A. WHY STUDY ECONOMICS?

As you open this textbook, you may be wondering, Why should I study economics? Let us count the ways. Many study economics to help them get a good job. Some people feel they should understand more deeply what lies behind reports on inflation and unemployment. Or people want to understand what kinds of policies might slow global warming or what it means to say an iPod is "made in China."

For Whom the Bell Tolls

All these reasons and many more, make good sense. Still, as we have come to realize, there is one overriding reason to learn the basic lessons of economics: All your life—from cradle to grave and beyond—you will run up against the brutal truths of economics. As a voter, you will make decisions on issues that cannot be understood until you have mastered the fundamentals of this subject. Without studying economics, you cannot be fully informed about international trade, tax policy, or the causes of recessions and high unemployment. Choosing your life's occupation is the most important economic decision you will make. Your future depends not only on your own abilities but also on how national and regional economic forces affect your wages. Also, your knowledge of economics can help you make wise decisions about how to buy a home, pay for your children's education, and set aside a nest egg for retirement. Of course, studying economics will not make you a genius. But without economics the dice of life are loaded against you. There is no need to belabor the point. We hope you will find that, in addition to being use-ful, economics is even a fascinating field. Generations of students, often to their surprise, have discovered how stimulating it is to look beneath the surface and understand the fundamental laws of economics.

SCARCITY AND EFFICIENCY: THETWIN THEMES OF ECONOMICS

Definitions of Economics

Let us begin with a definition of economics. Over the last half century, the study of economics has expanded to include a vast range of topics. Here are some of the major subjects that are covered in this book:

●Economics explores the behavior of the financial markets, including interest rates, exchange rates, and stock prices.

●The subject examines the reasons why some people or countries have high incomes while others are poor; it goes on to analyze ways that poverty can be reduced without harming the economy.

●It studies business cycles—the fluctuations in credit, unemployment, and inflation—along with policies to moderate them.

●Economics studies international trade and finance and the impacts of globalization, and it particularly examines the thorny issues involved in opening up borders to free trade.

●It asks how government policies can be used to pursue important goals such as rapid economic growth, efficient use of resources, full employment, price stability, and a fair distribution of income. This is a long list, but we could extend it many times. However, if we boil down all these definitions, we find one common theme:

Economics is the study of how societies use scarce resources to produce valuable goods and services and distribute them among different individuals.

Scarcity and Efficiency

If we think about the definitions, we find two key ideas that run through all of economics: that goods are scarce and that society must use its resources efficiently. Indeed, the concerns of economics will not go away because of the fact of scarcity and the desire for efficiency.

Consider a world without scarcity. If infinite quantities of every good could be produced or if human desires were fully satisfied, what would be the consequences? People would not worry about stretching out their limited incomes because they could have everything they wanted; businesses would not need to worry over the cost of labor or health care; governments would not need to struggle over taxes or spending or pollution because nobody would care. Moreover, since all of us could have as much as we pleased, no one would be concerned about the distribution of incomes among different people or classes.

In such an Eden of affluence, all goods would be free, like sand in the desert or seawater at the beach.

All prices would be zero, and markets would be unnecessary. Indeed, economics would no longer be a useful subject. But no society has reached a utopia of limitless possibilities. Ours is a world of scarcity, full of **economic goods**

. A situation of scarcity is one in which goods are limited relative to desires. An objective observer would have to agree that, even after two centuries of rapid economic growth, production in the United States is simply not high enough to meet everyone's desires. If you add up all the wants, you quickly find that there are simply not enough goods and services to satisfy even a small fraction of everyone's consumption desires. Our national output would have to be many times larger before the average American could live at the level of the average doctor or major-league baseball player. Moreover, outside the United States, particularly in Africa, hundreds of millions of people suffer from hunger and material deprivation. Given unlimited wants, it is important that an economy make the best use of its limited resources. That brings us to the critical notion of efficiency.

Efficiency denotes the most effective use of a society's resources in satisfying people's wants and needs. By contrast, consider an economy with unchecked monopolies or unhealthy pollution or government corruption. Such an economy may produce less than would be possible without these factors, or it may produce a distorted bundle of goods that leaves consumers worse off than they otherwise could be either situation is an inefficient allocation of resources.

Economic efficiency requires that an economy produce the highest combination of quantity and quality of goods and services given its technology and scarce resources.

B. THE THREE PROBLEMS OFECONOMIC ORGANIZATION

Every human society—whether it is an advanced industrial nation, a centrally planned economy, or an isolated tribal nation—must confront and resolve three fundamental economic problems. Every society must have a way of determining what commodities are produced, how these goods are made, and for whom they are produced. Indeed, these three fundamental questions of economic organization—what, how, and for whom—are as crucial today as they were at the dawn of human civilization. Let's look more closely at them:

- What commodities are produced and in what quantities? A society must determine how much of each of the many possible goods and services it will make and when they will be produced.

Will we produce pizzas or shirts today? A few high quality shirts or many cheap shirts? Will we use scarce resources to produce many consumption goods (like pizzas)? Or will we produce fewer consumption goods and more investment goods (like pizza-making machines), which will boost production and consumption tomorrow?

●How are goods produced? A society must determine who will do the production, with what resources, and what production techniques they will use. Who farms and who teaches? Is electricity generated from oil, from coal, or from the sun? Will factories be run by people or robots?

●For whom are goods produced? Who gets to eat the fruit of economic activity? Is the distribution of income and wealth fair and equitable? How is the national product divided among different households? Are many people poor and a few rich? Do high incomes go to teachers or athletes or autoworkers or venture capitalists? Will society provide minimal consumption to the poor, or must people work if they are to eat?

INPUTS AND OUTPUTS

To answer these three questions, every society must make choices about the economy's inputs and out-puts.

Inputs are commodities or services that are used to produce goods and services. An economy uses its existing technology to combine inputs to pro-duce outputs.

Outputs are the various useful goods or services that result from the production process and are either consumed or employed in further production. Consider the "production" of pizza. We say that the eggs, flour, heat, pizza oven, and chef's skilled labor are the inputs. The tasty pizza is the output. In education, the inputs are the time of the faculty and students, the laboratories and classrooms, the text-books, and so on, while the outputs are informed, productive, and well-paid citizens. Another term for inputs is

Factors of production

.These can be classified into three broad categories: land, labor, and capital.

●Land —or, more generally, natural resources—represents the gift of nature to our societies. It consists of the land used for farming or for under-pinning houses, factories, and roads; the energy resources that fuel our cars and heat our homes; and the non energy resources like copper and iron and sand. In today's congested world, we must broaden the scope of natural resources to include our environmental resources, such as clean air and drinkable water.

●Labor consists of the human time spent in production—working in automobile factories, writing software, teaching school, or baking pizzas. Thousands of occupations and tasks, at all skill levels, are performed by labor. It is at once the most familiar and the most crucial input for an advanced industrial economy.

●Capital resources form the durable goods of an economy, produced in order to produce yet other goods. Capital goods include machines, roads, computers, software, trucks, steel mills, automobiles, washing machines, and buildings. As we will see later, the accumulation of specialized capital goods is essential to the task of economic development

Restating the three economic problems in these terms, society must decide (1) what outputs to pro-duce, and in what quantity; (2) how, or with what inputs and techniques, to produce the desired out-puts; and (3) for whom the outputs should be produced and distributed.

C-Microeconomics and Macroeconomics

Economics focuses on the behavior and interactions of economic agents and how economies work. Consistent with this focus, primary textbooks often distinguish between microeconomics and macroeconomics. Microeconomics examines the behavior of basic elements in the economy, including individual agents and markets, their interactions, and the outcomes of interactions. Individual agents may include, for example, households, firms, buyers, and sellers. Macroeconomics analyzes the entire economy (meaning aggregated production, consumption, savings, and investment) and issues affecting it, including unemployment of resources (labor, capital, and land), inflation, economic growth, and the public policies that address these issues (monetary, fiscal, and other policies).

D- History

The term economics comes from the Ancient Greek οἰκονομία from οἶκος (oikos, "house") and νόμος (nomos, "custom" or "law"), hence "rules of the house (hold for good management)". 'Political economy' was the earlier name for the subject, but economists in the late 19th century suggested "economics" as a shorter term for "economic science" to establish itself as a separate discipline outside of political science and other social sciences.

A definition that captures much of modern economics is that of **Lionel Robbins** in 1932 essay which states as "the science which studies human behavior as a relationship between ends and scare means which have alternative uses."

Adam Smith's Wealth definition

Adam Smith wrote a book in 1776 whose title was "Wealth of Nations". In his book he discussed the word 'wealth' through its four aspects: production of wealth, exchange of wealth, distribution of wealth and consumption of wealth. Therefore it can be said according to Adam Smith: "Economics is a science of wealth". Wealth means goods and services transacted with the help of money. Production of wealth means the production of goods and services by combining four factors of production 1) Land: It is the natural resources such as Sea, Minerals, Live Stock and forest. 2) Labour: It is the mental or physical work, which is done for the sake of reward. 3) Capital: It means man made resources which help to produce goods and services. 4) Organization: It is the act of combing four factors of production to produce goods and services for the sake of profit. The production of wealth means production of goods and services. After the completion of production process this wealth is distributed among the four factors of production for their performance. Rent is given to land, wages to labour, and interest to capital and profit to organization. When people get their share from the production, they use it to satisfy their wants. They spent their income to purchase of goods and services. The surplus goods and services are exchanged with other surplus goods and services for the satisfaction of wants.

Criticism of the classical definition--- This definition is too narrow as it does not consider the major problems faced by a society or an individual. Smith's definition is based primarily on the assumption of an 'economic man' who is concerned with wealth-hunting. That is why critics condemned economics as 'the bread-and-butter science'. Literary figures and social reformers branded economics as a 'dismal science', 'the Gospel of Mammon' since Smithian definition led us to emphasize on the material aspect of human life, i.e., generation of wealth. On the other hand, it ignored the non-material aspect of human life. Above all, as a science of wealth, it taught selfishness and love for money.

Alfred Marshall's Welfare Definition

Alfred Marshall in his book 'Principles of Economics' published in 1890 placed emphasis on human activities or human welfare rather than on wealth.

According to Alfred Marshall, "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."

Thus, “Economics is on the one side a study of wealth; and on the other and more important side, a part of the study of man.” According to Marshall, wealth is not an end in itself as was thought by classical authors; it is a means to an end—the end of human welfare.

Criticism--- Robbins argued that Marshall could not establish a link between economic activities of human beings and human welfare. There are various economic activities that are detrimental to human welfare. The production of war materials, wine, etc., are economic activities but do not promote welfare of any society. These economic activities are included in the subject-matter of economics. . Marshall’s definition ignores the fundamental problem of scarcity of any economy. It was Robbins who gave a scarcity definition of economics. Robbins defined economics in terms of allocation of scarce resources to satisfy unlimited human wants.

Robbin’s Scarcity Definition

The most accepted definition of economics was given by Lord Robbins in 1932 in his book ‘An Essay on the Nature and Significance of Economic Science. According to Robbins, neither wealth nor human welfare should be considered as the subject-matter of economics. His definition runs in terms of scarcity: “Economics is the science which studies human behavior as a relationship between ends and scarce means which have alternative uses.”