

Chapter -1 **Introduction**

Meaning & Definition of Economics

In simple words, "Economics is a system in which people earn their livings."

In general term, economics explain the full utilization of resources, 'resources' are limited & 'wants' are unlimited, hence economics guide us to ensure the best possible use of resources.

Definition of economics:-

- 1) Wealth definition :- this is given by Adams Smith, According to him economics is the study of wealth. i.e. how the wealth is earn & how it is spends.
- 2) Welfare definition:- This is given by Alfred Marshall according to him, economics is the study of material welfare i.e. how can we ensure the welfare of mankind.
- 3) Scarcity definition:- This was given by Robbins according to him, Economics is the study of scarcity i.e. management of unlimited wants to limited resources.
- 4) Growth definition:- This was given by Samuelson, according to him, economics is the study to maximize the output with the help of min. Input, which is possible by proper utilization of resources.

Subject Matter of Economics

Economics can be studied under five main activities

- 1) Consumption:- It is the activity in which goods & services are used for the satisfaction of human wants this consumption can be individual (use of electricity by the household) or collective (Street light consumption by the society).
- 2) Production :- It is the activity in which utility of the commodity is created or value of a commodity is increased utility can be created under the following forms
 - a) Form utility:- wood is converted into firm
 - b) Place:- when sand is shifted from sea beach to construction site.
 - c) Time utility:- value of antiques increases with the passage of time
 - d) Possession utility:- when book is pur by a student from the bookseller
 - e) Service utility:- services of professional given to clients.
- 3) Investment :- It is the activity in which we produce them cap. Goods for the production of other goods services.
- 4) Exchange :- In this activity there is a pur & sale of goods & services and factors.
- 5) Finance:- It is the activity in which money is advanced by the bank financial institutes to the consumers as well as producers.

Branches of economics

Basis	Micro	Macro
1	In this we study the economic problems at the individual level.	In this we study the economic problems at the country level
2	Main instrument is individual demand & supply	Main instrument is aggregate demand & supply.
3	The main problem is price & output determination	The main problem is income & employment determination
4	The main assumption is ceteris paribus (other things remaining the same or constant)	In this ,we do not take such assumption because all macro economic variable are interrelated.

Natural of economics

Positive	Normative (Ideology)
In this approach we discuss the reality of fact	In this approach we discuss value judgment or ideology
It describes : What is what was & what will be"	It describes what ought to be.
For eg :- in India population growth rate is 1.7%	For eg :- it ought to be less than 1%.
For Eg:- economic growth rate of India is 7%	For eg:- it ought to be more than 10%
Literacy level of India is 60%.	It ought to be 100%.

Central problems of an Economy

Every economy has economic problems because resources are limited in every economy & wants are unlimited hence we have to make a choice to ensure the fuller utilization of resources.

What causes economic problems:-

- Unlimited wants :- Human wants are unlimited no man can satisfy all his wants. It is the human nature that we desire more than what we get.
- Limited resources:- resources are always limited as compared to their demand, hence there has always been a problem of shortage.
- Alternative uses:- Another cause of economic problem is that our resources have alternative use for eg:- milk is the scarce commodity which can be used for the preparation of ice-cream cheese butter etc if it is used for one purpose then it has to be sacrificed for other purpose. Hence there is a problem of economic choice.

Important central problems of an economy:-

- Problem of allocation of resources:- This is the basic problem related to allocation of resources which are limited. This problem has 3 aspects :
 - a) What & how much to produce:- This is the first & most problem of every economy to take a decision which can be discussed in two parts:-

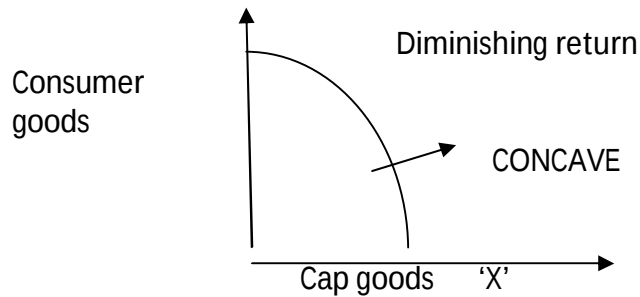
- 1) What to produce has to be decided by every economy i.e. either it should produce consumer goods like grains, clothes, sugar etc or it should produce cap goods like machines equipments.
 - 2) How much to produce:- An economy has to decide the quantity in which consumer goods should be produce or cap goods should be produce.
 - b) How to produce :- This problem is related to the choice of technique of production which can be discuss in two parts :-
 - Labor :- Intensive technique :- in this technique of production , we use more units of labor as compared to cap. It is more popular in labor abundant countries.
 - Cap :- Intensive technique :- It is more popular in cap abundant countries & in this technique we use more units of machines as compared to labor. For eg:- USA & Japan.
 - c) For whom to produce:- This problem depends upon income distribution if income is unequally distributed then economy should produce luxurious goods and if it is equally distributed then economy should produce general commodities which can be used by common people.
- Problem of fuller utilization of resources:- This is another central problem related to fuller utilization or full employment of human resources. Every economy has to use all it's resources to the full extent no economy can afford under utilization of resources.
 - Problem of economic growth:- This is another central problem to increase economic growth of resources and this can be achieved with the help of technological advancement.

Solution of central problems in different economic system:-

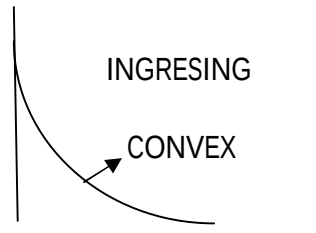
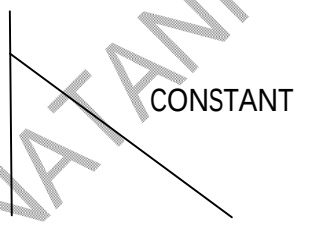
- 1) Capitalist economy:- In this economy most of the decision are taken on the basis of "price mechanism" – market oriented
Economy should produce those goods in which profitability is high. Economy should used that technique of production which gives less cost.
Economy should produce the goods for those people who can offer better price.
- 2) Socialist economy :- In this economy decision are taken by the central authority of the country. and these decision are not profit motive but welfare motive.
Economy should produce those goods which are socially useful. Economy should used that technique which is socially useful and economy should produce goods for those people who are suffering from hunger or starvation.
- 3) Mixed economy:- In this economy, decision are taken jointly on the basis of price mechanism & social consideration.
Economy should produce both type of goods i.e. commodities which are decided by the market & commodities which are socially important. The decision of technique is taken with the balance approach & economy should produce goods for all sections of society.

Production possibility curve

Combination	X	Y	Diminishing return
A	0	1000	
B	100	900	
C	200	700	
D	300	400	
E	400	0	



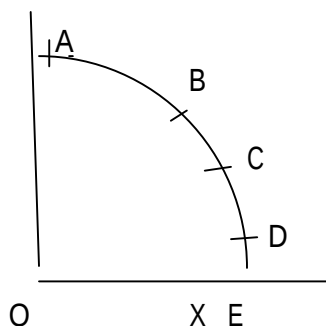
S.No.	Production1	2	3
1	100	100	100
2	210	200	190
3	330	300	270
4	460	400	340
5	600	500	400
	Increasing At increasing rate	constant rate	diminishing return



PPC offers different combinations of two commodities which can be produced by an economy when resources are fully utilized & technology is constant.

PPC is also called 'transformation curve' because when we increase the production of X commodity then we transfer our resources from the production of Y commodity to X commodity.

This curve can be explained with the help of schedule & diagram.



Schedule

Combination	Production	
	X	Y
A	0	1000
B	100	900
C	200	700
D	300	400
E	400	0

Basis properties of PPC :-

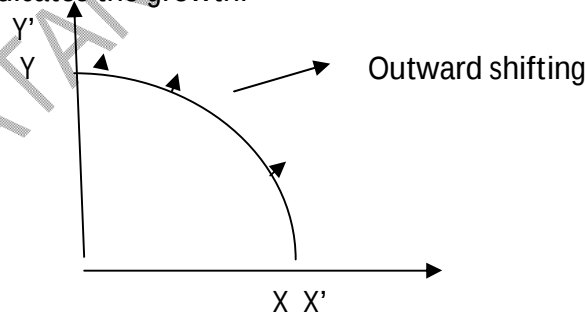
- 1) It is downwards :- PPC slopes downwards from left to right because when we increase the production of X commodity then we have to sacrifice the production of Y commodity. Hence, relationship between the production of X & Y commodity is inverse.
- 2) It is concave to the point of origin :- because when we have to increase the production of X commodity then we have to sacrifice more & more units of Y commodity.

Shifting of PPC

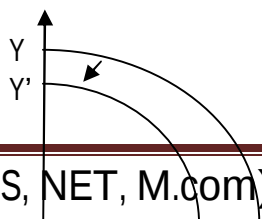
PPC shift under the following conditions

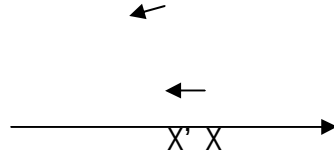
a) Change in resources

- When resources are increased:- then PPC will shift outwards from it's original curve which indicates the growth.



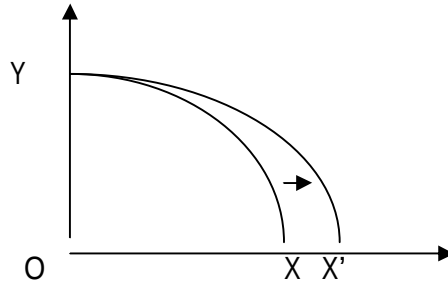
- When resources are under :- utilized -, In this situation, PPC will shift inwards from it's origin which indicates under-utilization of resources.



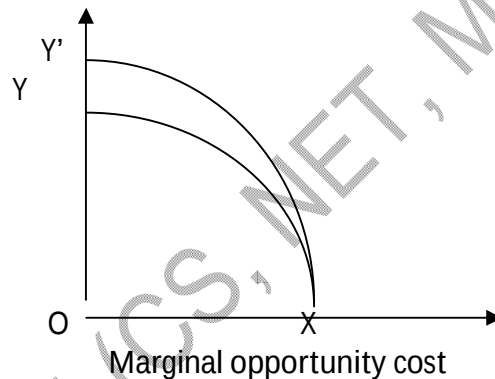


b) Change in technology:-

- When technology of X commodity improves -, then the production area of X commodity will expand from OX to OX'.



- When technology of Y commodity improves-, then the production area is increased from OY to OY'.



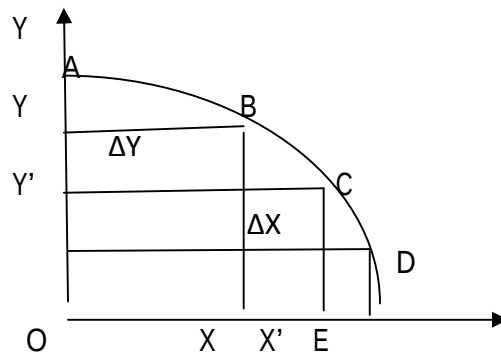
Marginal opportunity cost

Opportunity cost is the next best alternative use of the factor which an economy has to sacrifice for the production of other commodity.

MOC is the rate at which output of X commodity is increased by sacrificing output of Y commodity.

It can be understood by the table & diagrammed

Combination	X	Y	MOC
A	0	1000	0
B	100	900	100:100
C	200	700	100:200
D	300	400	100:300
E	400	0	100:400



Practice Questions

- 1) An economy can produce X & Y commodity in following combination find out MOC ?

X(In million)	Y(in 1000)	MOC
0	90	0
1	80	1:10
2	68	1:12
3	52	1:16
4	34	1:18
5	10	1:24

Units	T.U.	M.U
1	5	5
2	9	4
3	12	3
4	14	2

$$MU = \frac{\Delta T.U.}{\Delta Q}$$

$$TU = E.M.U.$$

Chapter -2

Consumer Equilibrium

In this Chapter – we will try to find out the maximum satisfaction of the consumer, income of the consumer is limited and with this limited income they want to get maximum satisfaction. This is explain by the consumer equilibrium but before to find out consumer equilibrium we have to understand the important terms:-

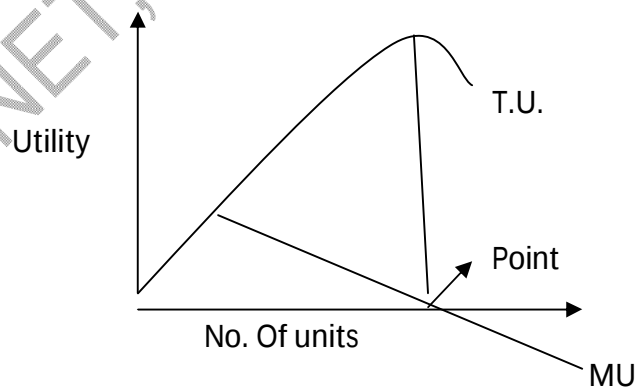
Utility :- It means satisfy power or usefulness of the commodity. Whenever we consumer a particular commodity, we get the satisfaction, this is called utility of teh commodity. It can discuss in two parts :-

- 1) Total utility:- This is the total satisfaction which a consumer derives from the consumption of no: of units.
- 2) Marginal utility:- This is the incremental change in total utility due to change in no: of units

$$Mu. = \frac{\Delta T.U}{\Delta Q} \quad \text{or } TU_n - TU_{n-1}$$

Relationship between T.U & M.U:- This can be explained by schedule & diagram.

S.No.	T.U.	M.U.
1	10	10
2	18	8
3	24	6
4	28	4
5	30	2
6	30	0
7	28	-2



Units	TU ₁	TU ₂	TU ₃
1	5	5	5
2	11	10	9
3	18	15	12
4	26	20	14

Units	TU	MU
1	5	5
2	9	4
3	12	3
4	14	2

$$MU. = \frac{\Delta T.U}{\Delta Q}$$

$$TU. = E.M.U.$$

- 1) When TU increases of diminishing rate, then M.U. falls
- 2) When TU. Is at the max point, then M.U. is zero
- 3) When TU is starts falling then M.U. becomes motive.

Law of Diminishing M.U.- It is a psychological law of consumption which stated that when a consumer consumes a particular commodity in continuation, then satisfaction received from every next unit keeps on decreasing. This law is applicable with certain exceptions & limitations.

Determination of consumer's equilibrium:-

"Consumer Equilibrium is a situation at which a consumer gets max satisfaction with the given income & at the given price."

"Equilibrium is a situation at which there is no tendency to change."

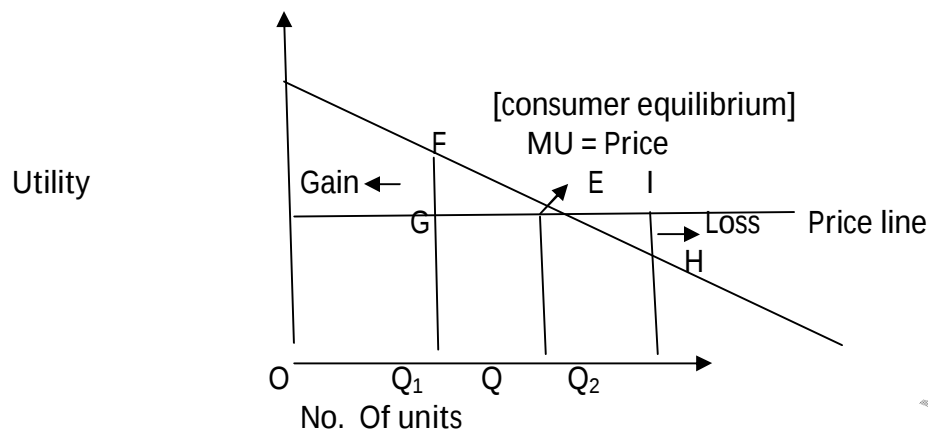
Assumption of consumer's equilibrium

- 1) Consumer is rational :- The objective of consumer should be to get max satisfaction with the limited income.
- 2) Cardinal measurement of utility:- utility of the commodity have to be expressed in terms of cardinal no such as 1,2,3,4 etc.
- 3) Consumer's money income is constant & it does not change during consumption process
- 4) Law of diminishing M.U. is applicable
- 5) Consumer taste, fashion & choice should not change

Consumer equilibrium can be determined with the help of schedule & diagram.

Units	T.U.	M.U.	Price	Consumer's supply
1	10	10	6	+4
2	18	8	6	+2
3	24	6	6	0[consumer equilibrium MU=price
4	28	4	6	-2
5	30	2	6	-4
6	30	0	6	-6
7	28	-2	6	-8

Utility is expressed in utile
1 utile = Re 1



Why consumer equilibrium is at point E ? or Justification of consumer equilibrium

Consumer equilibrium is determined at point E at which a consumer consumes OQ units of a commodity but if a consumer stop the consumption at OQ₁ then consumer will not be able to get gain equal to the ΔEFG , on other hand if a consumer continues the consumption till OQ₂ then consumer will have to face the loss equal to ΔEHI .