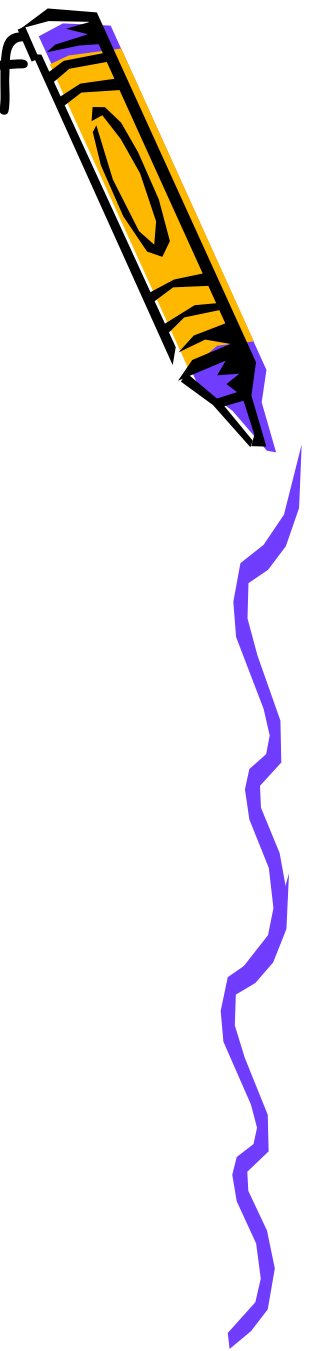
# According to him problem of resource allocation is a universal problem whether it is a better economy or an exchange economy.

# Definition is comprehensive in nature as it is both growth oriented as well as future oriented.

E. Need Oriented Definitions : According to Jacob Viner "Economics is what economists do"



# 3. Significance/Advantages of Economics



## Theoretical Advantages

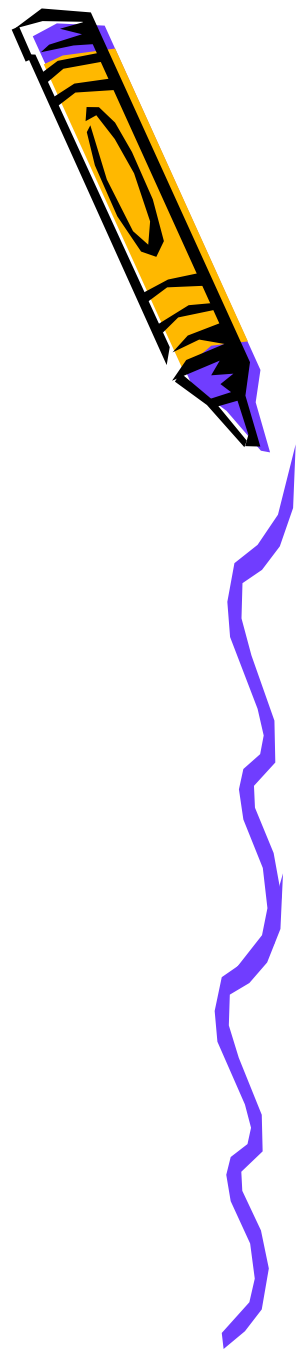
- Increase in Knowledge
- Developing Analytical Attitude

## Practical Advantages

- Significance for the consumers
- Significance for producers
- Significance for workers
- Significance for politicians
- Significance for academicians
- Significance for administrators
- Effective man-power planning
- Helpful in fixing price
- Solving distribution problems



# Economics Goals



- ECONOMIC GROWTH
- FULL EMPLOYMENT
- ECONOMIC EFFICIENCY
- PRICE LEVEL STABILITY
- Economic Freedom
- EQUITABLE DISTRIBUTION OF INCOME
- ECONOMIC SECURITY
- BALANCE OF TRADE



# 4. Economic Theory



## Branches of economics:

- a. **Microeconomics:** Concerned with the behavior of individual entities such as markets, firms and households.
- b. **Macroeconomics:** Concerned with the overall performance of the economy. This concept came into being after 1935 when *General Theory of Employment, Interest and Money* was published by John Maynard Keynes.
- c. **Econometrics:** Applies the tools of statistics to economic problems.



# 5. Economics as Science



- Science is the relationship between causes and effects.
- Classification of Science :
- a. Positive Science (What is? What was? What will be?) - actual happenings.

Examples of Positive statements :

- India is an over-populated country.
- Prices in Indian economy are constantly rising.

- b. Normative Science (What ought to be? What ought to have been?)

Examples :

- Fundamental principle of economic development should be the development of rural India
- Agricultural income should also be taxed.



# ECONOMICS AS AN ART

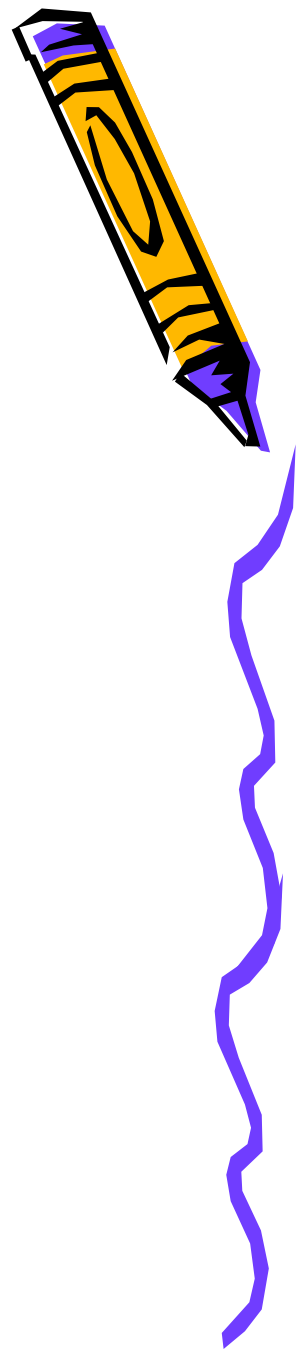


- Science is a theoretical aspect whereas Art is a practical aspect. In economics we study
- consumption, production, public finance etc, which provide practical solutions to our
- daily economic problems. Study of cause and effect of inflation or deflation falls within
- the purview of science but framing appropriate and suitable monetary and fiscal policies
- to control inflation and deflation is an art.





# 6. Economic Laws



- *Statement of general tendencies*

## Characteristics of Economic Laws :

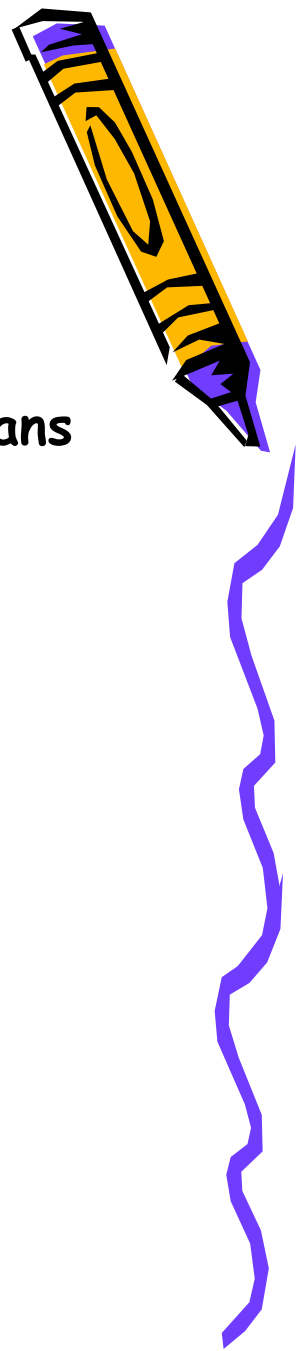
- Economic laws are statements of economic tendency.
- Economic laws are hypothetical.
- Economic laws are relative.
- Economic laws are human laws.
- Certain universal laws.

## Assumptions of Economic Laws :

- Other things remaining the same.
- Rationality of human laws.



# 7. Economic Problems



The problem of *choice making* arising out of limited means and unlimited wants is called *economic problem*.

Why do economic problems arise?

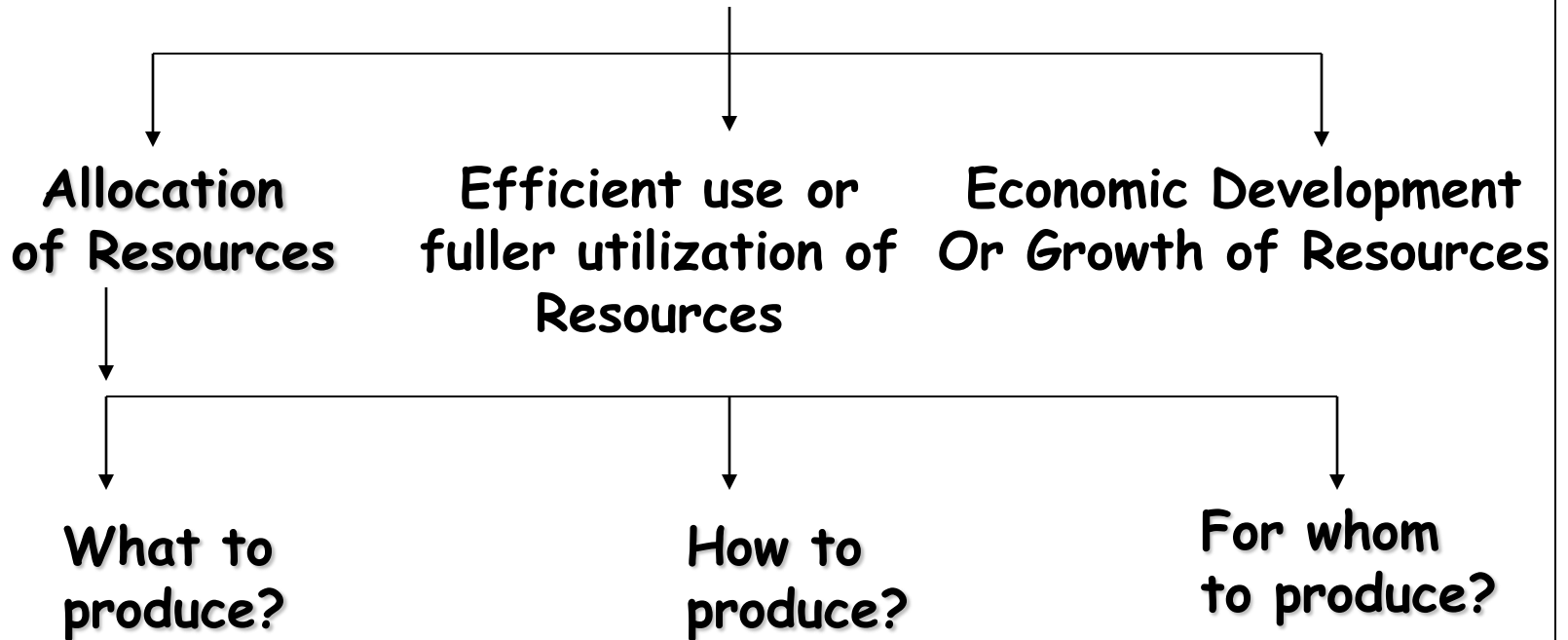
- Unlimited wants
- Different priorities
- Limited means
- Means having alternative uses.

Multiplicity of want



# Basic or Central Problems

## Three Basic or Central Problems of Economy

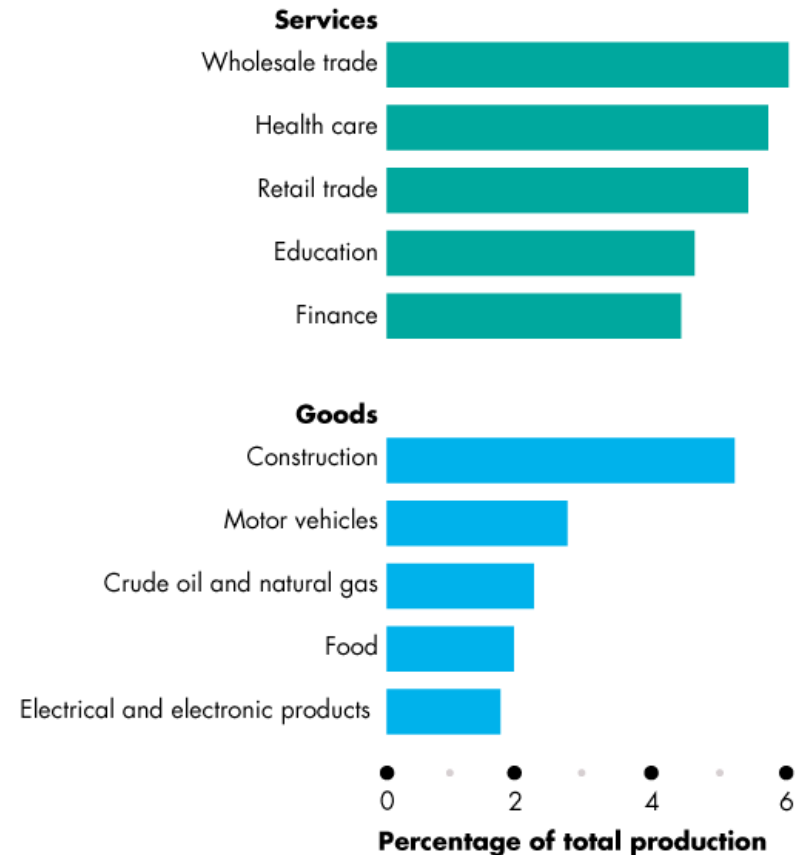


# Three Big Microeconomic Questions

• What Goods and Services are Produced?

- Figure 1.1 shows the major items produced in the Canadian economy today.

- It emphasizes the dominant place of services in our economy.

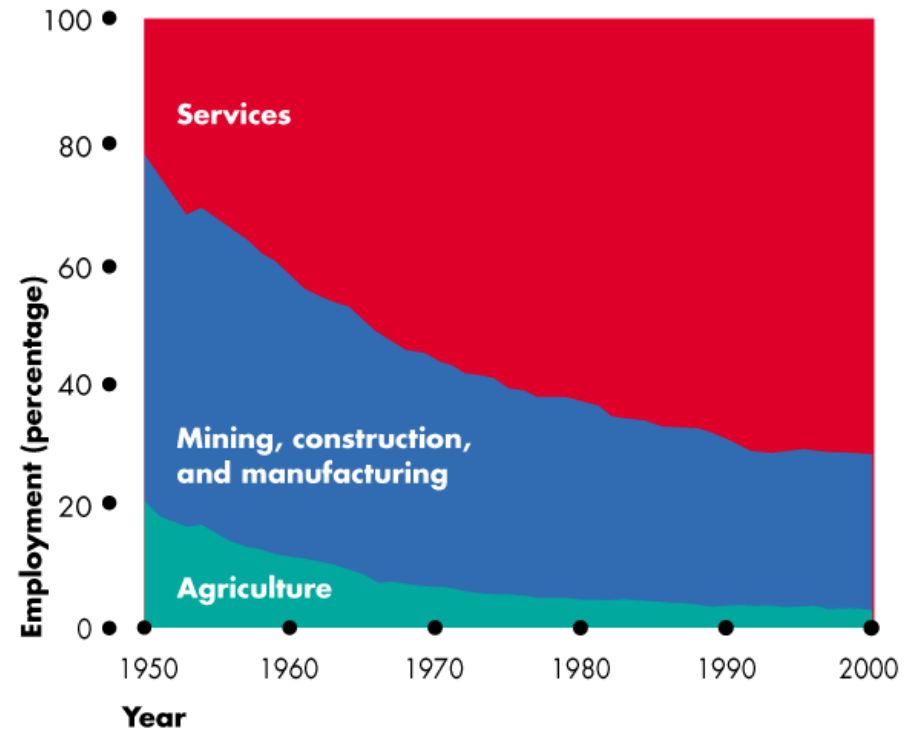


# Three Big Microeconomic Questions



-Figure 1.2 shows the trends in what the Canadian economy has produced over the past 50 years.

-It shows the decline of agriculture, mining, construction, and manufacturing, and the expansion of services.



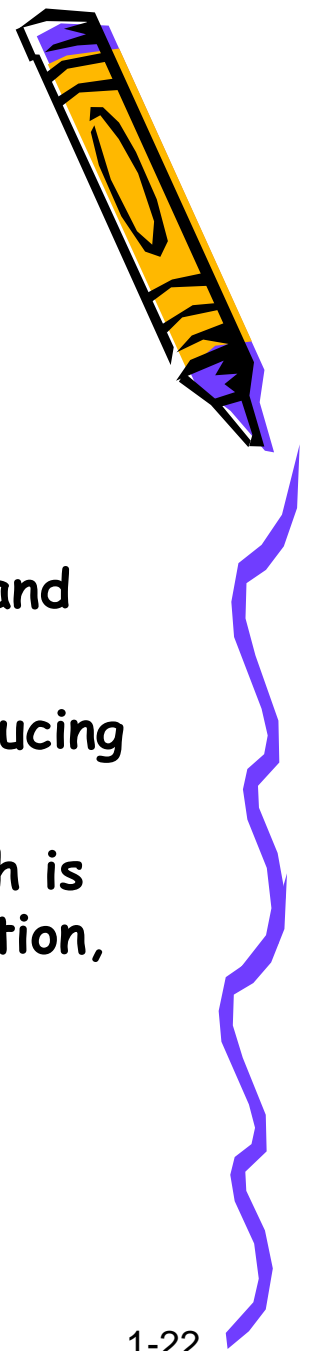
# Three Big Microeconomic Questions



- How are Goods and Services Produced?
  - **Factors of production** are the resources that businesses use to produce goods and services.
  - They are grouped into four categories:
    - Land
    - Labour
    - Capital
    - Entrepreneurship



# Three Big Microeconomic Questions



- The “gifts of nature” that we use to produce goods and services are **land**.
- The work time and effort that people devote to producing goods and services is **labour**.
- The *quality* of labour depends on **human capital**, which is the knowledge and skill that people obtain from education, on-the-job training, and work experience.



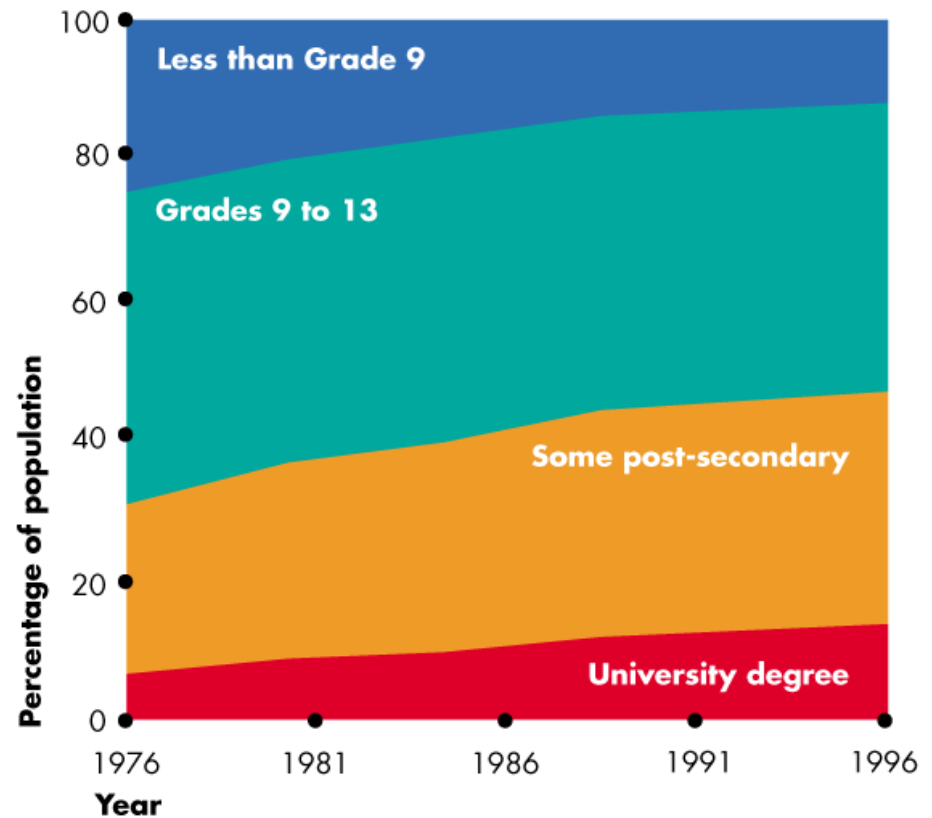


# Three Big Microeconomic Questions

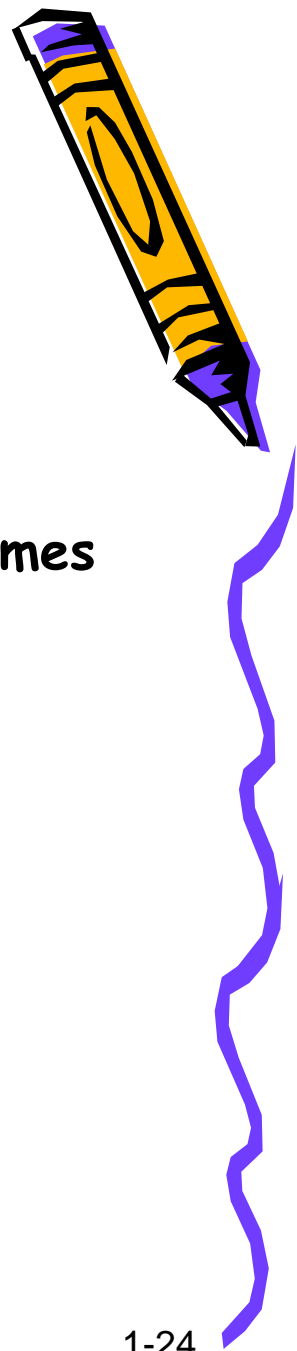
-The facts about how we produce raise the deeper question:

-What determines the quantities of capital, labour, and other resources that get used to produce goods and services?

-Microeconomics provides some answers to this question.



# Three Big Microeconomic Questions



- For Whom are Goods and Services Produced?
  - Who gets the goods and services depends on the incomes that people earn.
  - Land earns **rent**.
  - Labour earns **wages**.
  - Capital earns **interest**.
  - Entrepreneurship earns **profit**.



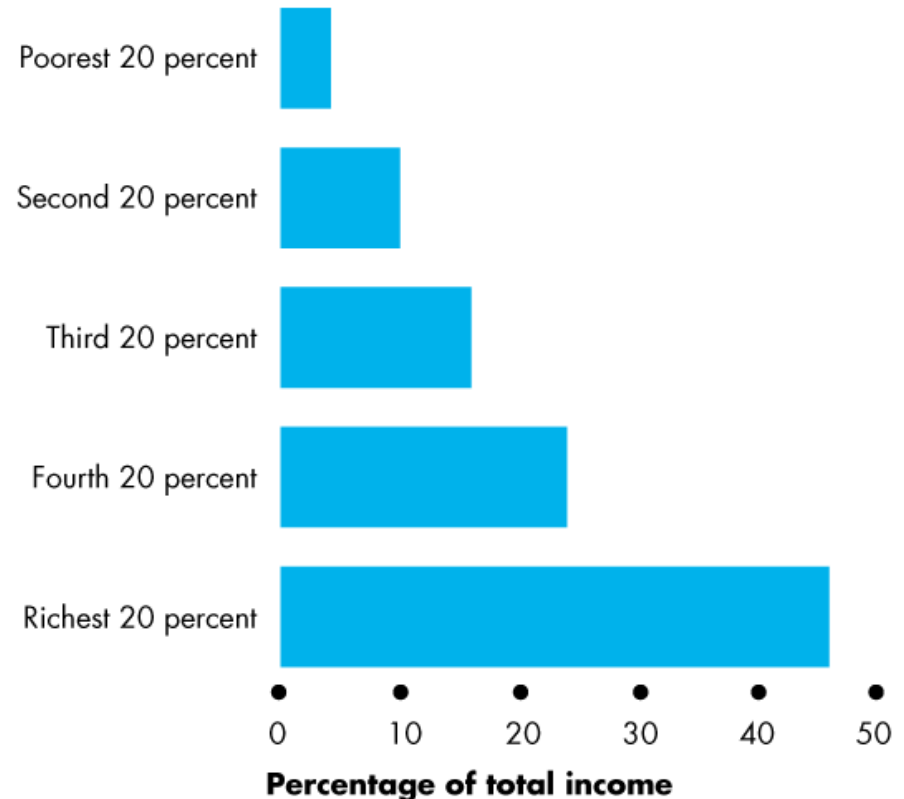
# Three Big Microeconomic Questions



-Figure 1.4 shows the distribution of income in Canada.

-The poorest 20 percent earn only 4 percent of total income while the richest 20 percent earn 46 percent of total income.

-



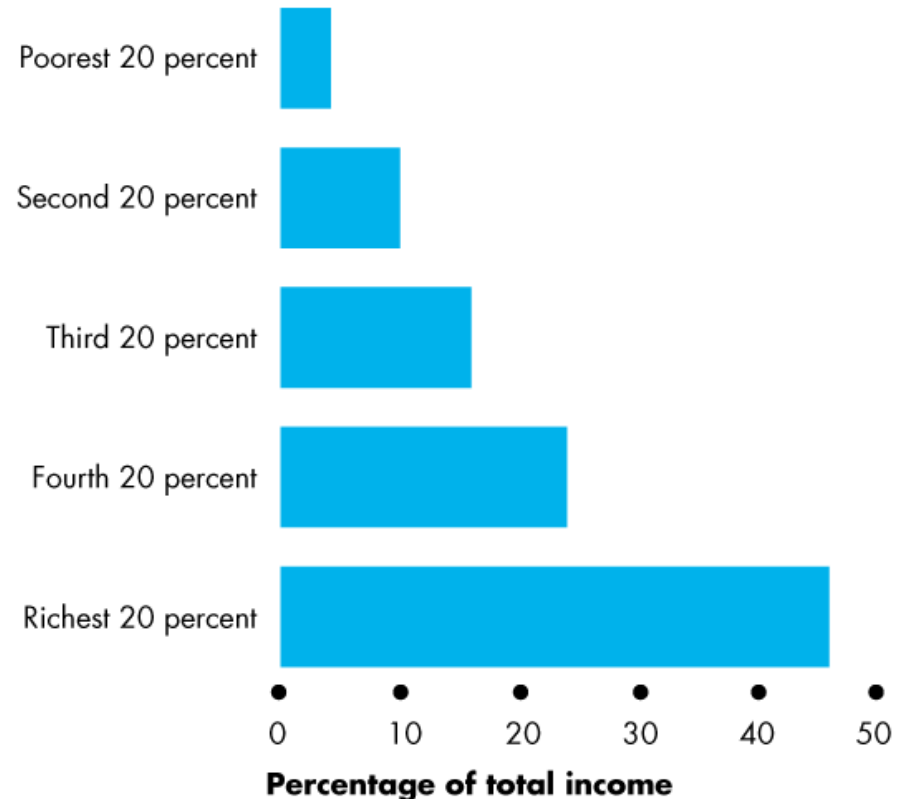
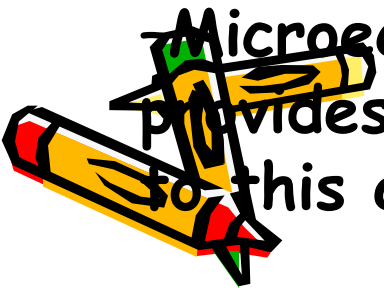
# Three Big Microeconomic Questions



-The facts about for whom raise the deeper question:

-What determines earnings and the distribution of income that in turn determine who gets the goods and services produced?

Microeconomics provides some answers to this question.



# The Twin theme around which Economics Revolve: Scarcity & Efficiency



**Scarcity:** Goods are limited and wants are limitless. Therefore not able to match limited goods with unlimited wants is what we call scarcity.

**Efficiency:** denotes the most effective use of a society's resources in satisfying people's wants and need. It is said that an economy is considered to be producing efficiently when it cannot increase the economic welfare of anyone without making someone else worse off.

**Economizing Resources:** means making the best use of resources (same as efficiency).

This is basically the axis on which the study of economics is rotating.



# 8. Production Possibility Curve



Market, Command and Mixed Economies:

Market Economy: Where individuals and private firms make the major decision about production & consumption. It may also be called laissez-faire economy e.g. America and other democratic countries

Command Economy: Where the Government makes all important decisions about production & distribution e.g. Soviet Union. It may be called as communistic economy as well.

Mixed Economy: Where the decision pertaining to production, consumption & distribution are taken by the Government as well as the individual such a market is called to have a mixed economy. There can not be a 100% Capitalist Economy but in the 19<sup>th</sup> century England came most close to it.



# Production



To match the limited resources with the unlimited want every society must make choices about the economy inputs and outputs

Inputs: These are the commodities/services that are used to produce goods and services.

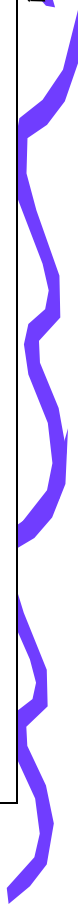
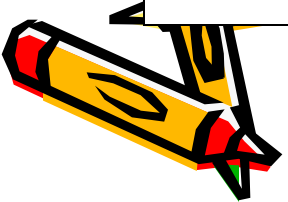
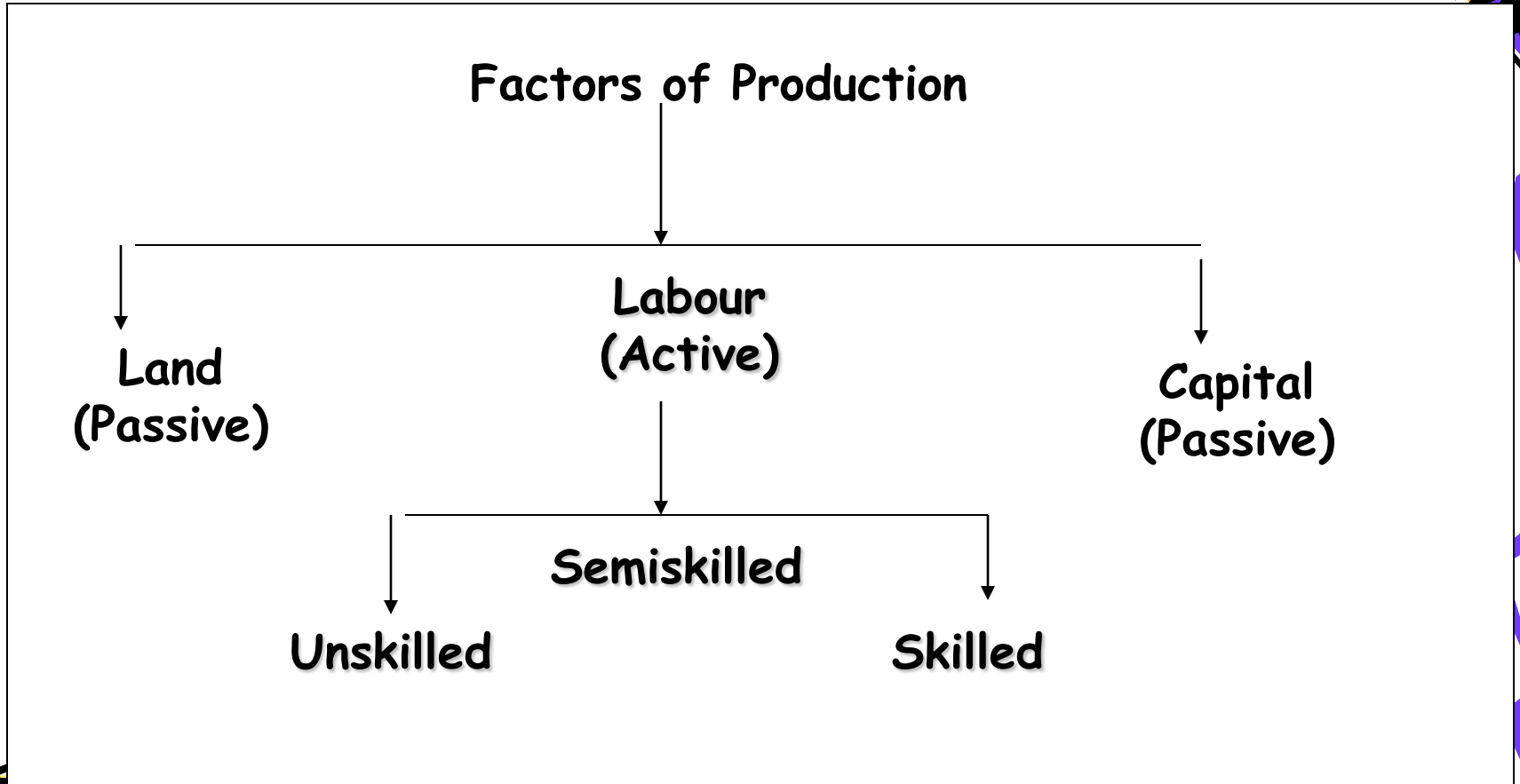
Outputs: These are the various useful goods or services that results from the production process and are either consumed or employed in further production.

Inputs can further be understood in terms of factors of production. These can further be classified into three broad categories:





# Production



# Production - Possibility Frontier



This explains the number of possibilities for production keep certain factors as unchanged.

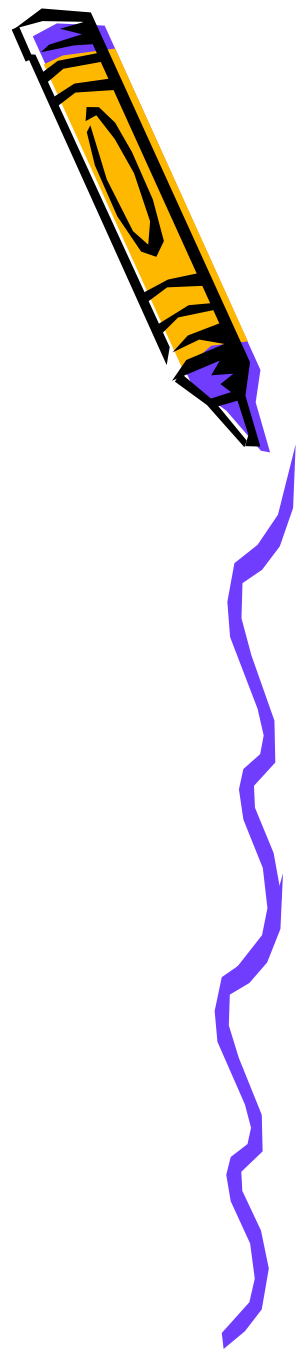
## Assumptions:

- Scarce input and technology
- Considering an economy which produces only two economic goods
- Economy is having full employment

The production possibility frontier shows the maximum amounts of production that can be obtained by an economy, given its technological knowledge and quantity of inputs available. The PPF represents the menu of goods and services available to society.



# PROD. POSSIBILITY SCHEDULE



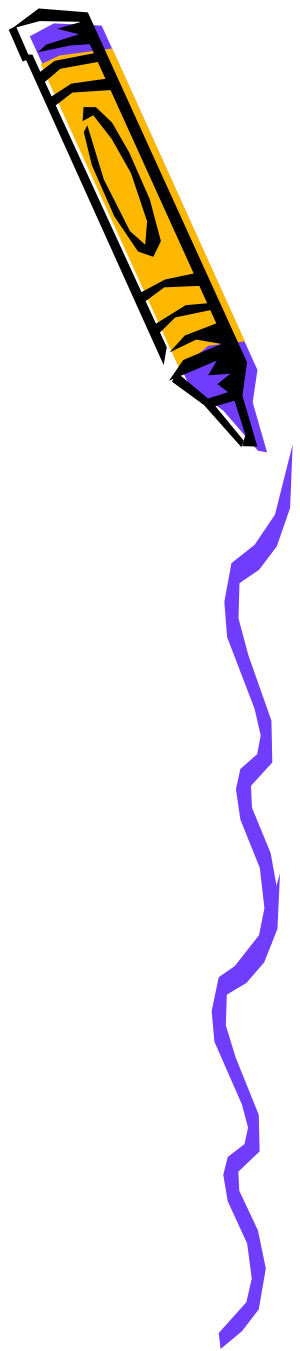
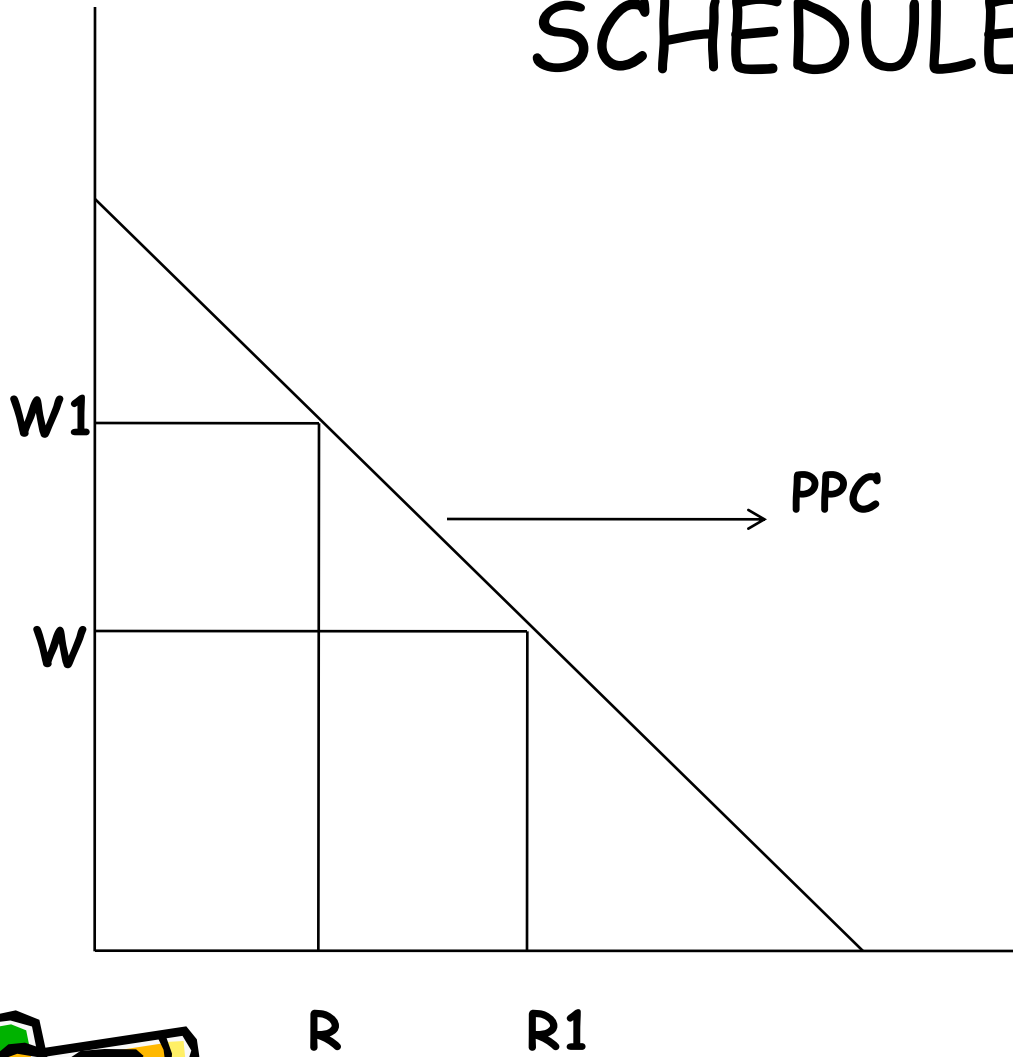
- WHEAT
- 
- 0
- 20
- 40
- 60
- 80
- 100

RICE

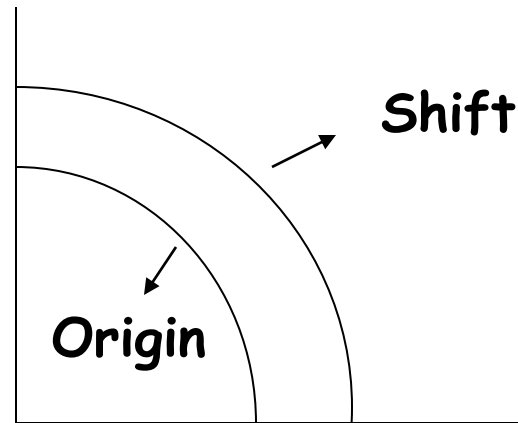
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# PROD POSSIBILITY SCHEDULE

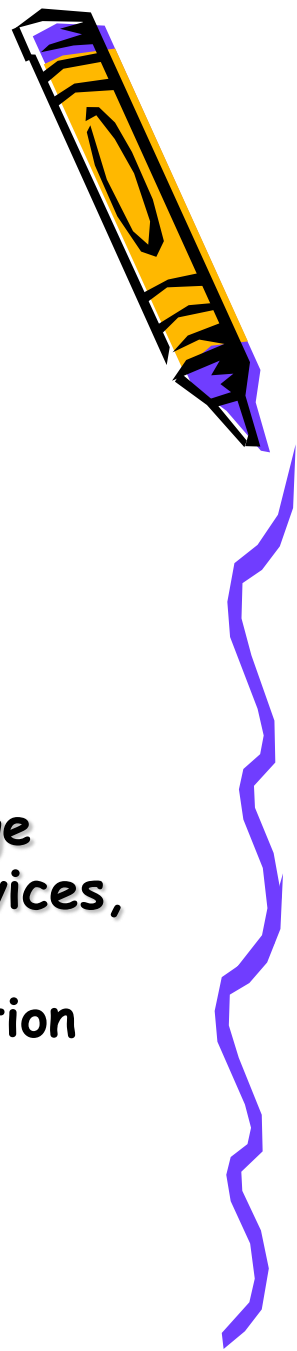


# Production Possibility Curve



An increase in inputs or improved technological knowledge enables a country to produce more of all goods and services, thereby shifting out the PPF.

Poor countries should devote more towards food production while rich countries towards luxuries



# Utility/Benefits of PPF

- # Helps in economy's choice between current consumption goods and investment or capital goods
- # At times also shows the crucial economic notion of tradeoffs

Productive Efficiency: occurs when an economy cannot produce more of goods without producing less of another good. This implies that an economy is on its PPF

Reasons for inside shift of PPF -

- # Business cycle and depression
- # Inefficiency and dislocation, strikes, political changes and revolution



# 9. Opportunity Cost

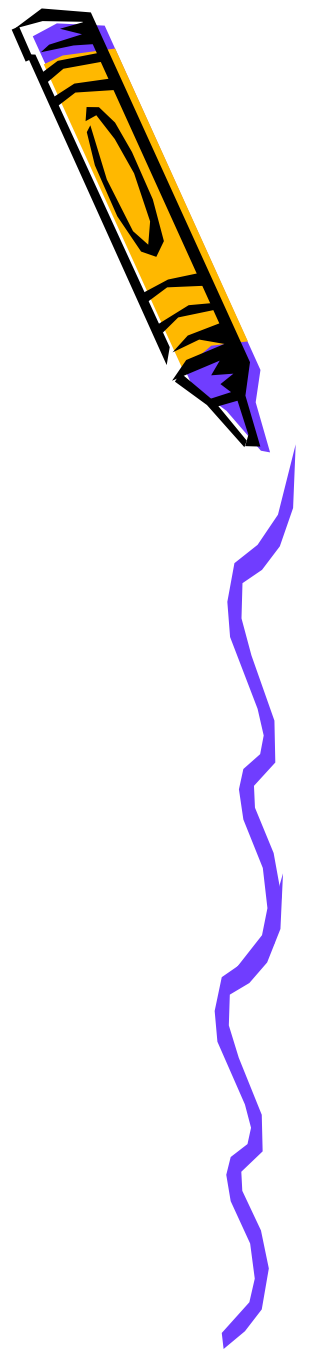


- The cost of the forgone alternative is the opportunity cost of decision. This cost can also be well explained using PPF.
- In the world of scarcity, choosing one thing means giving up something else. The opportunity cost of a decision is the value of the goods or service forgone.
- According to Furguson: The alternative of opportunity cost of producing one unit of commodity "x" is the amount of commodity "y" that must be sacrificed in order to use resources to produce "x" rather than "y".





# Question to Consider



- What is the opportunity cost of your attending university?
- Include all forgone options in your consideration.



# 10. Microeconomics



- Microeconomics is the study of individual units like individual household, pricing of a firm, wages of a worker, profit of an entrepreneur and so on.
- Definition: According to K.E. Boulding: "Microeconomics is the study of particular firms, particular households, individual prices, wages, incomes, individual industries, particular commodities"
- Scope of Microeconomics:
  - Theory of Demand
  - Theory of Production and Cost
  - Factor Pricing (Theory of Distribution)
  - Theory of Economic Welfare

