What is Economics?

Economics is the study of how people choose to use resources.

Resources include the time and talent people have available, the land, buildings, equipment, and other tools on hand, and the knowledge of how to combine them to create useful products and services.

Important choices involve how much time to devote to work, to school, and to leisure, how many rupees to spend and how many to save, how to combine resources to produce goods and services, and how to vote and shape the level of taxes and the role of government.

- It is defined “as a social science which covers the actions of individuals and groups of individuals in the process of producing, exchanging and consuming of goods and services to achieve optimization of resource use”

1. Production Decisions
2. Exchange Decisions
3. Consumption Decisions

- According to Lionel Robins, ”Economics is the science which studies human behavior as a relationship between ends and scarce means which have alternative uses”.

Different Themes of Economics

Scarcity : * It occurs when commodities used to satisfy people's material wants are not available in adequate amount. It is the root cause of economic problem.

Choice : If people have a lot of unlimited wants , they cannot satisfy all of their wants. Therefore people have to make choices.

Opportunity cost : It is a direct result of making a choice. In making choice, people have to sacrifice. This sacrifice is called opportunity.

Specialization : Specialization results from division of labour. It increases the productivity of labor.

Exchange : commodities produced must be bought and sold to help economic growth.

Income distribution : it is concerned with the distribution of income in the society and suggesting how poor people can be helped.

Economic system : it comprises of the forces of production and the relations of production.

Basic Principles of Economics

- When individuals make decisions, they face tradeoffs among alternative goals.
- The cost of any action is measured in terms of foregone opportunities.
- Rational people make decisions by comparing marginal costs and marginal benefits.
- People change their behavior in response to the incentives they face.

Basic Principles of Economics cont…

- Trade can be mutually beneficial.
- Markets are usually a good way of coordinating trade among people.
- Government can potentially improve market outcomes if there is some market failure or if the market outcome is inequitable.

Basic Principles of Economics Cont…..

- Productivity is the ultimate source of living standards.
- Money growth is the ultimate source of inflation.
- Society faces a short-run tradeoff between inflation and unemployment

Microeconomics

Meaning of Microeconomics

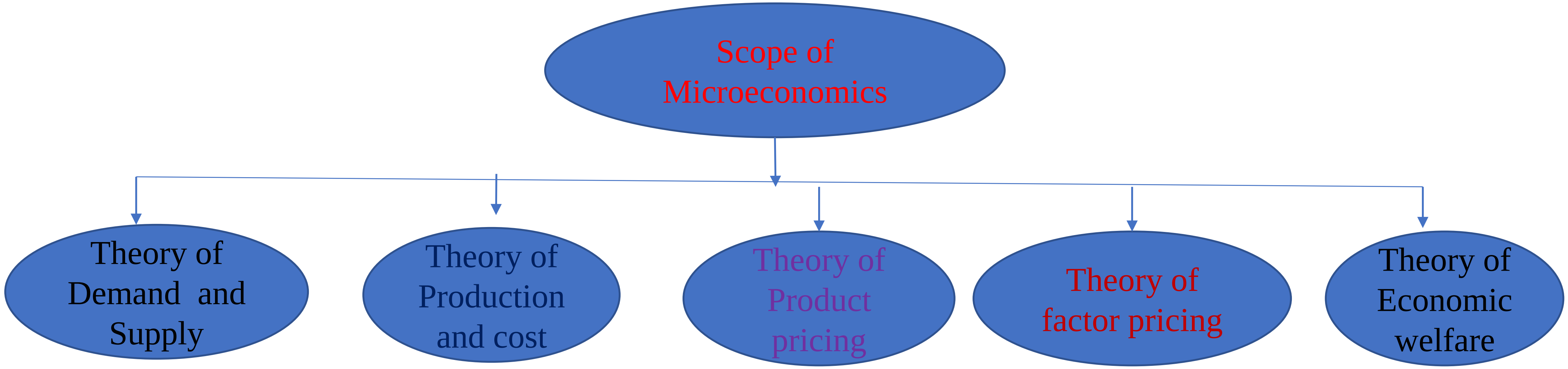
- Micro comes from the Greek word *mikros*, meaning "small"
- Studies the behavior of *individual* households, firms, and governments
  - Choices they make
  - Interaction in specific markets
- Focuses on individual parts of an economy
- "Microeconomic consist of looking at the economy through microscope." –A.P. Lerner.
- "Microeconomics is the study of particular firm, particular household, individual price, wage, income of the industry and particular commodity." – K.E. Boulding.

Features of Microeconomics

- Individualistic economics
- Assumes full employment
- Based on the assumption of ceteris paribus (other things remaining the same)
- Based on market economy
- Price theory
- Slicing method
- Allocation of resources at the individual level of the economy
- Individual prices, demand, supply income etc. are important variables.

Scope of Microeconomics

- Scope of microeconomics refers to the subject matter or areas of study under which microeconomics deals about various topics related to individual economic unit.



Uses or Importance of Microeconomics

- To understand the working of market economy
- Efficient allocation of resources
- To provide tools for economic policies
- Useful to understand international trade
- To examine the condition of social and economics welfare
- Useful in business decision making
    - pricing policy
    - optimal allocation of resources
    - optimal production decision
    - Demand analysis and forecasting
    - Analysis of cost of production

Limitations of Microeconomics

- Microeconomics is based on the basis assumption of laissez fair economy but no any economy can survive without assistance of government (ignore the role of the government).
- Microeconomic analysis is based on the assumption of full employment but in reality full employment is hypothetical concept.
- The condition derived for microeconomics may not be applicable for whole economy. (saving-paradox)
- Microeconomics studies only the small units of the economy.
- Microeconomics does not solve all types of economic problems like poverty, inflation, deflation, business cycle, unemployment etc.

Types of Microeconomics

- On the basis of time, the equilibrium between two variables in microeconomics is divided into three parts as

1. Micro statics,
2. Comparative micro-static and
3. Micro-dynamic which are also called types of microeconomics.

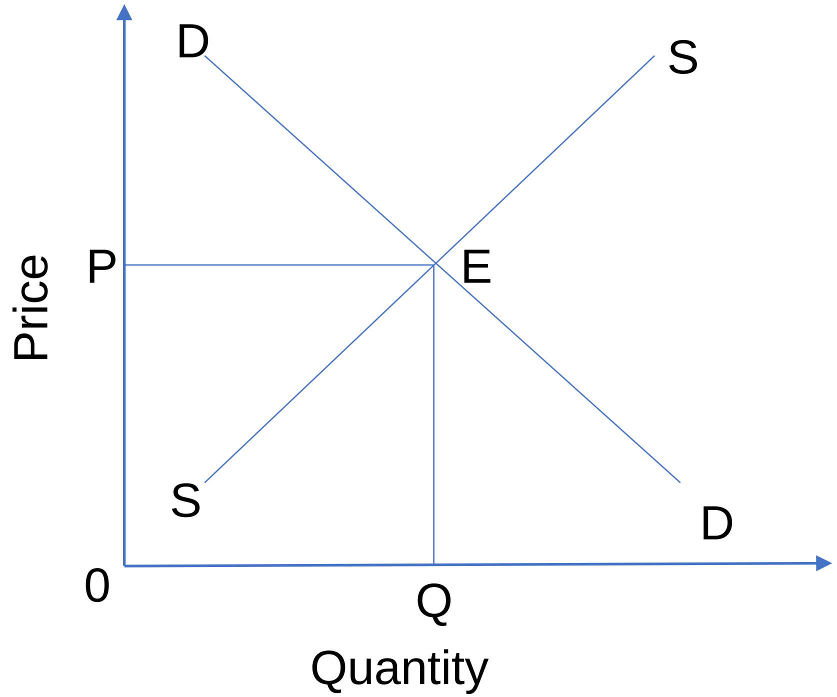
- The types of Microeconomics is explained separately as stated below;

1. Micro statics:

- Micro statics refers to the stationary situation 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.

Micro Statics:

- The concept of micro statics has been illustrated in the following figure as;
- 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 in time.
- So E is the point of equilibrium which relates two of the variables price (OP) and quantity (OQ) at a particular point in time.
- This is a static analysis.

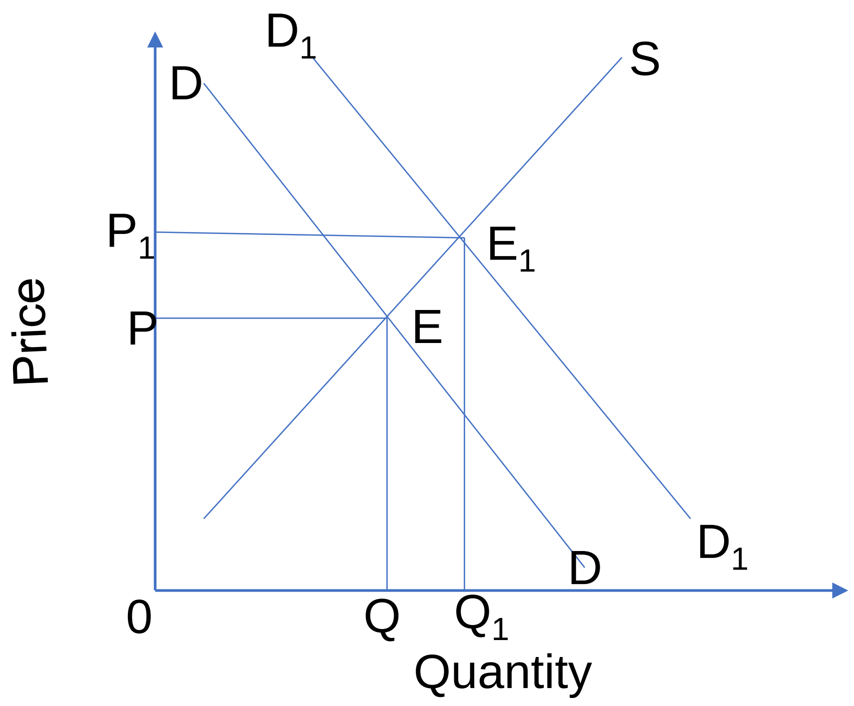


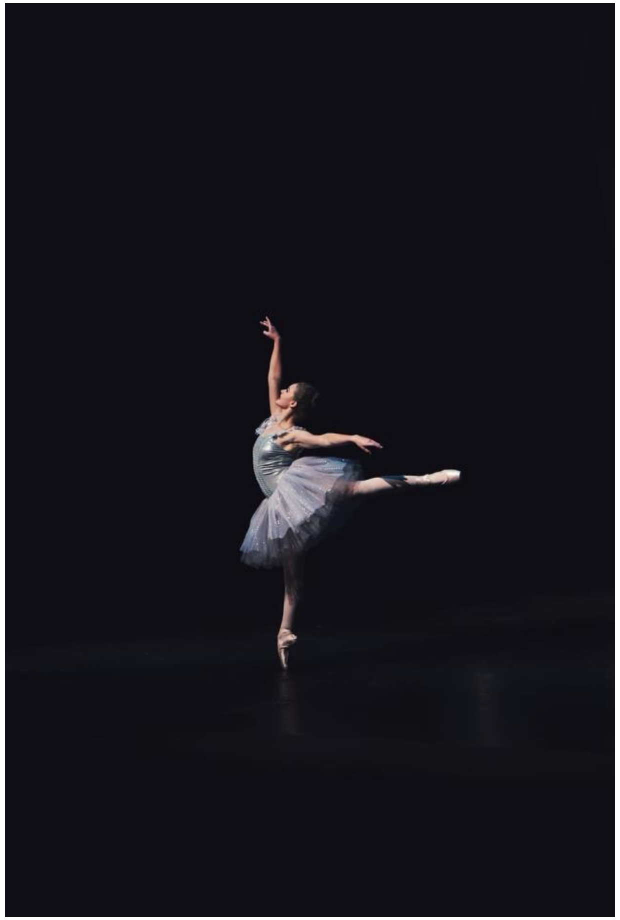
Comparative Micro Statics

- 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 of 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.

Comparative Micro Statics

- In the figure E is the initial equilibrium, where equilibrium price is OP and equilibrium quantity is OQ.
- When the demand rises from DD toD1D1, the new equilibrium shifted from E to E1 where the equilibrium price is OP1 and equilibrium quantity is OQ1.
- The comparative study of the two equilibrium points E, E1 is the comparative micro statics but this study does not explain about the process how a new equilibrium attains.



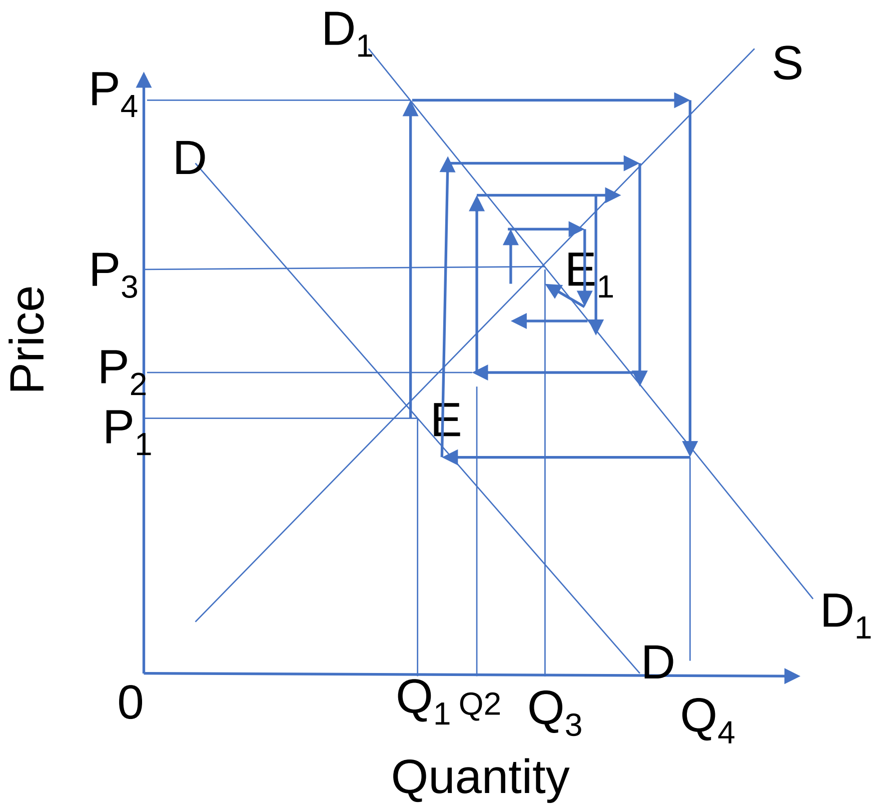


Micro Dynamics

- There is always change in time.
- This change brings change in price and the demand & 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 breaks and new equilibrium attains.

Micro dynamics

- In the figure, E is the initial point of equilibrium at which $0P_1$ piece & $0Q_1$ quantity are the equilibrium price & equilibrium quantity.
- Now let us suppose that there is an increase in income at given price $0P_1$.
- The increase in income causes a shift in demand curve from DD to D_1D_1.
- This brings about a disequilibrium in the market and the series of disequilibrium persists until the new equilibrium reached at point E_1.



Micro dynamics

- 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 0P1 to 0P5 by EA.
- This rise in price encourages the suppliers to increase in supply from 0Q1 to 0Q4.
- Now supply is more than demand by AB and 0P4 quantity is demanded only at price 0P2.
- So the price falls from 0P5 to 0P2.
- This fall in price causes a fall in supply from 0Q4 to 0Q2 or the supply is equal to 0Q2.
- But demand is still higher than supply which pushes the price up from 0P2 to 0P4.
- Again the supplier are encouraged to increase in supply.
- This process continues again & again until the final point of equilibrium is reached at price 0P3 & quantity at 0Q3.
- This is how micro dynamics explain about the process how an equilibrium breaks and another new point of equilibrium establishes.

- Macro-Economic Uses: Even though Business Economics has the nature of Micro-Economics, it also uses Macro- Economic approaches frequently. Certain matters in Macro-Economics like Business Cycles, National Income, Public Finance, Foreign trade etc. are essential for Business Economics. So, Business Economics uses the macro-economic phenomenon for taking business decisions.
- Economics is a science or an art. It is considered as science if it is a systemized body of knowledge which studies the relationship between cause and effect.

  -Art is nothing but practice of knowledge.

  -Where as science teaches us to know and art teaches us to do.
- It is science in which methodology and art in its application.