

What is Economics

Some Definitions:

It is a science of scarcity. Economics deals with unlimited wants and alternative usable limited resources. --- *L. Robbins*

Economics is the study of mankind in the ordinary business of life.--- *Marshall*

@‘If there were no scarcity, there would be no economic system and no economics’. -- *Stainer and Hague*

Economics is the study of the administration of the scarce resources and of the determinants of income and employment (i.e., how the level of income and employment in a society are determined) ---- Lord John Menard Keynes

Economics is the study of how a society chooses to use its alternative-usable and limited resources to produce, exchange and consume goods and services for achieving and maintaining growth and stability.

Book of the Father of Economics:

Adam Smith (1723-1790): An Enquiry into the Nature and Causes of Wealth of Nations.

Why Should you study Economics:

You cannot be, in any real sense a citizen unless you are also in some degree an economist. You need to know how the modern economy functions. Without a study of economics, you cannot be fully informed about international trade, the economic impact of the Internet, or the trade-off between inflation and unemployment.

Choosing your life's occupation is the most important economic decision you will make. Your future depends not only on your own abilities but also on how economic forces beyond your control affect your wages i.e., economic condition of your surroundings.

References

1. Economics

by John Sloman, Dean Gratt, John Gust

2. Microeconomic Theory

By Dominick Salvator (Schaum's Outline Series)

3. Modern Microeconomic Theory

by A. Koutsoyannis

THE MAIN CHALLENGES

Scarcity, Efficiency and Equity are the main challenges

Scarcity is a universal problem. Where ever you are you will find scarcity there Except in **the Paradise**

Efficiency refers to the **most effective use of a society's resources** in satisfying people's wants and needs. In economics, we say that an economy is producing efficiently when it cannot make anyone economically better off without making someone else worse off.

Equity refers to fair distribution of goods and services among the members of a society.

In order to ensure efficiency and equity we make

Choice: Which one of the alternatives to be taken up/implemented

AND

Allocation: How much resources to be invested to different projects/sectors

Expressing the Challenges through problems

The Basic Problems are: What to produce; how to produce; and for whom to produce

Fundamental Economic Problems

AND

Alternative solutions under: Capitalism, Socialism and Mixed economy

Q1. (a) Why is “**what to produce**” a problem in every economy? (b) How does the price mechanism solve this problem in a free-enterprise economy? (c) In a mixed enterprise economy? (d) In a centralized economy?

Ans:

(a) “**What to produce**” refers to those goods and services and the quantity of each that the economy should produce. Since resources are scarce or limited, no economy can produce as much of every good or service as desired by all members of society. More of one good or service usually means less of others. **Therefore, every society must choose exactly which goods and services to produce and how much of each to produce.**

(b) In a **free-enterprise economy**, the “what to produce” problem is solved by the **price mechanism**. Only those commodities for which consumers are willing to pay a price per unit sufficiently high to cover at least the full cost of producing them will be supplied by producers in the long run. By paying a higher price, consumers can normally induce producers to increase the quantity of a commodity that they supply per unit of time. On the other hand, a reduction in price will normally result in a reduction in the quantity supplied.

(c) In a **mixed-enterprise economy** such as ours, the government (through taxes, subsidies, etc.) **modifies** and, in some instances (through direct controls), **replaces the operation of the price mechanism** in its function of determining what to produce.

(d) In a **completely centralized economy**, the dictator, or more likely a **planning committee** appointed by the dictator or the party, determines what to produce. We in the West believe that this is inefficient. Even the Soviet Union (never a completely centralized economy) has been moving recently toward more decentralized control of the economy and toward greater reliance on the price mechanism to decide what to produce.

2. (a) Why is “**how to produce**” a problem in every economy? (b) How does the price mechanism solve this problem in a free-enterprise economy? (c) In a mixed-enterprise economy? (d) In a centralized economy?

(a) “**How to produce**” refers to the choice of the **combination of factors** and the particular **technique** to use in producing a good or service. Since a good or service can normally be produced with different factor combinations and different techniques, the problem arises as to which of these to use. **Since resources are limited in every economy, when more of them are used to produce some goods and services, less are available to produce others.** Therefore, society faces the problem of **choosing the technique which results in the least possible cost** (in terms of resources used) to produce each unit of the good or service it wants.

(b) In a **free-enterprise economy**, the “how to produce” problem is solved by the **price mechanism**. Because the price of a factor normally represents its relative scarcity, the best technique to use in producing a good or service is the one that results in the least dollar cost of production. If the price of a factor rises in relation to the price of others used in the production of the good or service, producers will switch to a technique which uses less of the more expensive factor in order to minimize their costs of production. The opposite occurs when the price of a factor falls in relation to the price of others.

(c) In a **mixed-enterprise economy**, the operation of the price mechanism in solving the “how to produce” problem is **modified and sometimes replaced by a government action**.

(d) In a **centralized economy**, this problem is solved by a **planning committee**.

3. (a) Why is “**for whom to produce**” a problem in every economy? (b) How does the price mechanism solve this problem? (c) Why does the government in a mixed-enterprise economy modify the operation of the price mechanism in its function of determining for whom to produce?

(a) “For whom to produce” refers to how the total output is to be divided among different consumers. Since resources and thus goods and services are scarce in every economy, no society can satisfy all the wants of all its people. Thus, a problem of choice arises.

(b) In the absence of government regulation or control of the economy, the problem of “for whom to produce” is also solved by **the price mechanism**. The economy will produce those commodities that satisfy the wants of those people who have the money to pay for them. The higher the income of an individual, the more the economy will be geared to produce the commodities the consumers want (if they are also willing to pay for them).

(c) In the name of **equity and fairness**, governments usually modify the workings of the price mechanism by taking from the rich (through **taxation**) and redistributing to the poor (through **subsidies** and **welfare payments**). They also raise taxes in order to provide for certain “**public**” **goods, such as education, law and order, and defence.**

Branches of ECONOMICS

Every field of study has its own language and its own way of thinking. *Economics is no different.*

Many subjects are studied on various levels. Economics is also studied on various levels. We can study the decisions of individual households and firms. Or we can study the interaction of households and firms in markets for specific goods and services. Or we can study the operation of the economy as a whole, which is just the sum of the activities of all these decision makers in all these markets.

The field of economics is traditionally divided into two broad subfields.

Microeconomics is the study of how households and firms make decisions and how they interact in specific markets.

Macroeconomics is the study of economy wide phenomena

The field of economics is divided into two subfields: microeconomics and macroeconomics. Micro economists study decision making by households and firms and the interaction among households and firms in the marketplace. Macroeconomists study the forces and trends that affect the economy as a whole.

Distinguish between (a) a hypothesis, (b) a theory, and (c) a law.

- (a) A hypothesis is an **“if-then” proposition** usually constructed from a casual observation of a real-world event which represents a tentative and yet untested explanation of the event.
- (b) A theory implies that some successful tests of the corresponding hypothesis have already been undertaken. **Thus, a theory implies a greater likelihood of truth than a hypothesis.** The greater the number of successful tests (and lack of unsuccessful ones), the greater the degree of confidence we have in the theory.
- (c) **A law is a theory which is always true** under the same set of circumstances, as, for example, the law of gravity.