Chapter - 1
Basic of economics
and allocation of resources

1. What do you mean by economic ?

Economics is the study of choice under scarcity. It studies how scarce resources are used to satisfy unlimited human wants .It is an unfinished science and always in the process of development. The definition of economics changes with changes in socio-economic conditions.

2. What do you mean by economics by Marshall's ?

Alfred Marshall defined economics as the study of man in the ordinary business of life. Marshall argued that the subject was both the study of wealth and the study of mankind. He believed it was not a natural science such as physics or chemistry, but rather a social science.

3. What do you mean by economics by Robbins ?

Lionel Robbins gave his definition of economics in his book" Nature and significance of Economic Science" in the year 1932 . He defined economics as, "Economics is the science that studies human behavior as a relationship between ends and scarce means which have alternative uses."

4.Define positive science.

Positive economics is that which studies the things as they happen in reality. It explains what is, what was and what will be. It studies cause and effect relationship between economic phenomena. For example, the law of demand studies cause and effect relationship between price and demand for a commodity.

5.Define normative science.

Normative economics is that which studies things as they should be. It is related to the criteria of 'what ought to be' or what should be done. For example, it suggests us about what should be done to solve the problem of inflation.

6. Define Macroeconomics.

Macroeconomics is the study of the economy as a whole, It deals with the problems of unemployment, inflation, national income, etc.

7.Define Microeconomics.

Microeconomics i s the study of the action of individuals and small group of individuals such as individuals, households, firms, industries, etc.

8.Define normal goods

Normal good is a good whose demand increases with an increase in income and decreases with the decrease in income of the consumer. There is positive relationship between income and demand.

9.Define inferior goods.

Inferior good is a good whose demand decreases with the increase in income and increase with the decrease in income of the consumer. Inferior goods are low quality goods like low quality rice, cloth, etc.

10.Define complementary goods.

When two or more goods are demanded simultaneously for the satisfaction of a particular want, they are called complementary goods. For example, Car and Petrol, tea and sugar, etc.

11. Define private goods.

Private goods are those goods which are owned by private individuals. Private goods have the characteristics of excludability and rivalry. For example, land, buildings, vehicles, etc. are private goods.

12. Define economic goods.

Economic goods are those goods whose demand is more than supply i.e. they are scarce. Most of the things that a man needs to satisfy his wants fall in this group. They are limited in quantity and are man-made things. Because of this shortage, economic goods have a positive price in the market.

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14.Mention any four characteristics of land.

The four characteristics are as follows:

1. Land is a free gift of nature.
2. Land is a passive factor of production.
3. Land is fixed in supply.
4. Land is permanent and indestructible.

15. What is labour ?

In ordinary language, labour refers to work done by unskilled workers. But in economics, labour refers to any human effort, physical or mental, which is undergone with a view of getting some monetary reward.

Important Questions and answers.

1. Explain the concept of positive and normative economics.

Positive and Normative Economics is rightly known as the two arms of Economics. Positive economics deals with various economic phenomena, while normative economics focuses on what economics should be, this branch of economics talks about the value of the company's fairness. In lucid language, positive economics answers the 'what' factor, whereas normative economics mandates the 'should be' or 'ought to be' section of economics.

Positive economics is the stream of economics that has an objective approach, relied on facts. It concentrates on the description, quantification, and clarification of economic developments, prospects, and allied matters. This subdivision of economics relies on objective data analysis and relevant facts and figures. Therefore, it tries to establish a cause-and-effect relationship or behavioral relationship that can help determine as well as test the advancement of economic theories.

Normative economics deals with prospective or theoretical situations. This division of economics has a more subjective approach. It focuses on the ideological, perspective-based, opinion-oriented statements towards economic activities. The aim here is to summarise the desirability quotient among individuals and quote factors like 'what can happen' or 'what ought to be'.

2. Distinguish between goods and services.

Basis of Difference	Goods (Material Goods)	Services (Non-Material Goods)
Existence	Goods have their own physical existence.	Services do not have any physical existence.
Transferability	Goods can be transferred from one place to another.	Non-material goods cannot be transferred.
Visible	Goods are visible. They have physical existence.	Services are invisible, because they don't have physical existence.
Time lag	There may be time lag between the consumption and production of goods.	There is no time lag between the consumption and production of services.
Storing	Goods produced may be consumed at the same time or stored for future consumption.	Services cannot be stored for consumption.

Exampl es	Books, pens, buildings, furniture, television, etc.	Medical checkup, teaching, waiters, offices etc.

3. Explain factors of production.

Anything that helps in production is the factor of production. These are the various factors by mean any resource is transformed into a more useful commodity or service.

They are the inputs for the process of production. They are the starting point of the production process. Factors of production are the parameters which affect the output of production.

Land

It refers to all natural resources. All natural resources either on the surface of the earth or below the surface of the earth or above the surface of the earth is Land. It is the primary and natural factor of production. All gifts of nature such as rivers, oceans, land, climate, mountains, mines, forests etc. are land.

The payment for land is rent.

Characteristics of Land as a Factor of Production

- The land is a free gift of nature.
- The land has no cost of production.
- It is immobile.
- The land is fixed and limited in supply.

Labor

All human effort that assists in production is labour. This effort can be mental or physical. It is a human factor of production. It is the worker who applies their efforts, abilities, and skills to produce.

The payment for labour is the wage.

Characteristics of Labor as a Factor of Production

- It is a human factor.
- One cannot store labour.
- No two types of labour are the same.

Capital

Capital refers to all manmade resources used in the production process. It is a produced factor of production. It includes factories, machinery, tools, equipment, raw materials, wealth etc.

The payment for capital is interest.

Characteristics of Capital as a Factor of Production

- Capital is a manmade factor of production.

- It is mobile.
- It is a passive factor of production.

Entrepreneur

An entrepreneur is a person who brings other factors of production in one place. He uses them for the production process. He is the person who decides

- What to produce
- Where to produce
- How to produce

The payment for land is profit.

Characteristics of Entrepreneur as a Factor of Production

- He has imagination.
- He has great administrative power.
- An entrepreneur must be a man of action.
- An entrepreneur must have the ability to organize

4. Definition of economics by Adam Smith.

The first definition of economics was given by Adam Smith, in 1776 A.D. a citizenship of Scotland. Adam smith has separated economics from other social science and defined economics for the first time. So, he is known as the father of economics.
Adam Smith has published his famous book entitled as "An Inquiry into the Nature and Causes of Wealth of Nations" in 1776 A.D. This book is popularly known as "Wealth of Nations". In the view of Adam, economics is the study of activities of people in the production of wealth. The definition of economics given by Adam Smith was supported by various classical economists like J.B Say, F.A Walker, J.S Mill, etc.

Characteristics of Wealth Definition

1. **Study of Wealth :-** According to this definition, economics is the study of wealth. It deals with the consumption, production, exchange and distribution of wealth.
2. **Secondary Place to the Study of Man:** This definition has given secondary place to the study of man. This shows that the classical economists view humans as a means and wealth as ends.
3. Meaning of Wealth: This definition includes only material goods in the meaning of wealth. Material goods are those goods, which are tangible or visible such as a pen, book, pencil, gold, etc.
4. Study of Economic Man: This definition has imagined the study of such a man who is always guided by self-interest and concerned with his own material welfare.
5. Investigation of the Causes of Wealth: Classical economists believe that economics is the investigation of the causes of wealth, i.e., how wealth can be increased. In order to increase the wealth of a nation, production of material goods has to be increased by increasing the scale of production, which is possible with the division of labour.

Criticisms of Wealth Definition

Many writers such as John Ruskin, Thomas Carlyle, William Morris and Mathew Arnold have criticized the wealth definition. They have characterized it as a 'Bastard Science' or 'Dismal Science' or 'Bread and Butter Science' or 'Gospel of Mammon'.
The main criticisms are as under:

1. Narrow Meaning of Wealth:

This definition gives a very narrow meaning of wealth. It includes only tangible goods and does not include intangible goods in the meaning of wealth. However, modern economists use the word 'wealth' in a much wider sense.

2. Undue Importance to Wealth:

This definition gives undue importance to wealth. It has given primary place to wealth and secondary place to man, while all economic activities are centered towards human wants. Wealth is simply a means to satisfy human wants.

3. Unrealistic Concept of Economic Man:

This definition is based on the unrealistic concept of economic man. As per this definition, economic man is one who is guided by self-interest alone whereas such a man does not exist in real life. He also has to carry out social, religious, political and other activities in his life.

4. Narrow Subject Matter of Economics:

This definition has confined the subject matter of economics only to the study of wealth. It does not consider the major economic problems faced by a society or an individual not related to wealth like diseases, natural calamities, etc.

5. Neglect Economic Welfare:

This definition has totally neglected the economic welfare of the society. According to Marshall, the sole aim of economics is to enhance the welfare of human beings and not to obtain wealth.

5. Definition of welfare definition by Alfred Marshall.

The second definition of economics was given by the leader of Neo-classical economists, Alfred Marshall (1842 A.D -1924 A.D). He was renowned British scholar and Professor of economics at Cambridge University. Alfred Marshall has published the book "Principles of Economics" in 1890 A.D and defined economics in term of material welfare.
According to Marshall, "Economics is a study of mankind in an 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. Thus, Marshall shifted the focus of economics from wealth aspect of Adam Smith to welfare aspect. No doubt, he considered as an important part of a human. But, he has given primary importance to mankind and secondary importance to wealth justifying wealth

should be used for the welfare of mankind. The Marshallian definition has been supported by A.C Pigou and Edwin Cannan.

Characteristics of Welfare Definition

1. **Primary Concern : -**

According to this definition, wealth is not required for its pawn sake. It is required for the sake of man and for the sake of his welfare. It is a means to an end, the end being human welfare. Economics is the study of wealth in relation to man and hence the primary importance should be given to men not to wealth.

2. **Study of Ordinary Man:**

According to this definition, Economics is related to the behavior of ordinary people. That means it studies about the rational man and ignores the activities of irrational man like 'Sadhu' or 'Sanyasi' (ascetics) in Hindu religion.

3. **Study of Material Welfare:**

According to this definition, economics studies only those activities of a common man which are concerned with the promotion of material welfare.

4. **Social Science:**

According to this definition, economics is a social science. It examines the economicproblems of those individuals who live in an organized society. But people like Robinson Crusoe living aloof from the society do not fall under the study of economics.

5. **Normative Science:**

As per this definition, economics is a normative science since it studies what should be done to promote the material welfare of mankind.

Criticisms of Marshall definition

This definition of economics has been strongly criticized by Lionel Robbins on the following grounds:

1. **Material and Immaterial Welfare:**

Marshall includes only material things in the study of economics and excludes all immaterial things. However, it is quite difficult to separate material and immaterial things. For example, if a doctor works for a fee, it is material and if he serves for philanthropy (Voluntary promotion of human welfare), it is immaterial.

2. **Connection between Economics and Welfare:**

The welfare definition tried to connect economics with welfare. However, economics studies several activities not conducive to welfare such as the production of wine, cigarettes, etc. as income obtained from these activities are included in national income. Robbins remarks, "Whatever economics is concerned with it is not concerned with material welfare as such"

3. **Welfare Cannot be Measured:**

Prof. A.C. Pigou regards money as an instrument to measure welfare. However, welfare is a subjective concept. It varies from person to person, place to place and time to time. It cannot be measured accurately. Welfare is supposed to be measured by the help of money. However, money itself is not an accurate measuring rod of satisfaction because poor and rich people get different levels of satisfaction from the same amount of money.

4. **Ordinary Business of Life:**

According to this definition, economics is the study of human activities in ordinary business of life. But the meaning of ordinary business of life is not clean in this definition.

5. **Economics is a Human Science:**

According to welfare definition , economics is not concerned with the man living outside the society. But even an isolates man like Robinson Crusoe is also subject to law of economics such as law of diminishing marginal utility.

6. Definition of scarcity definition by Lionel Robbins.

The third or modern definition of economics was given by Lionel Robbins in the decade of 1930s. Robbins was the citizen of British and professor at London School of Economics. He is one of the modern economists who shifted the focus of economics from welfare aspect to scarcity and choice. In 1932 A.D. he wrote a book entitled "An Essay on the Nature and Significance of Economic Science" and defined economics in terms of scarcity and choices.

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

This definition was supported by various famous economists like Stigler, Peter, etc.

Characteristics of Scarcity Definition

1. **Unlimited Ends:**

According to Alfred Marshall, human wants are unlimited which can never be fulfilled. Once the first and the most important desire is fulfilled, new wants crop up or arise immediately. When we fulfill the second want, another want arise. So, human wants are unlimited and never fulfilled.

2. **Scare Means:**

Human wants are unlimited but the resources to fulfill them are limited i.e. there is a scarcity of resource to fulfill human wants in the society. Hence, the word "means" refers to the natural resource, human resource, capital resource and physical resource which are available to mankind. As the size of population increases, the demand for goods and services also increases. As a result, the scarcity problem is growing more seriously day by

3. **Alternative Use of Resources:**

Robbins said that the resources available to satisfy unlimited human wants are available in a limited amount or quantity. These scarce means have alternative uses i.e. use here for a purpose or there for another purpose. Robbins suggested that a lot of alternative goods and service might be available in the market to meet our needs.

4. Problem of Choice:

When the characteristics of human life; namely, unlimited wants, scarce means, alternative use of means are kept together, there arises the problem of choice. One has to make a choice as which want to be satisfied first and by which means. However, at any given period, one of these wants, one of this wants may be more urgent and more important than other wants. As such wants differs in urgency. So, while choosing among the wants, everybody chooses the most urgent need at first and less urgent need get second priority.

5. Positive Science:

Lionel Robbins said that human wants are unlimited and resources are limited in the economy. It explains the real situation without any value judgment. So, for economics is positive science.

Criticisms of Robbins definition

Robbins definition of economics as the science of scarcity and choice is still popular definition. Despite wider acceptability and application in modern society, it has been criticized by various economists like Barbara Wotton, Fraser etc. Some major criticisms made by them are described below:

1. Hidden Concept of Welfare:

This definition criticizes the Marshallian concept of welfare, but this definition itself includes the concept of welfare through back door. When we make a choice between ends, we consider welfare. Even Abundance May Create Economic Problems: According to Robbins economics is the study of scarcity and choice. But many economic problems do not arise because of scarcity, but because of abundance. For example, the problem of unemployment is due to abundance of workers.

2. Self-contradictory:

This definition is self-contradictory. On the one hand, it regards economics as a positive science and hence neutral between ends. On the other hand, it regards economics as a science of choice and choices are made for optimal use of scarce resources. These two things are just opposite to each other.

3. Incomplete:

The definition does not cover current economic problems such as unemployement, inflation, economic growth etc. Therefore, this definition is incomplete. Economics not only a positive science: Critics argue that economics is not only positive, but also normative science. Economists cannot remain nuteral between ends. They must determine what is good and what is bad for the society. It is the job of an economist to make a value judgement and office solutions to solve economic problems.

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