MODULE 1 – EXPLORING THE SUBJECT MATTER OF ECONOMICS

- WHY STUDY ECONOMICS?
- DIFFERENCE BETWEEN MICROECONOMICS & MACROECONOMICS
- EXPLAINING THE CONCEPTS OF WEALTH, WELFARE & GROWTH
- SCOPE AND METHODS OF ECONOMICS
- EXPLAINING POSITIVE & NORMATIVE BRANCHES OF ECONOMICS
- ROLE OF VALUE JUDGEMENTS
- DESCRIBING SCARCITY & CHORES & THEIR RELATION
- BASIC PROBLEMS IN AN ECONOMY
- PPC & DETERMINATION OF GROWTH
- BASIC COMPETITIVE MODELS
- DIFFERENT TYPES OF ECONOMIES

WHY STUDY ECONOMICS ?

Economics is a branch of social science that deals with human wants and their satisfaction..

* Every individual in a society are economic agents and they engage in activities to satisfy their needs.

  eg:- Farmers in fields, clerks in offices etc.

* People work to earn money. They have multiple wants, ~~as ti~~ such as food, cloth, shelter, education, healthcare etc. They try to satisfy their wants with money. This is the basic reason for the engagement of people in economic scenerio. The unlimited wants of human

beings keeps the economy dynamic.

Two major aspects of economic activities

→ All are engaged in earning money, or, economic activities or are economic agents.

→ Income or money earned enables them to satisfy their wants.

This relationship between wants and satisfaction acts as the central object of economics.

SUBJECT MATTER OF ECONOMICS

There are four major points coming under the subject matter of economics.

1) Consumption - human wants & satisfaction.
2. Production - Production of utilities/goods & services.
3. Exchange - Transfer of goods & services through media like money/credit instruments.
4. Distribution - Sharing the income from production among factors of production.

* Public Finance and Planning.

The financial operations of government falls under this category.

→ An efficient and organised state authority is important for an economy.

SCOPE OF ECONOMICS

* To understand the behaviour of the society.

* This includes all economic agents in a society.
  Eg:- Farmers, professionals, wage labourers, Government, financial authorities, households etc.
  Economic analyses the activities carried by economic agents and how the unlimited wants of humans are satisfied using limited resources.

  Another point is the implementation and impact of Governmental policies and measures

* The Economics helps in suggesting efficient solutions to economic issues and advices in formulating policies by govt or other financial authorities.

* Economics plays a major role in formulating public policies. Eg:- education, healthcare, public finance, banking & pensions.

* Thorough understanding of economics is needed to understand the degree of application of

policies formulated.

* Economics provides useful logic for solving complex problems.

Origin of the Subject

The term 'economics' derived from the Greek word 'oikanomia' which means 'household management'.

* In the older times, the term 'political economy' was used instead of economics. It comprised most other branches of social sciences such as sociology, political sciences etc.

* Alfred Marshall was the first person to used the term 'economics' instead of political economy. the term was popularized when he used the term in his famous work 'Principles of Economics' published in year 1890.

* Economics as a distinct branch of social science for analysis was developed largely due to the efforts of Adam Smith. His book 'An Inquire into the Nature and Causes of Wealth of Nations' came out in 1776 is considered as the first systematic work in economics.

Defining the Subject

Economics is a dynamic and always changing subject. The theories, concepts and interpretations in and about economics keep on changing. Hence there is no universally accepted definition for economics developed yet.

Economists from various periods have tried to attach a universally and forever accepted defitition to economics.

Jacob Viner, A famous Canadian economist defined economics "as "what an economist do".

There are four major definitions attached with economics. They are :-

* Wealth Definition by Adam Smith
* Welfare Definition by Alfred Marshall
* Scarcity Definition by Lionel Robins
* Growth Definition by Paul .A. Samuelson.

1. Wealth Definition

Developed by : Adam Smith

"Economics is an Enquiry into the Nature and Causes of Wealth of Nations"

2. Welfare Definition

Developed by : Alfred Marshall

Alfred Marshall defined economics as a study of welfare of the society.

He quoted : "It is a study of mankind in the ordinary business of life. It examines that part of individual and social actions which is most closely connected with the attainment and use of material requisites of well-being"

3. Scarcity Definition

Developed by Lionel Robbins.

"Economics studies human behaviour as a relationship between ends and scarce resources which have alternative uses"

The Scarcity Definitions covers certain facts about economic activities -

* human wants are unlimited
* resources are limited
* resources have alternative uses.

4. Growth Definition

Developed by Paul A Samuelson

Economics is the study of how people and society choose, with or without use of money, to employ scarce productive resources which could have alternative uses, to produce various commodities overtime and distributed them for consumption now and in the future amongst various persons and groups or society.

Definition by Keynes

Considered as the 'Father of Modern Economics, John Maynard Keynes defined economics as the study of administration of scarce resources and of the determinants of employment and income

Positive Economics & Normative Economics

The subjects of economics are broadly classified into Positive economics and normative economics. these are two standard branches of economics, Positive economics describes and explains various economic phenomena while normative economics focuses on the value of economic fairness or what the economy should be.

* Positive economics is often called the "what is" branch of economics. It is ~~soly~~ solely based on facts. The statements made in positive economics can't be and not required to be approved disapproved.

* Mean while, the branch of economics that tries to determine people's desirability to different economic programmes ~~such~~ and conditions by using 'what should be" or " what ought to be". ~~Atom~~ is what normative economics is. It is a reflection of personal opinions and based on value judgements.

→ Value judgements - judgements of the rightness and wrongness of something or someone. Usefulness of something or someone based on comparison or relativity.

Positive Economics	Normative economics
* The stream of economics that focuses on description, quantification and explanation of economic developments, expectations and associated phenomena	* focuses on Ideological, opinion-related, prescriptive, value judgements aimed towards economic development, investments, projects and Scenerios
* relies on objective data analysis, relevant facts and associated figures	* originating from personal perspectives, feelings or opinions involved in decision-making process
* attempts to establish any cause-effect relationships or behavioural associations which can help ascertain and test the development of economic theories	* goal is to summarise peoples desirability to various economic developments, situations and programmes by asking or quoting what should happen or what ought to be.
* Objective	* abjective
* facts-based	* value-based
* Statements are precise, descriptive, and clearly measurable (testables). They can be measured	* statements are rigid and perceptive in nature. They often sound political or

against tangible evidence or historical instances

* authoritarian

* No instances of approval or disapproval

* statements are open to critisism and analysis.

eg:- "Govt. provided healthcare increases public expenditures".
This statement is fact-based and has no value judgement attached to it. Its validity can't be proven or disproven by studying healthcare spending where govt. provides healthcare.

eg:- "the govt. should provide basic health care facilities to all citizens"
This statement is value-based, rooted in personal perspective and satisfies the requirements of what should be.

Scarcity (Paucity)

Two facts are there behind the existance of economies.

* human wants are limitless
* Resources are limited or scarce.

Scarcity refers to the basic economic problem, the gab between scarce resources and theoretically limitless wants.

It is when the means to fulfill ends are limited, i.e, a limited supply to larger amount of demand.

* Scarcity is often referred to as "paucity"
* Scarcity applies to individuals, households, firms and society as a whole.
* It is the foundation of the essential problem of economies: the allocation of limited means to fulfill unlimited wants and needs.
* This doesn't mean absolute scarcity. But rather relative. In addition to basic needs, people have demands and desires for extra comforts and luxuries. People are often unable to achieve all these due to the limited resources they have.

eg:- Money and time are quintessential resources in the world. But people are always figured with the absence or scarcity of one or other and sometimes both.

→ An unemployed young man would have a lot of time in his hand but he will be unable even to pay the rent.

→ A top-notch executive would have enough money to live a comfortable life but has to stick on to a tight schedule and sleep for just four hours a day.

* The concept of scarcity also applies to society.

eg:- The state would want to build dams, bridges, roads and other infrastructure facilities for the Public. But the resources ~~would~~ will not be enough for all these.

Problem of Choice

There is a scarcity for resources in relation to the wants. The basic problem in an economy is how to allocate resources to acheive the best possible satisfaction of human wants.

* for making best use of available resources, the society must make choices. This is because resources are not only scarce, but they also have alternative uses.
* If resources had only one use each, there wouldn't have been a problem of choice. But in reality, resources have alternative uses and it is important to allocate the most needed one.

* Once employed for a use, a resource can't be used for any other needs. This puts more stress on the problem of choice. The question of "what to produce and in what quantity" arises due to this situation.

* money and time are important resources. These can be put to many uses. Some used / needs surpasses other and the consumers most often consider these urgent needs. When they purchase or attain a utilization, they are sacrificing all other wants and uses that the resources could have put to. This leaves the consumers unsatisfied.

Opportunity cost represents the potential benefits an individual, investor or business misses out on when choosing one alternative over another. The idea of opportunity costs is a major concept in economics.

Understanding the potential missed opportunities forgone by choosing one investment over another allows for better decision-making.

while financial reports do not show opportunity costs, business owners often use the concept to make educated decisions when they have multiple options before them.

* Opportunity cost is the foregone benefit that would have been derived by an option not chosen.

* To properly evaluate opportunity costs, the costs and benefits of every option available must be considered and weighed against the others.

* Considering the value of opportunity costs can guide the individuals and organizations to more profitable decision-making.

Opportunity cost $= FO - CO$

where,

FO = Return on best foregone option

CO = Return on chosen option.

The formula for calculating an opportunity cost is simply the difference between the expected returns of each option.

Eg:- Consider 2 options, Option A & option B.

Option A : to invest in the stock market hoping to generate capital gain returns.

Option B : to reinvest money back into business, expecting that newer equipment will increase production efficiency, leading to lower operational expenses and a higher profit margin.

Assumptions -

1. Expected return on investment in the stock market is 12% over the next year
2. The company expects the equipment update generate a 10% return over the same period.

$$OC = FO - CO$$

$$FO = 12\% \quad , \quad CO = 12\%$$

$$\therefore OC = FO - CO$$
$$= 12\% - 10\%$$
$$= 2\%$$

By investing in business, you would forgo the opportunity to earn a higher return.

In economics, PPF can be used to demonstrate the point that any nation's economy reaches its greatest level of efficiency when it produces only what is best qualified to produce and trades with other nations for the rest of what it needs.

It is simply the graphical representation of all different combinations of output that can be produced by an economy using all the available resources and technology.

* Production Possibility Frontier (PPF) is also referred to as Production Possibility curve (PPC) or the transformation curve.

* It is the point at which a country's economy is most efficiently producing its various goods and services and therefore, allocating its resources in the best possible way.

* If the economy is producing more or less of the quantities indicated by the PPF, resources are being managed inefficiently and the nation's economic stability will deteriorate. In case of underutilization of resources, an increase in its rate can boost output production.

* The PPF demonstrates that there are, or should be, limits on production. An economy, to achieve efficiency, must decide what combination of goods and services should be produced. It also demonstrates that the production of one commodity may increase only if the production of the other community decreases.

* ~~When~~ As far as PPF is considered, it is assumed that all the resources and technological amentities are brought into utilization and the economy produces only 2 goods/services. Due to the problem of scarcity and the resultant problem of choice, the nation should carefully choose the combination of production of goods/services.

* PPF is graphically depicted as an arch, i.e, it has a concave shape.
* the x-axis represents one of the commodities and the y-axis the other.

* Each point on the arch shows the most efficient number of the two commodities that can be produced

with the available resources and technology.

eg :- Hypothesis :-

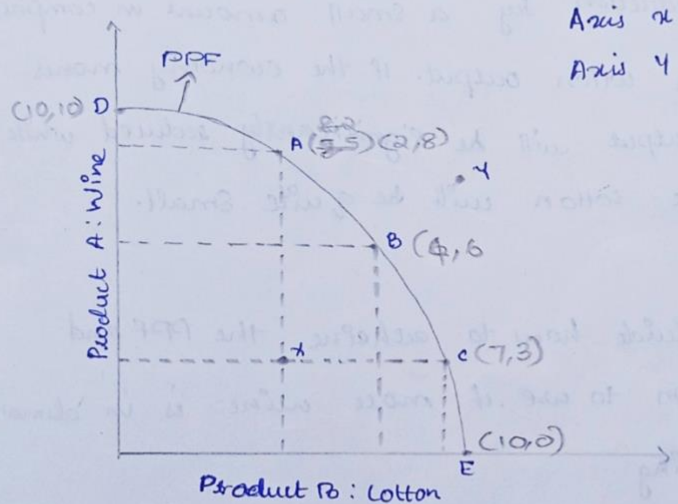
A national economy can produce only 2 things:

* wine
* cotton

According to PPF, points A, B & C on the curve represent the most efficient use of resources by the economy.

Axis x = cotton

Axis Y = wine



A, B, C, D & E = most efficient use of resources by the economy.

x = inefficient use of resources. Feasible but not desirable

Y = not feasible. It's a goal that the economy simply cannot attain its present levels of resources.

In order for the economy to produce more wine, it must give up some of the resources that is currently used to produce cotton. If the economy starts producing more cotton, it'd need to produce less wine than it it is producing at A.

* At point D, all the resources are used to produce to wine and the production of cotton is O.(zero).

* By moving production from A to B, the economy must increase wine production by a small amount in comparison to the increase in cotton output. If the economy moves B to C, wine output will be significantly reduced while the increase in the cotton will be quite small.

* The nation must decide how to acheive the PPF and which combination to use. if more wine is in demand, the cost of increasing