UNIT 1

INTRODUCTION TO ECONOMICS

Topics discussed here: Definitions, Nature, Scope, Difference between Microeconomics & Macroeconomics Theory of Demand & Supply; meaning, determinants, law of demand, law of supply, equilibrium between demand & supply Elasticity; elasticity of demand, price elasticity, income elasticity, cross elasticity

Economics: “ईक'नॉमिक्स्”

The study or principles of the way money, business and industry are organized

मुद्रा, व्यवसाय और उद्योग की संगठन रीतियों के सिद्धांतों का अध्ययन; अर्थशास्त्र

Economics is a **social science concerned with the production, distribution, and consumption of goods and services**. It studies how individuals, businesses, governments, and nations make choices about how to allocate resources.

Various Definitions

Economy is the art of making most of life.
- George Bernard Shaw

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

Economics is the science which studies human behaviour as a relationship between ends and scarce means which have alternative uses.
- Lionel Robbins

Economics comes in whenever more of one thing means less of another.
- Fritz Machlup

The theory of economics is a method rather than a doctrine, an apparatus of mind, a technique of thinking, which helps its possessor to draw correct conclusions.
- John Maynard Keynes

Economics is the study of the use of scarce resources to satisfy unlimited human wants.
- Richard Lipsey

Economics is defined as the social science that deals with the production, distribution, and consumption of goods and services. Evolved in the 19th century, the economic studies have become one of the most significant studies of modern days. From a small shop to a country, Economics plays a crucial role in the efficient running of both. No business can flourish without applying the principles of economics. The study of economics is extensive and varied. The nature and scope of economics depend upon the interaction of economic agents and how economies work. Let's analyze the nature and scope of economics deeply.

Nature of Economics

The nature of economics deals with the question that whether economics falls into the category of science or arts. Various economists have given their arguments in favour of science while others have their reservations for arts.

Economics as a Science

To consider anything as a science, first, we should know what science is all about? Science deals with systematic studies that signify the cause and effect relationship. In science, facts and figures are collected and are analyzed systematically to arrive at any certain conclusion. For these attributes, economics can be considered as a science. However, economics is treated as a social science because of the following features:

- It involves a systematic collection of facts and figures.
- Like in science, it is based on the formulation of theories and laws.
- It deals with the cause and effect relationship.

These points validate that the nature of economics is correlated with science. Just as in science, various economic theories are also based on logical reasoning.

Economics as an Art

It is said that "knowledge is science, action is art." Economic theories are used to solve various economic problems in society. Thus, it can be inferred that besides being a social science, economics is also an art.

Scope of Economics

Economists use different economic theories to solve various economic problems in society. Its applicability is very vast. From a small organization to a multinational firm, economic laws come into play. The scope of economics can be understood under two subheads: Microeconomics and Macroeconomics. Let's discuss these in detail:

Microeconomics

Microeconomics examines individual economic activity, industries, and their interaction. It has the following characteristics:

- **Elasticity:** It determines the ratio of change in the proportion of one variable to another variable. For example- the income elasticity of demand, the price elasticity of demand, the price elasticity of supply, etc.
- **Theory of Production:** It involves an efficient conversion of input into output. For example- packaging, shipping, storing, and manufacturing.
- **Cost of Production:** With the help of this theory, the object price is evaluated by the price of resources.
- **Monopoly:** Under this theory, the dominance of a single entity is studied in a particular field.
- **Oligopoly:** It corresponds to the dominance of small entities in a market.

Microeconomics focuses on the choices made by individual consumers as well as businesses concerning the fluctuating cost of goods and services in an economy. Microeconomics covers several aspects, such as –

- Supply and demand for goods in different marketplaces.
- Consumer behaviour, as an individual or as a group.
- Demand for service and labour, including individual labour markets, demand, and determinants like the wage of an employee.

One of the main features of microeconomics is it focuses on casual situations when a marketplace experiences certain changes in the existing conditions. It takes a bottom-up approach to analyse the economy.

Macroeconomics

It is the study of an economy as a whole. It explains broad aggregates and their interactions "top down." Macroeconomics has the following characteristics:

- **Growth:** It studies the factors which explain economic growth such as the increase in output per capita of a country over a long period of time.
- **Business Cycle:** This theory emerged after the Great Depression of the 1930s. It advocates the involvement of the central bank and the government to formulate monetary and fiscal policies to monitor the output over the business cycle.
- **Unemployment:** It is measured by the unemployment rate. It is caused by various factors like rising in wages, a shortfall in vacancies, and more.
- **Inflation and Deflation:** Inflation corresponds to an increase in the price of a commodity, while deflation corresponds to a decrease in the price of a commodity. These indicators are valuable to evaluate the status of the economy of a country.

An economy is primarily divided into two categories - microeconomics and macroeconomics. Microeconomics is the study of the economy on an individual level. Contrarily, macroeconomics observes a nation's economy as a whole, including its performance, structure, and future direction.

Micro and macroeconomics are interdependent to some extent. Several differences also exist between these two segments of economics.

Macroeconomics studies the economic progress and steps taken by a nation. It also includes the study of policies and other influencing factors that affect the economy as a whole. Macroeconomics follows a top-down approach, and involves strategies like –

- The overall economic growth of a country.
- Reasons that are likely to influence unemployment and inflation.
- Fiscal policies that are likely to influence factors like interest rates.
- Effect of globalisation and international trade.
- Reasons that affect varying economic growths among countries.

Another feature of macroeconomics is that it focuses on aggregated growth and its economic correlation.

There are a few differences between these two categories. Here are the primary dissimilarities –

Microeconomics Vs Macroeconomics

S.No	Microeconomics	Macroeconomics
1.	Microeconomics studies individual economic units	Macroeconomics studies a nation's economy, as well as its various aggregates.
2.	Microeconomics primarily deals with individual income, output, price of goods, etc.	Macroeconomics is the study of aggregates such as national output, income, as well as general price levels.
3.	Microeconomics focuses on overcoming issues concerning the allocation of resources and price discrimination.	Macroeconomics focuses on upholding issues like employment and national household income.

4.	Microeconomics accounts for factors like demand and supply of a particular commodity.	Macroeconomics account for the aggregated demand and supply of a nation's economy.
5.	Microeconomics offers a picture of the goods and services that are required for an efficient economy. It also shows the goods and services that might grow in demand in future.	Macroeconomics helps ensure optimum utilisation of the resources available to a country.
6.	Microeconomics helps point how equilibrium can be achieved at a small scale.	Macroeconomics help determine the equilibrium levels of employment and income of the nation.
7.	Microeconomics also focuses on issues arising due to price variation and income levels.	The primary component of macroeconomic problems is income.

Example of Microeconomics –

- Price determination of a particular commodity.
- Consumer equilibrium.
- Output generated by an individual organisation.
- Individual income and savings.

Example of Macroeconomics –

- National income and savings.
- General price level.
- Aggregated demand as well as supply.
- Poverty.
- Rate of unemployment.

Similarities Between Micro and Macro Economics

The unique characteristics of microeconomics and macroeconomics form a corresponding and co-dependent relation between the two schools of economics. Factors that might directly affect microeconomic factors can also impact macroeconomics in the long run.

Similarly, State-level policies, a component of macroeconomics, can also affect individual consumers and businesses. For example, a tax hike (macroeconomics) can increase the retail price of certain products, affecting the rate of consumption (microeconomics).

Effect of Micro and Macro Economics

Any changes in these categories have a direct impact on a country's economy. Several factors affect it; let's take a look –

- Decision Making

Uncontrollable external factors such as changes in interest rate, regulations, number of competitors present in the market, cultural preferences, etc. play a key role influencing an organisation's strategies and performance. These can have a cumulative effect on a nation's economy as well.

- Economic Cycles

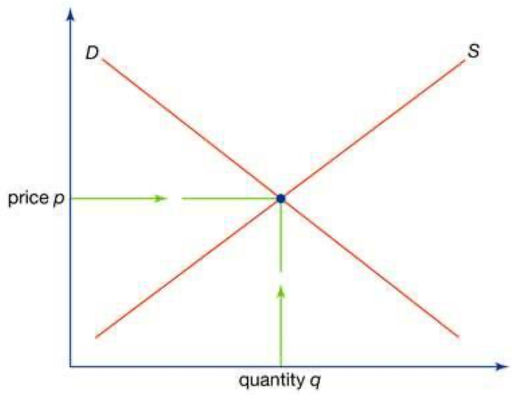
Experts consider macroeconomics as a cyclic design. Higher demand level, personal income, etc. can influence price levels, which in turn can affect a nation's economy. Contrarily, when supply outweighs demand, the cost of daily goods reduces. This pattern continues until the next cycle of supply and demand.

- Price of Products and Services

The primary goal of an organisation is to keep cost at the minimum and increase the profit margin. The cost of labour is one of the highest expenses incurring factors in microeconomics, thereby directly affecting the overall cost of production and retail.

To understand the uses of microeconomics and macroeconomics as well as several other central components of an economy, visit Vedantu's official website today.

SUPPLY AND DEMAND

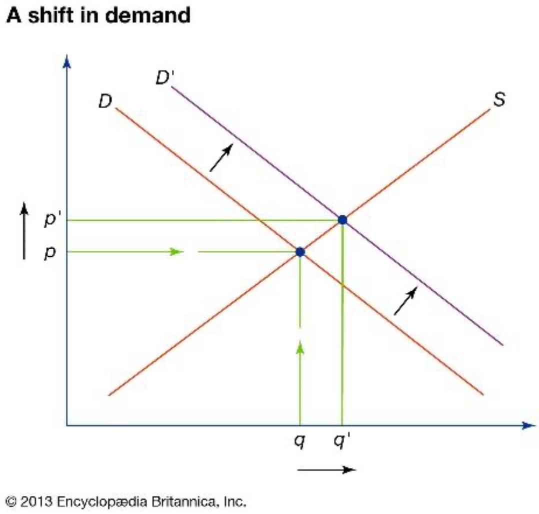


Relationship Of Price To Supply And Demand

Supply and demand, in economics, relationship between the quantity of a commodity that producers wish to sell at various prices and the quantity that consumers wish to buy. It is the main model of price determination used in economic theory. The price of a commodity is determined by the interaction of supply and demand in a market. The resulting price is referred to as the equilibrium price and represents an agreement between producers and consumers of the good. In equilibrium the quantity of a good supplied by producers equals the quantity demanded by consumers.

Demand curve

The quantity of a commodity demanded depends on the price of that commodity and potentially on many other factors, such as the prices of other commodities, the incomes and preferences of consumers, and seasonal effects. In basic economic analysis, all factors except the price of the commodity are often held constant; the analysis then involves examining the relationship between various price levels and the maximum quantity that would potentially be purchased by consumers at each of those prices. The price-quantity combinations may be plotted on a curve, known as a demand curve, with price represented on the vertical axis and quantity represented on the horizontal axis. A demand curve is almost always downward-sloping, reflecting the willingness of consumers to purchase more of the commodity at lower price levels. Any change in non-price factors would cause a shift in the demand curve, whereas changes in the price of the commodity can be traced along a fixed demand curve.

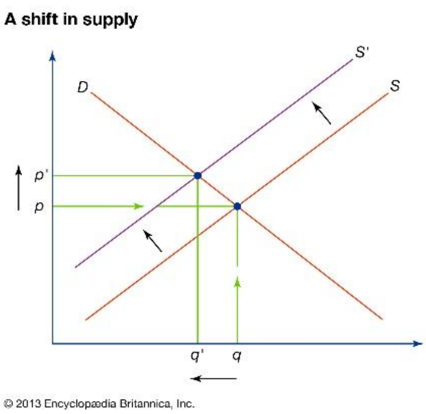


Increase in demand

Illustration of an increase in equilibrium price (*p*) and equilibrium quantity (*q*) due to a shift in demand (*D*).

Supply curve

The quantity of a commodity that is supplied in the market depends not only on the price obtainable for the commodity but also on potentially many other factors, such as the prices of substitute products, the production technology, and the availability and cost of labour and other factors of production. In basic economic analysis, analyzing supply involves looking at the relationship between various prices and the quantity potentially offered by producers at each price, again holding constant all other factors that could influence the price. Those price-quantity combinations may be plotted on a curve, known as a supply curve, with price represented on the vertical axis and quantity represented on the horizontal axis. A supply curve is usually upward-sloping, reflecting the willingness of producers to sell more of the commodity they produce in a market with higher prices. Any change in non-price factors would cause a shift in the supply curve, whereas changes in the price of the commodity can be traced along a fixed supply curve.



Decrease in supply

Illustration of an increase in equilibrium price (p) and a decrease in equilibrium quantity (q) due to a shift in supply (S).

Market equilibrium, or balance between supply and demand

Supply and demand are equated in a free market through the price mechanism. If buyers wish to purchase more of a good than is available at the prevailing price, they will tend to bid the price up. If they wish to purchase less than is available at the prevailing price, suppliers will bid prices down. The price mechanism thus determines what quantities of goods are to be produced. The price mechanism also determines which goods are to be produced, how the goods are to be produced, and who will get the goods—i.e., how the goods will be distributed. Goods so produced and distributed may be consumer items, services, labour, or other salable commodities. In each case, an increase in demand will lead to the price being bid up, which will induce producers to supply more; a decrease in demand will lead to the price being bid down, which will induce producers to supply less. The price system thus provides a simple scale by which competing demands may be weighed by every consumer or producer.

The tendency to move toward the equilibrium price is known as the market mechanism, and the resulting balance between supply and demand is called a market equilibrium.

As the price of a good rises, the quantity offered usually increases, and the willingness of consumers to buy the good normally declines, but those changes are not necessarily proportional. The measure of the responsiveness of supply and demand to changes in price is called the price elasticity of supply or demand, calculated as the ratio of the percentage change in quantity supplied or demanded to the percentage change in price. Thus, if the price of a commodity decreases by 10 percent and sales of the commodity consequently increase by 20 percent, then the price elasticity of demand for that commodity is said to be 2.

In algebraic form,

Elasticity (E) is defined as $E = \%\Delta y / \%\Delta x$;

(y is elastic with respect to x if E is greater than 1, inelastic with respect to x if E is less than 1, and "unit elastic" with respect to x if E is equal to 1.)

Several other types of elasticities are frequently used to describe well-known economic variables. These include, but are not limited to, the income elasticity of demand, the cross-price elasticity (the elasticity of the price of a good with respect to the price of another good), the elasticity of substitution between different factors of production (for example, between capital and labour), and the elasticity of intertemporal substitution (for example, the elasticity of consumption in the future relative to consumption in the present).

Several other types of elasticities that are frequently used to describe well-known economic variables have acquired their own special names over time. These include, but are not limited to, the income elasticity of demand, the cross-price elasticity (the elasticity of the price of a good with respect to the price of another good), the elasticity of substitution between different factors of production (for example, between capital and labour), and the elasticity of intertemporal substitution (for example, the elasticity of consumption in the future relative to consumption in the present).

The demand for products that have readily available substitutes is likely to be elastic, which means that it will be more responsive to changes in the price of the product. That is because consumers can easily replace the good with another if its price rises. The demand for a product may be inelastic if there are no close substitutes and if expenditures on the product constitute only a small part of the consumer's income. Firms faced with relatively inelastic demands for their products may increase their total revenue by raising prices; those facing elastic demands cannot.

Supply-and-demand analysis may be applied to markets for final goods and services or to markets for labour, capital, and other factors of production. It can be applied at the level of the firm or the industry or at the aggregate level for the entire economy.

Types of Elasticity

Elasticity of Demand
The quantity demanded of a good or service depends on multiple factors, such as price, income, and preference. Whenever there is a change in these variables, it causes a change in the quantity demanded of the good or service.

Price elasticity of demand is an economic measure of the sensitivity of demand relative to a change in price. The measure of the change in the quantity demanded due to the change in the price of a good or service is known as price elasticity of demand.

Income Elasticity
Income elasticity of demand refers to the sensitivity of the quantity demanded for a certain good to a change in real income of consumers who buy this good, keeping all other things constant. The formula for calculating income elasticity of demand is the percent change in quantity demanded divided by the percent change in income. With income elasticity of demand, you can tell if a particular good represents a necessity or a luxury.

Cross Elasticity

The cross elasticity of demand is an economic concept that measures the responsiveness in the quantity demanded of one good when the price for another good changes. Also called cross-price elasticity of demand, this measurement is calculated by taking the percentage change in the quantity demanded of one good and dividing it by the percentage change in the price of the other good.

Price Elasticity of Supply

Price elasticity of supply measures the responsiveness to the supply of a good or service after a change in its market price. According to basic economic theory, the supply of a good will increase when its price rises. Conversely, the supply of a good will decrease when its price decreases.

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