

PRINCIPLES OF ECONOMICS

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Reference: *Karl E. Case, Ray C. Fair and Sharon M. Oster: Principles of Economics, Pearson Publisher*

Syllabus

Unit I Basic Concepts of Economics

- Scope and Method of Economics: What is Economics, Why study Economics, Scope and Fields of Economics, The methods of Economics, The Economic Policy.
- Demand, Supply and Market Equilibrium: Firms and Household; input markets and output markets: The Circular Flow; Demand and supply, individual and market demand and supply and their determinants, Market Equilibrium, Price Elasticity and its determinants.
- Household Behaviour and Consumer Choice: The consumption decisions –Choices made by Households; budget constraints, Basis of Choice: Utility; Diminishing MU, allocating income to maximise utility, income and substitution effects, Consumer and Producer Surplus.

Unit II Firm Behaviour and Market

- Production: Production, Behaviour of profit maximizing firms, Production Functions with one variable factor of production, TP, MP, AP, Production Functions with Two variables factor of production, Isoquant and Iso-cost lines, Cost minimizing equilibrium Condition
- Cost and Revenue Functions: Accounting and Economic costs, Costs in the short run, Fixed costs, variable costs, Marginal costs, Long run AC and MC, TR,MR,AR.
- Markets, Perfect and Imperfect, Features of Perfect Competition, Monopoly, Oligopoly and Monopolistic Competition

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Unit III Input Markets

- Input Markets: Labour, Land and Capital Markets (Basic concepts), Demand for inputs, Diminishing Returns, Marginal Revenue Product, Input demand curve; Labour Market and demand for labour; shifts in input demand curves; Land markets and rent, Capital Market, Capital Income-Interest and profit

Unit IV Introduction to Macroeconomics

- The roots of macroeconomics, Difference between micro and macro economics, macroeconomic concerns, the role of government in the macro economy, the components of the macro economy, the methodology of macroeconomics. Introduction to National Income Accounting: Concepts of GDP, GNP and national income, approaches to calculating GDP, personal income, Nominal and real GDP, Limitations of the GDP concept, GDP and the black economy.

Unit V Money in the Modern Economy

- Characteristics of a monetary economy; The demand for money; The supply of money and overall liquidity position; credit creation. Inflation: The causes of inflation, level of prices and the value of money, the Fisher effect, the cost of inflation.

Unit VI The International Economy

- Trade surpluses and deficits, the economic basis for trade—absolute advantage and comparative advantage, terms of trade, exchange rates; Trade Barriers--tariffs, subsidies and quotas; The cases for free trade or protection; Balance of Payments--The current and capital account.

What is Economics?

- Economics is a study of rationing systems
- It is the study of how scarce resources are allocated to fulfill the infinite wants of consumers
- According to Prof. Lionel Robbins

“Economics is the science which studies human behaviour as a relation between ends and scarce means which have alternative uses”

Characteristics of Robbins Definition

A. Unlimited Wants

- According to Prof Robbins definition, human wants are unlimited. On satisfaction of one wants, another want arises immediately and this sequence continues forever.

B. Scarce Means

- Robbins definition stated that through on one side human needs are unlimited yet on the other side, the means to satisfy these wants, like- time, power, money etc. are also limited. Due to this, many of man's needs remain unsatisfied.

C. Alternative Use of Scarce Means

- In Robbins's view though the to 'satisfy man's needs are scarce, yet he has alternative uses. For example – such a resource like land can be use in many ways, such as it can be used for agriculture or for building a house or to established a factory etc.

D. Variation in the Intensity of wants

- Robbins definition states that the intensity of man's needs is different. Some wants are more intense than the others. Since our means are limited and all wants cannot be satisfied with the limited means; as a result, we have to select some more intense wants from our unlimited wants and the less intense wants have to be either dropped or postponed to a future date.

Why Study Economics?

- There are four main reasons to study economics:
 - to learn a way of thinking,
 - to understand society,
 - to understand global affairs, and
 - to be an informed voter.

The Scope of Economics

MICROECONOMICS AND MACROECONOMICS

- **microeconomics** The branch of economics that examines the functioning of individual industries and the behavior of individual decision-making units—that is, business firms and households.
- **macroeconomics** The branch of economics that examines the economic behavior of aggregates— income, employment, output, and so on—on a national scale.

Microeconomics looks at the individual unit—the household, the firm, the industry. It sees and examines the “trees.” Macroeconomics looks at the whole, the aggregate. It sees and analyzes the “forest.”

THE DIVERSE FIELDS OF ECONOMICS

TABLE 1 Examples of Microeconomic and Macroeconomic Concerns

DIVISION OF ECONOMICS	PRODUCTION	PRICES	INCOME	EMPLOYMENT
Microeconomics	<i>Production/output in individual industries and businesses</i> How much steel How much office space How many cars	<i>Price of individual goods and services</i> Price of medical care Price of gasoline Food prices Apartment rents	<i>Distribution of income and wealth</i> Wages in the auto industry Minimum wage Executive salaries Poverty	<i>Employment by individual businesses and industries</i> Jobs in the steel industry Number of employees in a firm Number of accountants
Macroeconomics	<i>National production/output</i> Total industrial output Gross domestic product Growth of output	<i>Aggregate price level</i> Consumer prices Producer prices Rate of inflation	<i>National income</i> Total wages and salaries Total corporate profits	<i>Employment and unemployment in the economy</i> Total number of jobs Unemployment rate

The Economic Problem

- Unlimited Wants
- Scarce Resources – Land, Labour, Capital
- Resource Use
- Choices

The Central Problem of an Economy

- **What goods and services should an economy produce?** – should the emphasis be on agriculture, manufacturing or services, should it be on sport and leisure or housing?
- **How should goods and services be produced?** – labour intensive, land intensive, capital intensive? Efficiency?
- **Who should get the goods and services produced?** – even distribution? more for the rich? for those who work hard?

Factors of Production

- Land

- natural resources available for production
- renewable resources: those that replenish
- non-renewable resources: cannot be replaced

- Labor

- physical and mental effort of people used in production

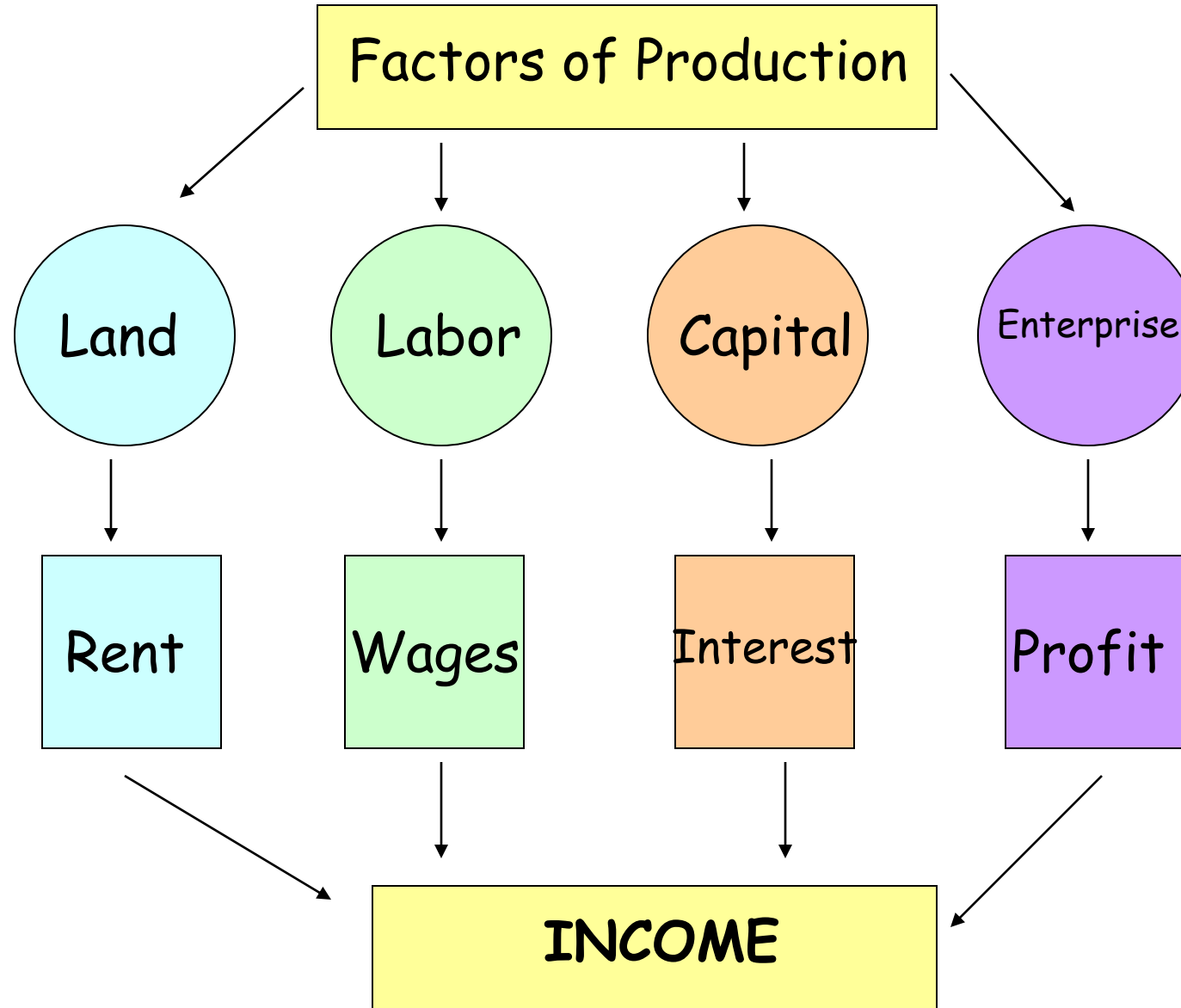
- Capital

- all non-natural (manufactured) resources that are used in the creation and production of other products

- Enterprise (Entrepreneurship)

- refers to the management, organization and planning of the other three factors of production

Payments
to factors
of Production



Opportunity Cost

- Definition – the cost expressed in terms of the next best alternative sacrificed
- Helps us view the true cost of decision making
- Implies valuing different choices

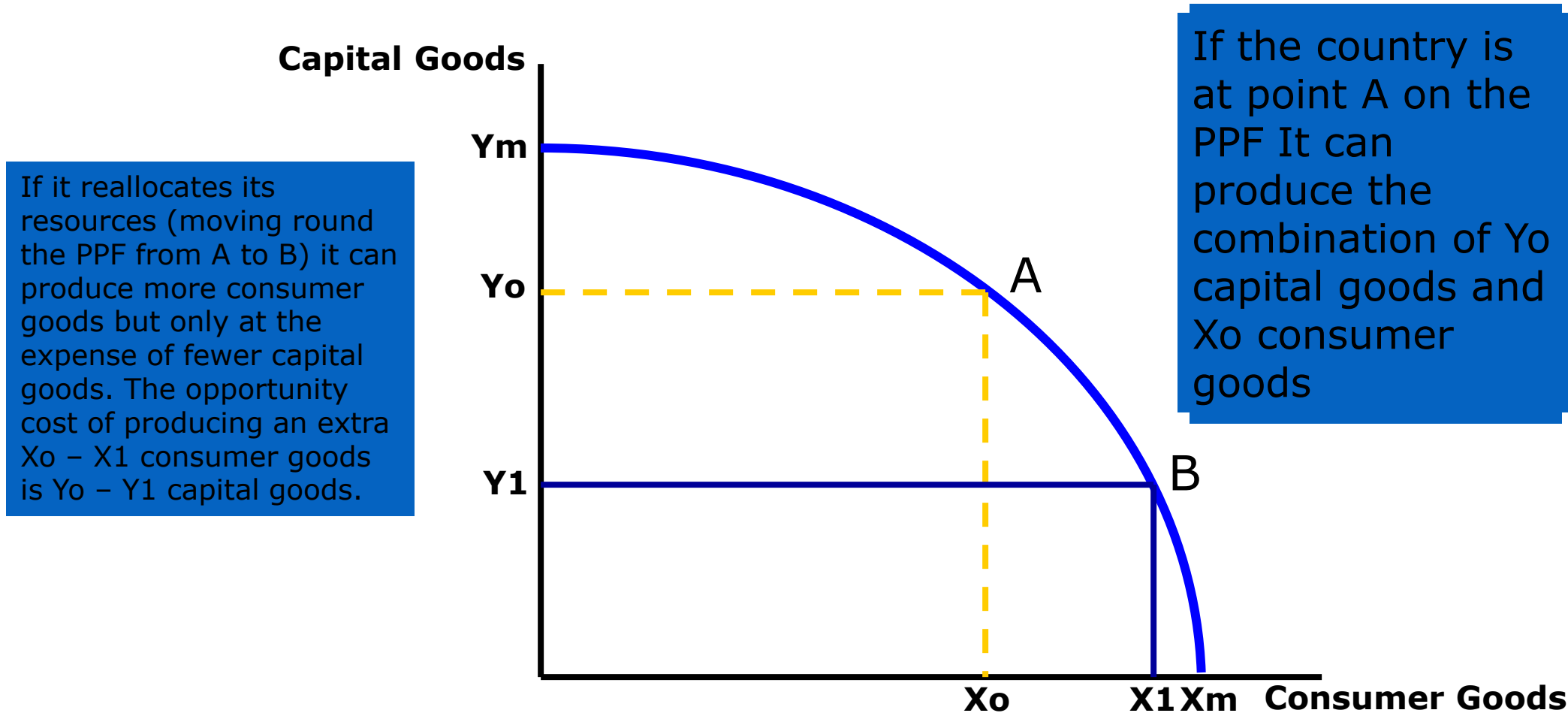
Production Possibility Curves (Frontier) also known as PPF

- **Production** – output of goods and services
- **Possibility** – maximum attainable amount
- **Frontier** – border or boundary
- **PPF** shows the boundary of what is possible and is used as an illustration in economics to show the choices facing all countries in producing goods which use limited factors of production.

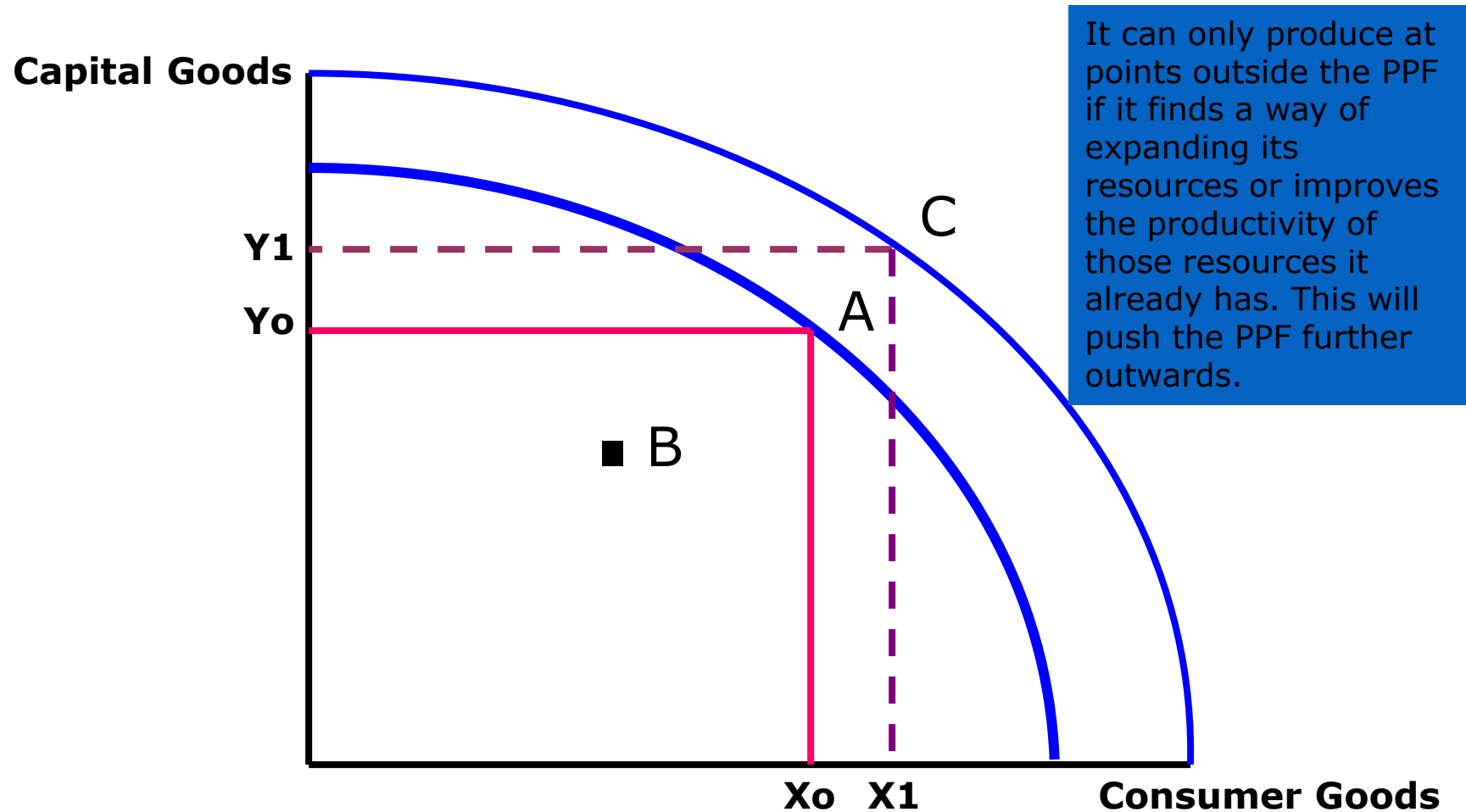
Production Possibility Frontiers

- Show the different combinations of goods and services that can be produced with a given amount of resources
- No 'ideal' point on the curve
- Any point inside the curve – suggests resources are not being utilised efficiently
- Any point outside the curve – not attainable with the current level of resources
- Useful to demonstrate economic growth and opportunity cost

Production Possibility Frontiers



Shift of PPF



Any Questions?