

UNIT- I

Introduction(Nature and scope of managerial economics)

MODULE- 1

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1.0: LEARNING OBJECTIVES:

The main objective of this unit is to introduce you to the subject of economics and its sub- branch managerial economics. After studying this unit, you should be able to understand the:

- Origin of economics
- Definitions of economics
- Difference between micro and macro economics

1.01: INTRODUCTION (ORIGIN OF ECONOMICS)

One can trace the roots of economics in the 3rd century B.C. Kautilya, also known as Chanakya, Minister at Chandragupta Mourya's court, authored Arthashastra. In that book in addition to discussing at length the state craft, he discussed the methods of revenue mobilization. In 6th and 7th century A.D, Greek philosophers also used the word economics in their writings in a crude manner. They discussed economics as part of political economy and not as a separate entity. The word 'economics' evolved out of Greek words 'Okino Mikos' which implies

household activity. In a way, the Greeks associated economics as the management of household activity.

1.02: DEFINITIONS OF ECONOMICS

The era of modern economics was rooted in the writings of Adam Smith. By the end of 18th century Adam Smith has drawn a beautiful picture of economics through vivid writings on different aspects of economics. In his writings, he outlined the boundaries of economics. In economics literature Adam Smith is generally considered as the 'father of economics'. He cemented strong foundations for the growth of economics as one of the unique subjects within the gambit of social sciences.

Adam Smith published his pathbreaking and first modern work of economics titled "An inquiry into the nature and causes of wealth of nations" passionately called as "wealth of nations" and "epic on economics" in the year 1776. In that book, he stated explicitly that 'self-interest' is the basic motivational force behind growth of economies as well as individuals. According to him, unless there is an element of self-interest in the activities of human beings, it is impossible to see the light at the end of the tunnel. Progress of nations and also individuals to a large extent depends on the self-interest oriented attitude of individuals. Regarding self-interest Smith stated that "by pursuing his own interest he frequently promotes that of society more effectually than when he really intends to promote it". It is self-interest that governs the activities of individuals. In this context Smith strongly felt that "It is not from the benevolence of the butcher, the brewer or the baker that we expect our dinner but from their regard to their own interest. We address ourselves not to their humanity but to their self love and never talk to them of our own necessities but of their advantages". Smith described how rational self-interest and competition oriented free market mechanism can sustain economic prosperity.

According to Adam Smith economics confines itself to the study of creation of wealth, distribution of wealth and consumption of wealth. According to Adam Smith, in brief, economics is the study of wealth. He described wealth as “the annual produce of land and labour of the society”.

In the later part of 19th century Alfred Marshall of Cambridge School proposed welfare definition of economics. He published “Principles of Economics” in the 1890. In that book he emphasized the discussion of ‘welfare-centric human activity’ as the heart and soul of economics.

Marshall stated that “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”. According to Marshall, economics is on the one side a study of wealth and on the other and most important side a study of human welfare. He strongly advocated that promotion of human welfare is the ultimate goal of economics. According to Marshall “wealth is for man and not man is for wealth”.

Edwin Cannan, Pigou, Beveridge strongly supported Marshall’s views and also described economics as the study of human welfare. According to Pigou economics is confined to “that part of social welfare which can be brought directly or indirectly into relation with the measuring rod of money”

Lionel Robbins disagreed with Marshall’s description of economics as the study of human welfare and proposed his understanding of economics in the form of a book titled “An Essay on the Nature and Significance of Economic Science” in the year 1935. His description of economics is in relation to unlimited human wants, limited resources and their alternative uses. He defined economics as “the positive science which studies human behavior as a relationship between ends and scarce means which have alternative uses”.

Robbins definition also known as scarcity definition brings out the true nature of human activity. It is a fact that there is no end to human wants. If a person satisfies one want, immediately there arise another want. At the same time, the available resources at the disposal of any individual are limited. Since the resources have alternative uses, if they use some resources to satisfy any one want, to that extent they are not available to satisfy another want. This leads to universal problem of economic choice and the prioritisation of wants. This is true with reference to individuals and also nations.

The inescapable fact is that individuals and also nations have plans at their respective levels, ex:

(1). household plans and national plans. The reason for this is that they have to satisfy innumerable wants but the means (resources) to satisfy ends (wants) are not sufficient. As a result it puts pressure on the planning authority to take note of wants to be satisfied immediately and in future.

(2). As a student you have to satisfy many a want. You want to buy a note book, pen, watch a movie and have breakfast. To satisfy all these wants you require Rs 200. Assume that the amount of money at your disposal is Rs 100. Since the means are not sufficient to fulfill all wants, it force you to prioritise wants and accordingly you have to satisfy them keeping in mind the intensity of wants and available resources. Hence economics revolves around 'wants-efforts-satisfaction' in a circular fashion.

ACTIVITY-1

1. List out the definitions of economics.

2. List out your wants as a rational student.

3. Spell out, how you are going to satisfy all/few listed wants?.

1.03: MICRO AND MACRO ECONOMICS

The subject matter of economics has been broadly classified into two parts. They are (1). Micro economics (2). Macro economics. We shall try to understand these two parts of economics in detail.

1.03.1: MICRO ECONOMICS:

This part of economics studies the behavior of individual units such as

Purchase pattern of a consumer at different prices

Supply pattern of a producer at different prices

Equilibrium price determination of individual commodities

Profit maximization by a producer

Utility maximization by a consumer

In micro economics we discuss how the innumerable individual units of the economy, for example: consumers, producers and resource suppliers, conduct their economic activities and reach equilibrium state. According to Boulding “Micro economics is the study of particular firms, particular households, individual prices, wages, incomes, individual industries, particular commodities”. Micro economic theory seeks to determine the mechanism by which the different economic units attain the position of equilibrium. Micro economic analysis concerns itself with narrowly defined individual units and it does not study the totality of behavior of all units in the economy. Further micro economic theory studies resource allocation and the determination of product and factor pricing. It also seeks to explain whether allocation of resources is efficient or not. Economic efficiency in the allocation of resources is attained when the resources are so allocated that maximizes the satisfaction of the people. Economic efficiency involves efficiency in exchange/distribution, efficiency in production and efficiency in the allocation of resources among business firms. What to produce, how to produce, whom to produce for and the production & distribution of these goods for consumption is efficient or not, fall within the domain of micro economics. The whole content of micro economic theory also known as price theory is summarized in the following chart.

-Chart- 1

1.03.2 MACRO ECONOMICS

Macro economics is the study of aggregates. It deals with the behavior of the whole economy. It studies the behavior of macro economic aggregates such as

national income, national output, employment, unemployment, aggregate expenditure, saving , investment, exports, imports, general price level. Since it studies the behavior of aggregates, macro economics also called as aggregate economics or employment theory or theory of income determination.

-Chart-2

We can sum up the contents of micro and macro economics by saying that micro economics studies the characteristics of each and every tree in a forest separately whereas macro economics studies the character of the forest as a whole irrespective of kind of trees and their canopy.

ACTIVITY -2

1. What do understand by the behavior of individual units? .

2. Explain the meaning of economic efficiency

3. List out macro economic variables.

ACTIVITY - 3

Match the following

1. Wealth definition

Micro economics()

2. Welfare definition

Kautilya ()

| | |
|------------------------|------------------------|
| 3. Scarcity definition | Marshall () |
| 4. Resource allocation | Aggregate economics() |
| 5. Employment theory | Robbins () |
| 6. Arthashastra | Adam Smith () |

1.04: SUMMARY

In this unit we introduced you to the origin of economics, definitions of economics and the contents of micro and macro economics. The word 'economics' evolved out of Greek words 'Okino Mikos' which implies household activity. In a way, the Greeks associated economics as the management of household activity. Adam Smith has drawn a beautiful picture of economics by stating economics revolves around 'wealth'. According to Marshall the backbone of economics is human welfare. According to Robbins the heart of economics is the scarcity of resources and wants are unlimited. Economics has been broadly classified into micro and macro economics. The basic character of micro economics is to study the behavior of individual/ small units. Micro economics is called as price theory. On the other hand the basic character of macro economics is the study of behavior of aggregates. Macro economics is called as aggregate economics/ employment or income determination theory.

1.05: ADDITIONAL READINGS:

1. Adam Smith: Wealth of Nations
2. Alfred Marshall: Principles of Economics
3. L.Robbins : Economic Science

For these books 1,2,3 students are advised to take help from internet.

4. Jeffery M. Perloff: Micro Economics, second edition, Pearson Education Asia.

5. N. Gregory Mankiw : Macro Economics, fifth edition, Worth Publishers.

6. Michael R. Edgmand: Macro Economics- Theory and Policy, Prentice Hall of India

1.06 SELF ASSESSMENT TEST

1. How does micro economics differs from macro economics?.
2. Bring out the main features of wealth definition of economics.
3. Explain the statement 'Economics revolves around wants- efforts-satisfaction'.
4. 'Scarcity is the root cause of all economic problems'-discuss with suitable examples.
5. According to Marshall, what is the ultimate goal of economics?