Introduction

6 Hours

Concept of Microeconomics

Unit 1 LH 3

Concept of Microeconomics

- Derived from Greek word, mikros- small. It studies the activity of small economic unit like individual consumers, producers, resource owners, etc.

- According to K.E. Boulding, “Microeconomics is the study of particular firm of a particular household, individual prices, wages, income, individual industries, particular commodities.”

Scope of Microeconomics

Scope of microeconomics indicates subject matter or issue that are explained and analyzed in microeconomics. The area or scope of microeconomics cover:

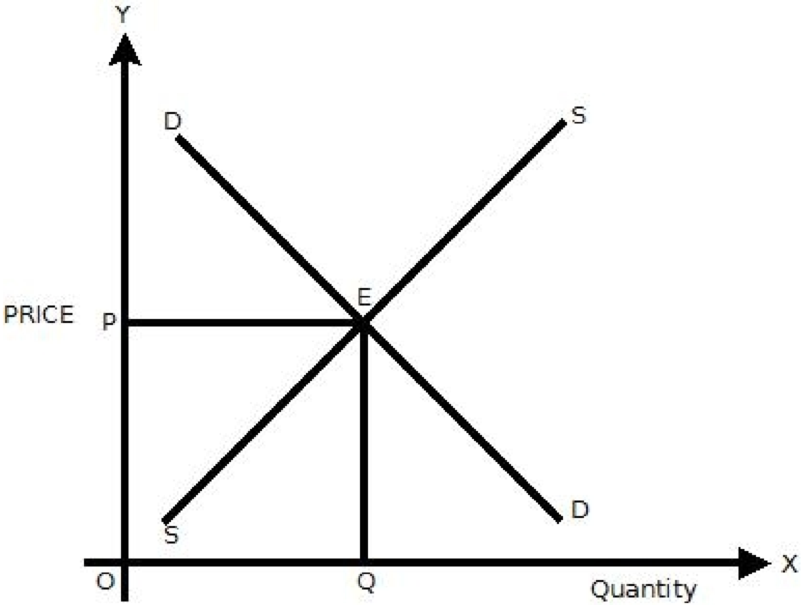
1. Theory of Demand
   It includes law of demand, elasticity of demand, law of diminishing marginal utility, law of equi-marginal utility, indifference curve, revealed preference theory and so on.
2. Theory of Production and Costs
   It includes law of variable proportion, law of return to scale, least cost combination of input, different concept of costs and linear programming.
3. Product Pricing
   It includes basic law of supply, determination of various goods through interaction between demand and supply.

Scope of Microeconomics

4. Theory of Factor Pricing
   Resources of production like land- rent, labour- wage, capital- interest, organization/entrepreneur- profit.
5. Theory of Welfare Economics
   Allocation of scarcely available resources, economic welfare of human community- whom to produce, how to produce, what to produce, when to produce.

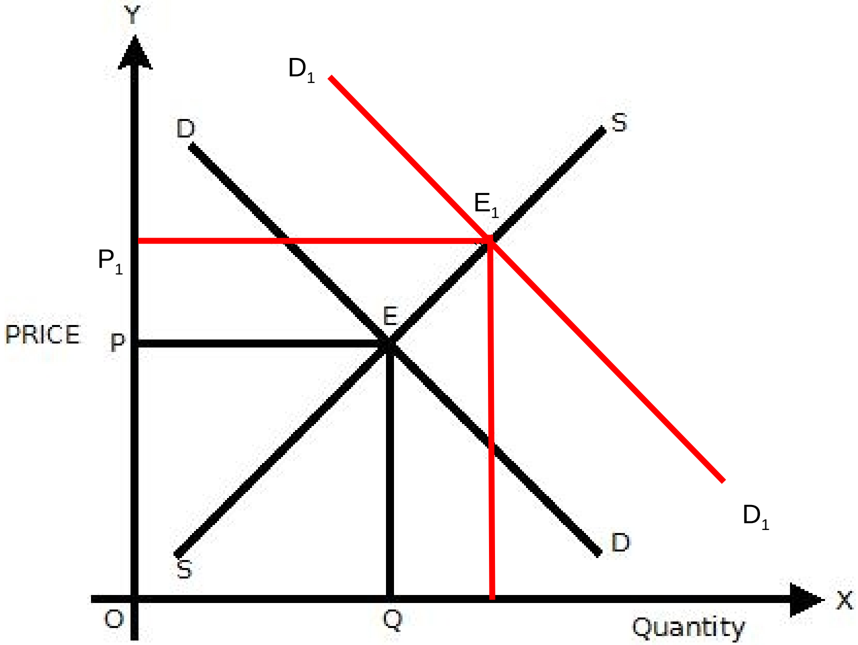
Types of Microeconomics

- **Micro-statics**
  - Explains relationship between two microeconomic variables measured at same time. Example: Equilibrium of demand for and supply of potatoes at a particular price at a particular date.
  - Demand: $Qd = f(P_t)$
  - Supply: $Qs = g(P_t)$
  - Market equilibrium: $Q_d = Q_s$ at the same time ‘t’



Comparative Micro-Statics

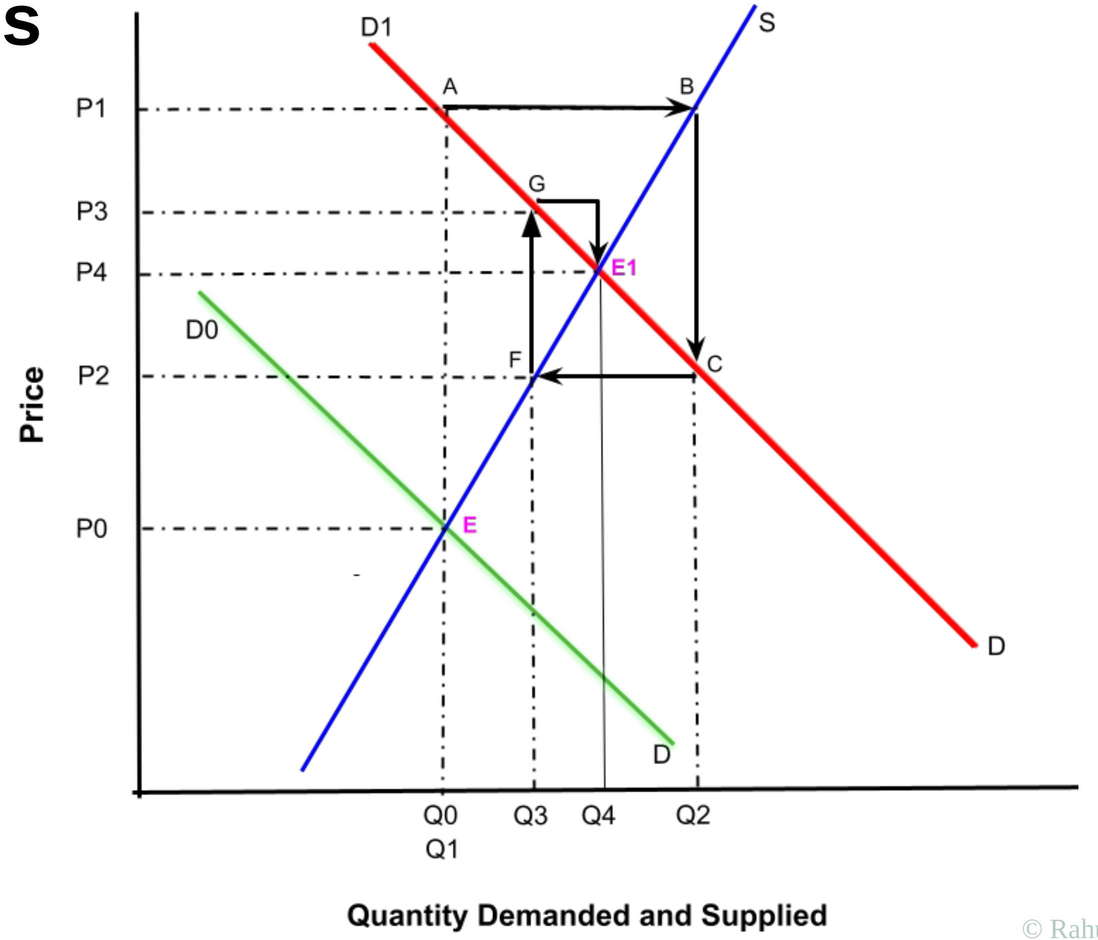
- It compares one equilibrium with another when the data have changed and the system has finally reached to another equilibrium position.
- Does not exhibit how system has reached to the final position



Microdynamics

- Study of forces leading towards equilibrium positions.
- If the initial equilibrium position is disturbed, a new equilibrium will ultimately be achieved.
- Dynamics is studied because the value of variable in the present date depends not only on the current time value of relevant variables but also past time values of other variables or even past values of same variables.
- Example: Change in income level can impact price-demand relationship at current time where Qd = f (Pt) but on the supply side there might be a lag as supply is dependent upon the price of previous period hence : Qs = g (Pt-1)

Microdynamics



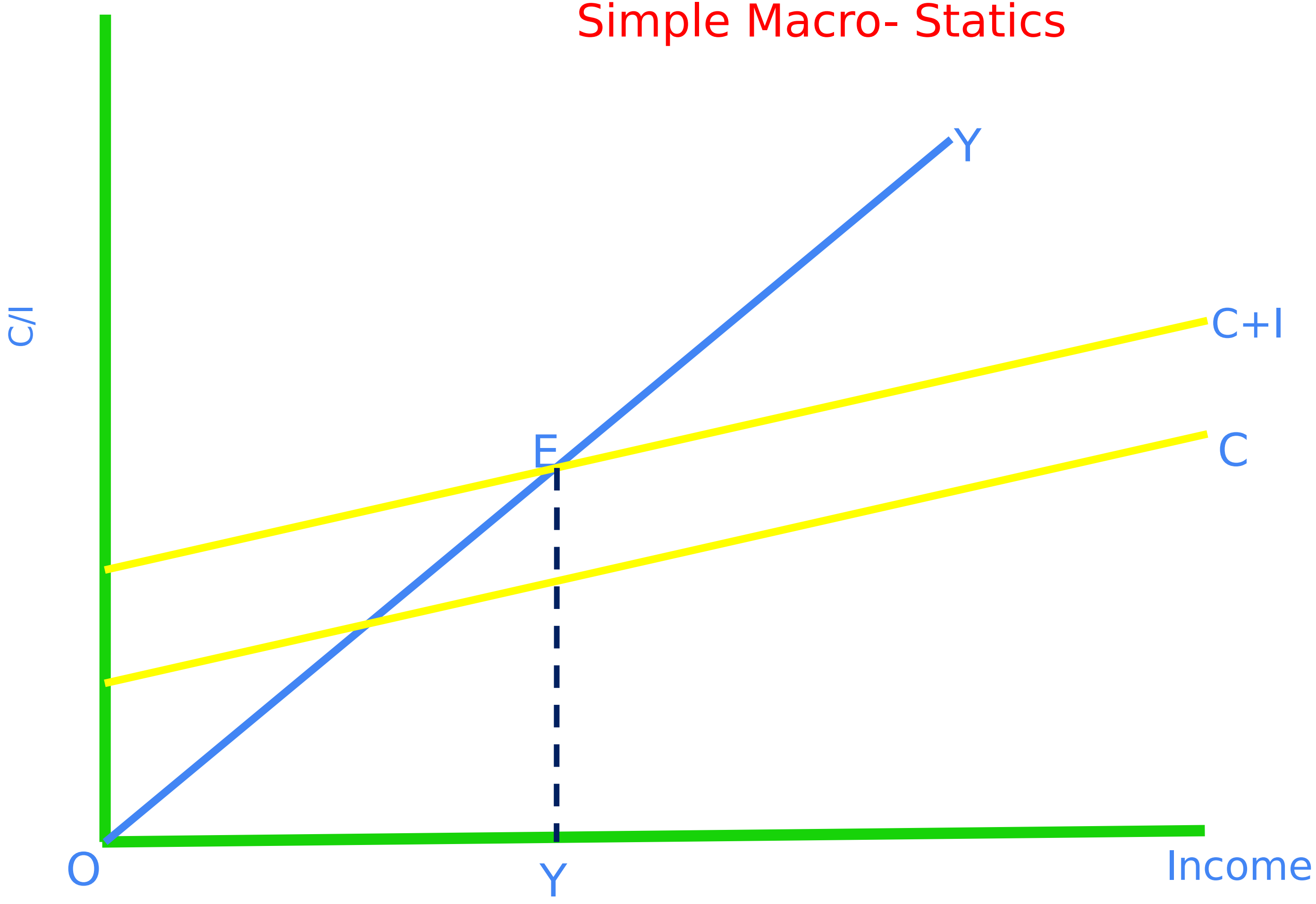
Macro Economics: Concept and Scope

- The word ‘Macroeconomics” was derived from Greek word ‘Makros’ which means large or big.
- It was first coined by Prof. Ragner Frisch in 1933 AD.
- The Concept of macro economics was developed by British economist J.M.Keynes in 1936 AD.
- it was the outcome of the failure of classical and neo- classical thought which was resulted into the problem of ‘Great Depression’ in 1930’s.
- The first book of macroeconomics was ‘The General Theory’ published by J.M.Keynes.
- Macro-economics is also called as Keynesian economics.

Types of Macroeconomics

- **Simple Macro statics:**
  - Study of one static equilibrium point of the economy.
  - Study of relationship between aggregate economic variables from still picture point of view.
  - Doesn’t deal with the process of attaining and breaking the equilibrium points.
  - Related with single point of time.
  - Y=C+I

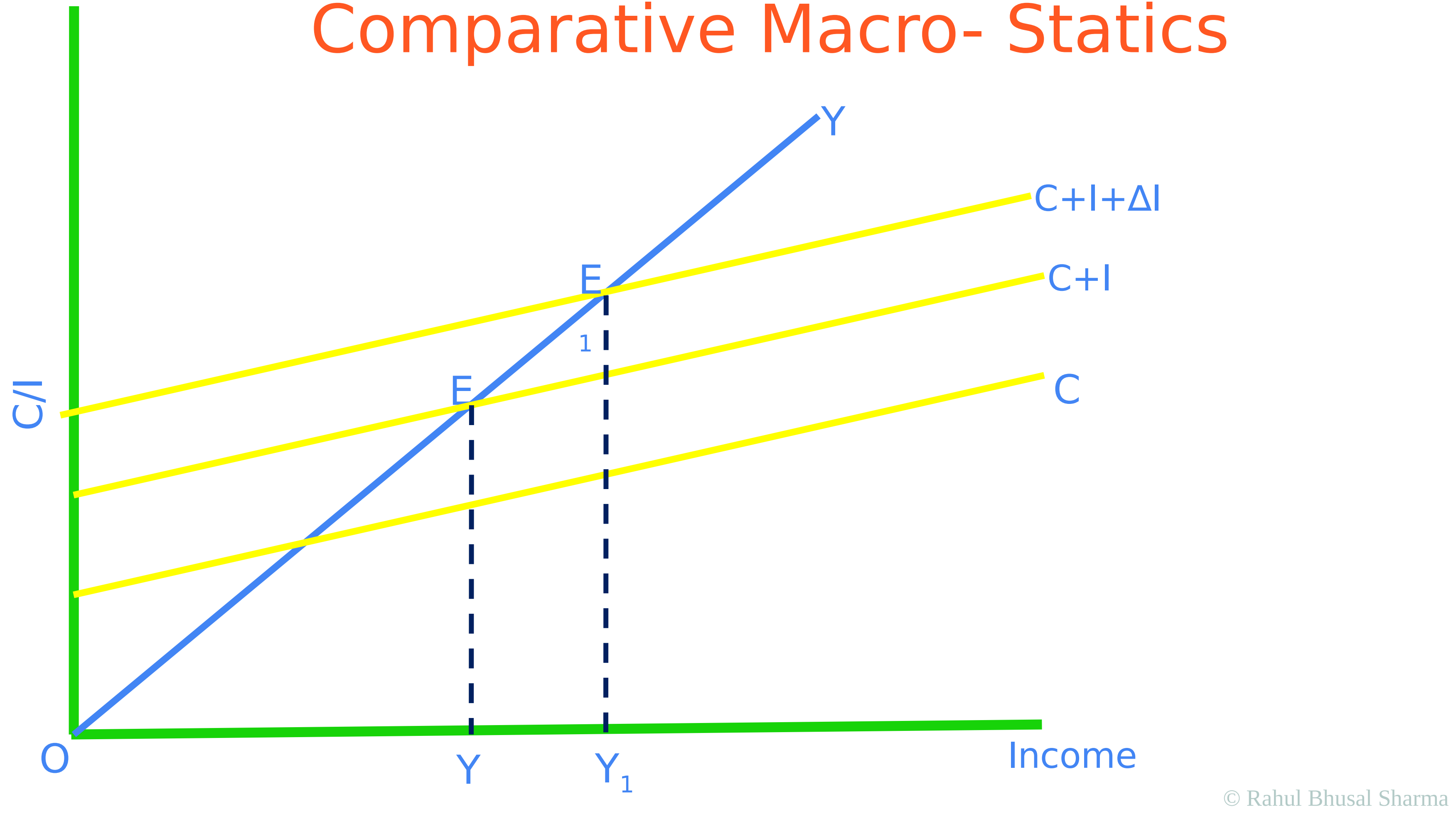
Simple Macro- Statics



Comparative Macro-statics

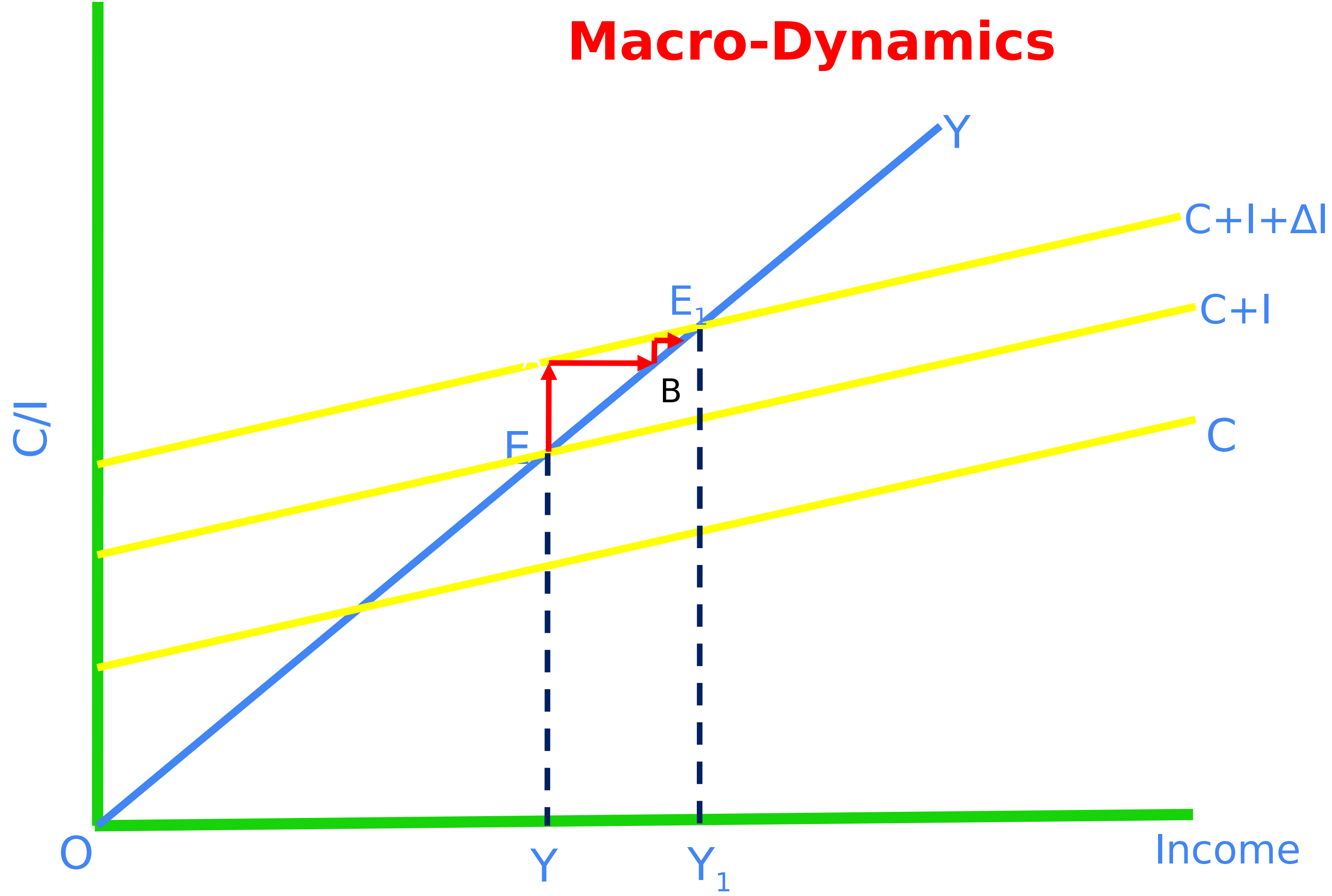
- Comparative study of two or more static equilibrium points.
- Comparison of two still pictures.
- Conclusion on the basis of comparative study.
- Don’t deal about the process of attaining and breaking equilibrium points.
- Don’t answer the following questions:
  - What are the causes responsible for breaking initial equilibrium point?
  - What are the causes responsible for attaining final equilibrium point?
  - What is the actual process in between them?

Comparative Macro- Statics



Macro Dynamics

- It explains the lagged relationship between macro economic variables.
- Studies the process of breaking and attaining equilibrium points.
- Analyses the macroeconomic variables from motion picture point of view.
- It involves the analysis of period of time rather than point of time.
- It answers all the following questions:
  - What are the causes responsible for breaking initial equilibrium point?
  - What are the causes responsible for attaining final equilibrium point?
  - What is the actual process in between them?


Macro-Dynamics
Y
C+I+ΔI
C+I
C
E$_1$
B
E
C/I
O
Y
Y$_1$
Income

- Macroeconomics is the study of **nature, relationship and behavior** of **aggregate economic variables** such as **National Income, employment level, total consumption, saving and investment, general price level, trade cycle** etc.
- It is the study of whole economy rather than individual units of the economy.
- R.E.Boulding, “Macroeconomics deals not with individual quantities as such with aggregates of these quantities, not with individual income but with national income, not with individual prices but with price levels, not with individual outputs but with national output.”
- Mc.Connel, “macroeconomics examines the forest not the trees. It gives us a bird’s eye view of the economy.”

- Macroeconomics explains the causes and solution of aggregate economic problems like unemployment, inflation, disequilibrium in BOP, economic fluctuations etc.
- The **main objective** of macroeconomics is to explain the principles, problems and policies related to full employment and growth of resources.
- It explains the process how national income is disbursed among various sectors of the economy and how it creates employment opportunities, therefore it is called as ‘income and employment theory’.
- The subject matter of macroeconomics constitutes the study of current output, sustainable economic growth, economic fluctuations, unemployment, inflation and the current trends of liberalization and globalization.

Goals of Macroeconomics

(i) Full employment,

(ii) Price stability,

(iii) Economic growth,

(iv) Balance of payments equilibrium and exchange rate stability, and

(v) Social objectives.

Instruments of Macroeconomics

Fiscal Policy:

Formulated by the Government coordinated by Ministry of Finance. Related to priorities of government, tax and legal policy matter.

Monetary Policy:

Formulated by the Central Bank. Related to Money Supply and Interest Rates.

Exchange Rate Policy:

Formulated by Government. Major policymakers are related to Central Government, Ministry of Foreign Affairs, Ministry of Finance.