Course Title: Applied Economics (3cr.)
Course Code: CAEC353
Year: III
Semester: VI
Class Load: 3Hrs/Weak

Unit 1: Introduction (6 Hrs)

a. Concept and types of Microeconomics and Macroeconomics

b. Distinction between Microeconomics and Macroeconomics

c. Goals and instruments of Macroeconomics

Some Important Terminology Regarding Economics

Economics:- The word ‘Economics’ is derived from Greek word ‘Oekonomicus’. In Greek, ‘Oeko’ means households and ‘nomicus’ means study. Economics is the study of man’s livelihood. It studies how he earns and how he spends. The focus of the economic study is human welfare and happiness.

Development of Economics

Classical Period (1776-1890): Economics is the study of wealth and its significance. Adam Smith, J. B. Say, T. R. Malthus and David Ricardo are the famous economists of this period. According to Adam Smith, “Economics is the science of wealth”.

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- **Neo-Classical Period (1890-1932):-** The period between the eighteenth through nineteenth centuries in the history of economics is known as the neo-classical period. This period is regarded as the most fertile period. The famous economists of this period were Marshall, A.C. Pigou, Fisher, Carl Menger and Edwin Canon. The characteristic feature of this period was their focus on the subject matter of economics as the satisfaction or welfare derived from the consumption of material goods. According to Marshall, *"Economics is a study of mankind in ordinary business of life. It inquires how a man earns income and how he uses it. Thus, it is on the one side the study of wealth and on the other, the most important part, is the study of mankind".*
- **Modern Period (1932 onwards):-** The era of the twentieth century is popularly known as the modern period in the history of economics. In this period many new economists contributed in defining economics in scientific way. The famous economists of this period are Lionel Robbins, Barbara Wotton, J. M. Keynes, Samuelson etc. According to Robbins, "Economics is the science which studies human behavior as a relationship between ends and scarce means which have alternative uses".

- ➢ Unlimited wants
- ➢ Scarce resources
- ➢ Alternative uses
- ➢ Problems of choice

Division of Economics (Traditionally)

- **Consumption:** Destruction of utility of goods and service. Utility refers to the human want satisfying power of the commodity.
- **Production:** Creation of utility for sales of goods and services.
- **Exchange:** Transfer of goods and services from surplus unit to deficit or from the side of supply to demand.
- **Distribution:** Allocation of revenues to the factors of production
- **Public Revenue:** It is the policy of government.
- **Economic Development :** Economic development is the growth of the living of standard of a nations people from a *low-income* (poor) economy to a *high-income* (rich) economy. Development looks at a wider range of statistics than just GDP per capita. Whether there is an economic development or not we have to observe real income per head, level of literacy, health care, housing quality, environment sustainability, life expectancy.
- **International Trade:** Transfer of goods from one country to another

Important Terminology

- **Economic Growth:** Economic growth means an increase in real national income. GDP measures the total volume of goods and services produced in an economy generally taken within one year.
- **Inflation:** Inflation is sustained increase in the general price level of goods and services in an economy over a period of time. When general price rises, each unit of currency buys fewer goods and services.
- **Deflation:** Opposite of inflation or decrease in overall price level
- **Stagnation:** Stagnations is the combination of inflation, slow economic growth and high unemployment

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Sectoral Classification of Economy

- **Primary Sector:** It is an extraction sector like mining, fishing, agriculture etc. We can collect raw materials for production from this sector.
- **Secondary or Manufacturing Sector:** It takes raw materials from primary sector and combines them to produce a higher value added finished goods which are ready to sold in tertiary sector.
- **Service or Tertiary Sector:** The service sector is concerned with the intangible aspect of offering services to consumers and business. Example Boarding, hospital, college, banking, insurance company etc.

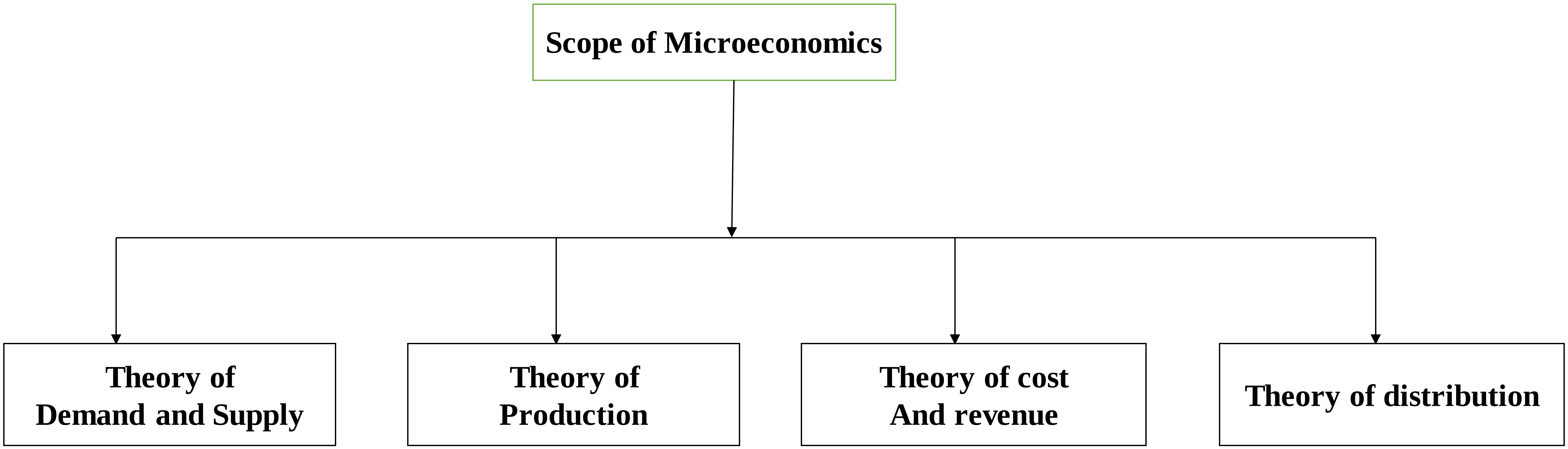
Agent of Economics

Consumer, Producer, Government, Exporter, Importer

Microeconomics

- The term micro was originated from word ‘MIKROS’; means small. Thus microeconomics studies the economic action and behaviour of individual units and small groups of individual units. Microeconomics deals about the problems and solution regarding to individual economic activities. According to A. P. Lerner *“ Microeconomics consist of looking at the economy through microscope”.*
- Similarly, According to K. E. Boulding *“ Microeconomics is the study of particular firm, particular household, individual price, wage, income of the industry and particular commodity”.*
- Microeconomics is called as price theory because it studies the determination of the price of commodities and factor of production by their demand and supply forces.

Scope of Microeconomics



Types of Microeconomics

- On the basis of time, *the nature of equilibrium* between two variables in microeconomics is divided into three parts as micro statics, comparative micro statistic and micro dynamics which are also called types of microeconomics is explained separately as started below:-

Micro Statics:- Micro statics refers to the stationary situations of the equilibrium between different variables at certain point of time. In other words, when the value of economic variables are related to the same point of time, the functional relationship between variables is said to be statics. It is expressed as $D_t = f(P_t) = a\text{-}bp$

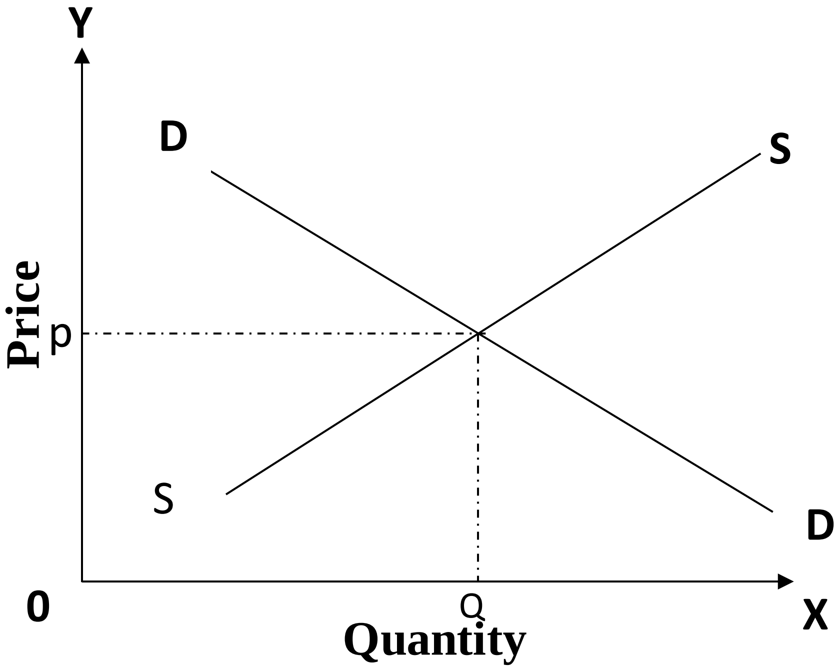
$S_t = f(P_t) = -c+dp$

The equilibrium condition at a particular point of time is D_t=St at P_t.

D_t = Demand of a quantity at a point of time

S_t = Supply of a quantity at a point of time

P_t = Equilibrium price at a point of time



- The figure shows the equilibrium of the market in a certain point of time. Both the demand curve DD and supply curve SS have intersected each other at point E in a particular point of time. So E is the point of equilibrium which relates two of the variables price (OP) and quantity (OQ) at a particular point of time. This is a static analysis.

Comparative Micro Statics

- As time passes, there is change in the condition of demand and supply. This change in demand and supply brings a change even in the equilibrium condition. This type of change in equilibrium at different points of time is the study comparative micro-statics. Therefore, comparative micro statics is the study of different equilibriums at different points of time.
- Comparative micro statics compares one equilibrium with other equilibrium but it does not study about the process how one equilibrium breaks and another equilibrium establishes. The comparative micro static can also be shown in the figure below as,

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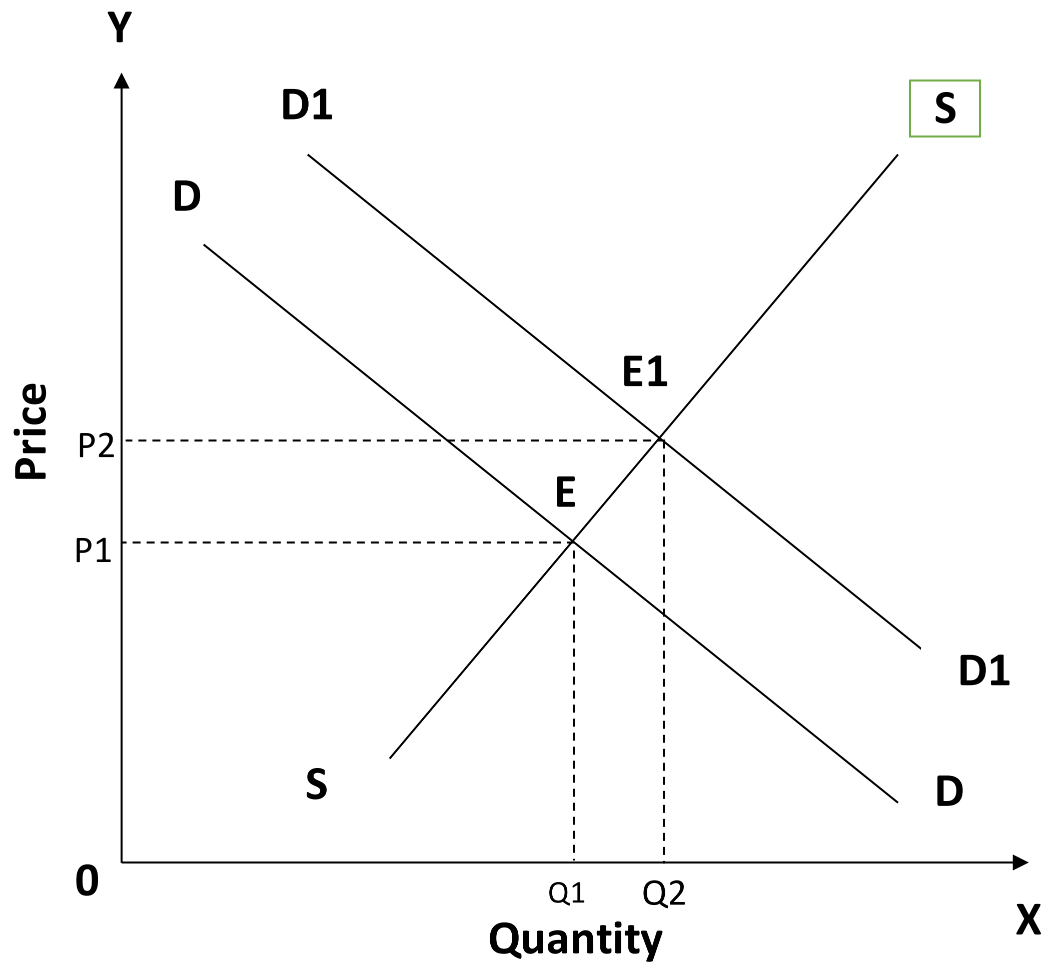
- In the figure E is the initial equilibrium, where equilibrium price is OP1 and equilibrium quantity is OQ1. When the demand rises from DD to D1D1, the new equilibrium shifted from E to E1 where the equilibrium price is OP2 and equilibrium quantity is OQ2. The comparative explanations of the two equilibrium points E and E1 is the comparative micro static. But it does not explain about the process how a new equilibrium attains.



Micro Dynamics

- There is always change in time. This change brings change in price and the demand and supply of quantity of commodities. Consequently there is a change in equilibrium. Therefore micro dynamics refers to that situation of equilibrium in which an equilibrium of different variables goes through disequilibrium and new equilibrium establishes. Hence micro dynamics is the study of the process which shows how the initial equilibrium attains. Micro dynamics can also be explained by the following figure.
- In the figure, E is the initial point of equilibrium at which OP1 price and OQ1 quantity are the equilibrium price and equilibrium quantity. Now let us suppose that there is an increase in income at given price OP1. The increase in income causes a shift in demand curve from DD to D1D1. This brings about disequilibrium persists until the new equilibrium reached at point E1.
- Let’s start the process from disequilibrium to new equilibrium. The increase in demand can not be fulfilled by increasing in supply immediately. So, the price level rises from OP1 to OP5 by EA. This rise in price encourages the suppliers to increase in supply.

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