

CHAPTER-1

INTRODUCTION TO MICRO ECONOMICS

INTRODUCTION

- ✓ Economics is an important branch of social science, which deals with the behaviour of human beings in relation to economic activities.
- ✓ Economics is derived from two Greek words viz. ^{51&52}"Oikos" (means household) and "Nomia" (means rnanagement). Therefore. economics was understood as a "Science of Household Management" - managing a household with the limited resources available, in an economical manner.

Oikos-Nomia

- ✓ But later, the scope of economics has expanded from mere household management to the nation's management.
- ✓ Infact, Out of social sciences, it is economics which has more practical applicability, hence regarded as 'Queen of Social Sciences'.
- ✓ The science of economics was born with the publication of Adam Smith's classical work "An Inquiry into Nature and Causes of wealth of Nations" in the year 1776. Before Adam Smith, there were many people who expressed ideas on economics. In the 17th century, Adam smith was the first person who put all the economic ideas in a systematic way, Hence, he is considered to be the "father of economics ".

WHAT IS ECONOMICS

^{4&64} Economics is mainly concerned with the way in which a society chooses to employ its scarce resources which have alternative uses, for the production of goods for present and future consumption.



⁵⁹ Balance between Unlimited Wants Limited Resources

ECONOMIC AROUND YOU

It is your birthday and your mother gives you Rs. 100 as birthday gift. You are free to spend the money as you like. What will you do? You have many options before you, like :

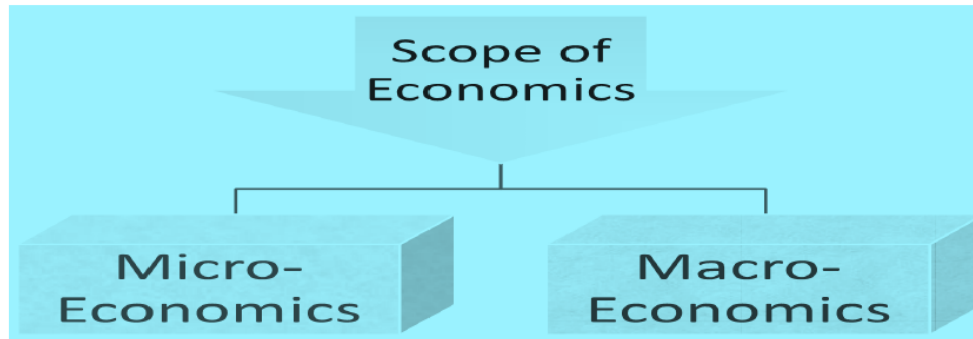
Option 1 : You can go for a movie

Option 2 : You can eat Ice-cream.

Option 3 : You can buy yourself a dress

Option 4 : you can give return gift to your friend.

Option 5 : You can recharge your cell-phone.

MICRO ECONOMICS AND MACRO ECONOMICS

Micro = "Mikros" (Greek Word) meaning "small"



Particular Unit (we study the economic behavior of individual, household, firm, industry in the national economy)

- ✓ According to Prof. Boulding, "Microeconomics is the study of particular firms, particular households, individual price, wages, income, individual industries and particular commodities"
- ✓ ⁴⁷Micro Economic theory deals with the problem of allocation of resources.
- ✓ Under Micro Economics we study:
 - (i) product pricing;
 - (ii) consumer behaviour;
 - (iii) factor pricing;
 - (iv) economic conditions of a section of the people;
 - (v) study of firms; and
 - (vi) location of industry.

Macro = "Makros" (Greek Word) meaning "large"



Aggregates (we study the working and performance of the economy as a whole such as total production, total consumption, total saving and total Investment)

- ✓ According to Mc Connel, "Macroeconomics examines the forest and not the trees. Thus it analyses and establishes the functional relationship between large aggregates".
- ✓ Micro Economic theory deals with growth and development of resources.
- ✓ Under Macro Economics we study:
 - (i) national income and output;
 - (ii) general price level;
 - (iii) balance of trade and payments;
 - (iv) external value of money;
 - (v) saving and investment; and
 - (vi) employment and economic growth.

Example

Case	Micro	Macro
Production	How many burgers does McDonald's produce?	How many goods does the India produce each year?
Prices	Prices the price of an McDonald's Burger?	What Is the price of all consumer goods In the economy?
Income	What are the wages of the workers at McDonald's?	What are the total wages and salaries of workers in the economy?
Employment	How many workers are employed at McDonald's	What are the total number of workers In an economy?

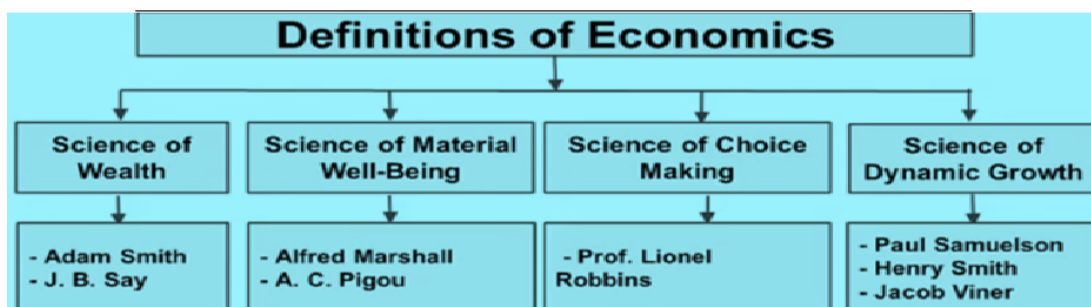
Differences between Micro economics and Macro economics

Micro Economics	Macro Economics
Studies a particular part or a component of the economy.	Studies the economy as a whole
It is known as 'Price Theory'	It is known as 'Income Theory'
Makes assumptions while studying an economy	Doesn't make any assumptions
It is unrealistic study	It is more realistic study
It has limited scope	It has wider scope

It gives a worm's eye view of an economy	It gives a bird's eye view of an economy
It is known as Microscopic study	It is known as Telescopic study
Studies bit by bit	Studies whole economy at one stretch
Eg. ¹⁵ Lockout in TELCO, ¹³ Finding the Causes of Failure of X & Co.	E.g. Per capita Income, Corporate Income Tax, Economy Growth

Note:- ¹¹It should be noted that micro & macro Economics are interdependent .

DEFINITION OF ECONOMICS



1. Science of Wealth

Definitions

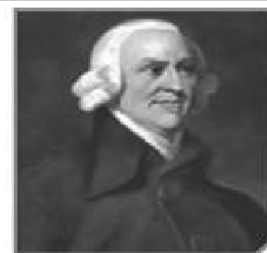
- **Adam Smith**, "Economics is an inquiry into the nature and causes of wealth of nations."
- ⁶⁵**J.B. Say**, "Economics is the science which deals with wealth"

Features

- ✓ Economics is a science of study of wealth only;
- ✓ The main objective of human life is acquisition and attainment of wealth.
- ✓ Economics is a science which deals with the causes behind the creation of wealth of nation.
- ✓ It only considers material wealth.

Merits

- ✓ It highlighted an important problem faced by each and every nation of the world, namely creation of wealth.
- ✓ It focused on various important issues of economies by considering the problems of poverty, unemployment etc. can be solved to a greater extent when wealth is produced and is distributed equitably; it goes to the credit of Adam Smith and his followers to have addressed to the problems of economic growth and increase in the production of wealth.



Adam Smith

He is the author of the famous ^{53&54}book "Wealth of Nations" (1776). He is known as the Father of Political Economy because he was the first person who put all the economic ideas in a systematic way. It is only after Adam Smith, we study economics as a systematic science.

Demerits

- ✓ Adam Smith and other classical economists concentrated only on material wealth. They

COMPLETE NOTES ON

2.

CA- CPT MICRO

ECONOMIC AVAILABLE

ON Rs. 490/- ONLY.

Merits

- ✓ This definition is **more wide and comprehensive** as it covers not only wealth in the scope of economics, but also the welfare of human beings. According to this definition, economics is a **normative science**
- ✓ It lays emphasis on the material requisites of well-being. So material things such as **food, clothing and shelter are important economic objectives.**

Demerits

- ✓ **Neglect of Immaterial things** : Economics is concerned with not only material things but also with immaterial things like services of singers, teachers, actors etc. Marshall and Pigou chose to ignore them.
- ✓ **The concept of welfare is very vague** : Robbins criticised the welfare definition on the ground that it is very difficult to state which things would lead to welfare and which will not. He is of the view that we would study in Economics all those goods and services which carry a price, whether they promote welfare or not.

3. Science of Choice Making

Definitions

- ¹**Lionel Robbins**, "Economics is the science which studies human behaviour as a relationship between ends and scarce means which have alternative uses".

Features

- ✓ **Economics is a science**: Economics studies human behavior scientifically. It studies how human beings use the scarce resources optimally under given constraints. (⁷positive Science)
- ✓ **Unlimited ends**: Ends refer to wants. It is a general human tendency that when one want is satisfied, another want crops up. Thus, a choice has to be made between more important and less important wants.
- ✓ **Scarce Means** (⁶⁰ $W > R$) : Means refer to resources. Resources may be **natural** (oil, mineral ore) or **man-made** (capital goods, consumer goods). ²Wants are unlimited, but the resources (means) to satisfy these wants are limited i.e. ^{5&30}all wants cannot be satisfied. ¹⁴Economic goods are considered scarce because they do not exist in adequate quantity to satisfy social requirement. To quote Prof. Oscar Lange's words here: "Economics is" science of Administration of Scarce resources in human society",
Example: A steel producing firm wants to produce steel, iron and cement. It also wants to diversify geographically, but the amount of capital it has is limited. The labour force is also limited. Availability of steel and iron is also scarce. Hence, it has to restrict itself to the scarce means.
- ✓ **Alternative uses**: Resources are not only scarce, but they can also be put to many uses. Thus, a choice has to be made between the most urgent and the less urgent needs.



Prof. Lionel Robbins

Prof. Lionel Robbins of the London School of Economics gave a new definition to Economics in his famous book ⁵⁵"Nature and Significance of Economics" which he brought out in 1931.

Example! Arun, a student, has exams on the next day. However, he wants to watch cricket match. His friends want him to attend a birthday party. Given the many alternatives. Arun has to choose the best way of utilizing the scarce resource (time).

Merits

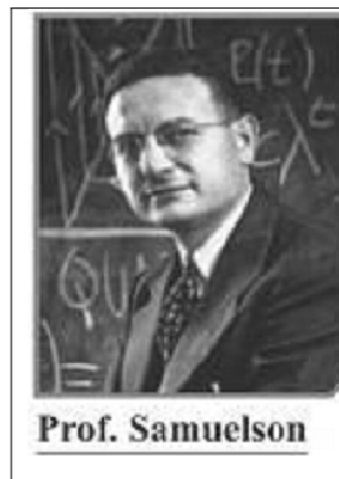
- ✓ This definition has **widened scope** of economics. In Economics we **study all sorts of**

COMPLETE NOTES ON
CA- CPT MICRO
ECONOMIC AVAILABLE
ON Rs. 490/- ONLY.

4. Science of dynamic growth and development

Definitions

- **Paul A. Samuelson**, "Economics is the study of how men and society choose, with or without the use of money, to employ scarce productive resources which could have alternative uses, to produce various commodities over time and distribute them for consumption now and in the future amongst various people and groups of society".
- ⁵⁶**Prof Henry Smith**, "Economics, is the "the study of how in a civilized society one obtains the share of what other people have produced and of how the total product of society changes and is determined".
- ⁵⁷**Jacob Viner**, "Economics is what Economists do".



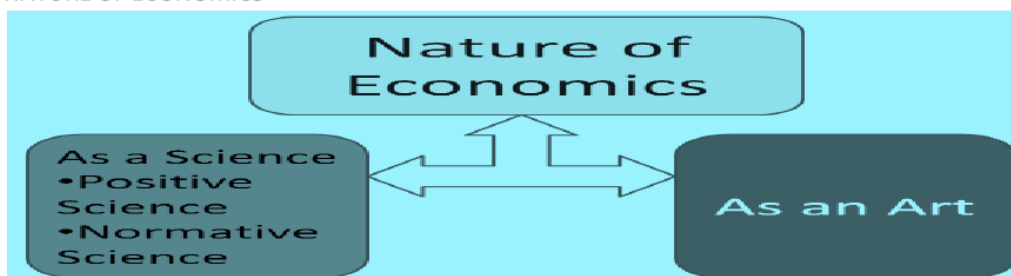
Features

- ✓ The above definition is very comprehensive because it does not restrict to material well-being or money measure as a limiting factor. But it considers economic growth over time.
- ✓ Samuelson's definition is combination of wealth, welfare and scarcity definitions
- ✓ Samuelson goes a step further and discusses how a society uses limited resources for producing, goods and services for present and future consumption of various people Or groups.

Conclusions

- ✓ Economic is a science that studies those activities, which are, concerned with the efficient production, consumption, exchange, and distribution of scarce means which have alternative uses.
- ✓ The purpose of economics is to achieve maximum satisfaction of wants and increasing of welfare as well as economic growth.

NATURE OF ECONOMICS



Economics as a Science

A subject is considered as Science if	Whether economics has features of science,
It is systematised body of knowledge which	Yes, E.g. Law of demand

studies the relationship between cause and effect.	
It is capable of measurement.	Yes, the measurement is in terms of money.
It has its own methodological apparatus	Yes, Deductive and inductive method.
It has the ability to forecast.	Yes, future market condition can be predicted with the help of various statistical and non-statistical tools.

But it is to be noted that Economics is not a perfect science like physics or chemistry as:-

- Economists **do not have uniform opinion about** a particular event.
- The subject matter of Economics is the economic **behaviour of man which is highly unpredictable.**
- **Money**, which is measurement economy, **is itself a dependent variable.**
- It is not possible to make correct predictions about the behaviour of economic variables.

Economics as an Art

- ✓ Art is the practical application of knowledge and it guides us as how to achieve an objective.
- ✓ Whereas science teaches us to know, art teaches us to do. Unlike science which is theoretical, art is practical.
- ✓ Daily problems can be solved with help of general economic activities like production, distribution, etc. Many economic concepts, which are theoretical are also pragmatic. For example, elasticity of demand concept being used while imposing tax on a product or service. Law of diminishing marginal utility concept being used while deciding the price of a commodity,

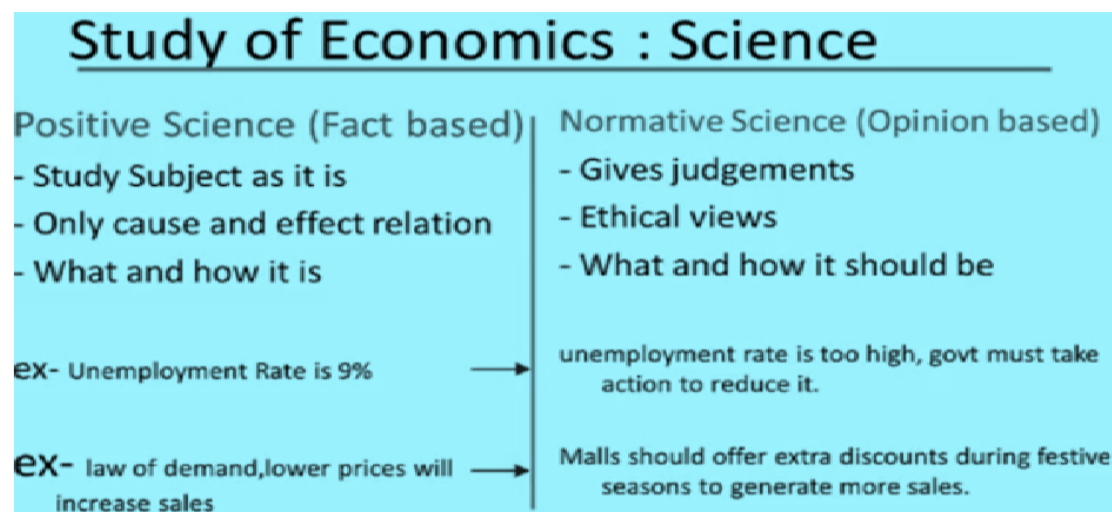
**COMPLETE NOTES ON
CA- CPT MICRO
ECONOMIC AVAILABLE
ON Rs 490/- ONLY**

Normative science: Normative science not only studies the facts, but also makes value judgement. Normative science has following features:

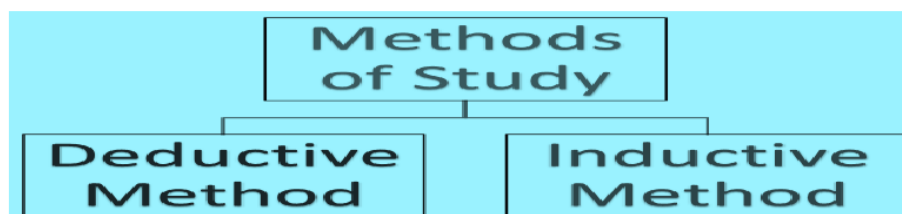
- It tells us what should be the situation
- It Involves value judgement
- It also takes ethics into consideration

Economics is a body of systematized knowledge concerning what ought to be. Its objective is the establishment of ideals. It is a prescriptive science as it describes the problems and also gives suggestions, It is the tool user. Prof. Marshall and Pigou say that economics should be normative in nature. For example. it gives judgement on various economic activities like what should be the level of national income. wage rate, ⁴¹steps to be taken to solve various economic problems, ⁸Reducing inequality should be a major priority of mixed economies etc.

Thus, we can conclude that economics is both. a positive and a normative science. While framing theories. it is a pure and positive science, but when practically applied it is normative in nature.



METHODS OF STUDY OF ECONOMICS:-



(1) **Deductive Method:-**

Deductive method is the process of reasoning from general to particular or universal to individual. This method is called abstract or a priori because it is based on a priori reasoning and conclusions are drawn from certain fundamental assumptions. and not on actual facts.

(2) Inductive Method:-

Inductive method is the process of reasoning from particular to general or from individual to Universal. The generalizations are based on observation of individual instances.

Difference Between Induction & deduction method

Basis	Deduction Method	Induction Method
Process of reasoning	From general to particular	From particular to general
Advocated by	Classical economist	Modern economist

**COMPLETE NOTES ON
CA- CPT MICRO
ECONOMIC AVAILABLE
ON Rs. 490/- ONLY.**

Human wants are unlimited and productive resources are scarce. An economy without scarcity is not found in the real world. All wants cannot be satisfied with the scarce productive resources for the satisfaction of wants, so ²¹problem of use of scarce resources arise. This is generally called 'the central economic problem'. The central economic problem may be four types-

WHAT to Produce

- Capital Goods or Consumer goods and in what quantities

HOW to Produce

- Labour Intensive Techniques or Capital Intensive Techniques

FOR Whom to Produce

- Share of different people in nation's population
produce mass consumption goods at a large scale or goods for upper classes

What PROVISIONS for Economic Growth i.e., Future Growth

- Resources for current consumption, and future requirement by means of saving & investment.
- ³¹Increase in current level of consumption provides slower economic growth in the future & ⁴⁶larger production of capital goods would lead to higher production in future.

Key Note: - ⁴⁴it is to be noted here that 'when are goods produced' is not central problem of economy.

PRODUCTION POSSIBILITY CURVE (PPC)

- Production-possibility curve (PPC) or "Production possibility Frontier (PPF)" or ⁶⁶"transformation curve"
- may be defined as a curve which shows the ⁴⁹different rates of production of two goods with limited productive resources and technology.

Assumption

1. Two types of goods –cloth & wheat produced
2. Productive Resources remain Fixed.
3. Full Employment of Productive Resources- neither Unemployed nor Underemployed.
4. No change in technology.

It is assumed that there are only two types of goods-cloth & wheat. The resources of economy can be alternatively used in both the commodities. If the production of a commodity is increased then the production of the other commodity will be decreased. Following table shows the production possibilities of production.

COMPLETE NOTES ON

CA- CPT MICRO

ECONOMIC AVAILABLE

ON Rs. 490/- ONLY.

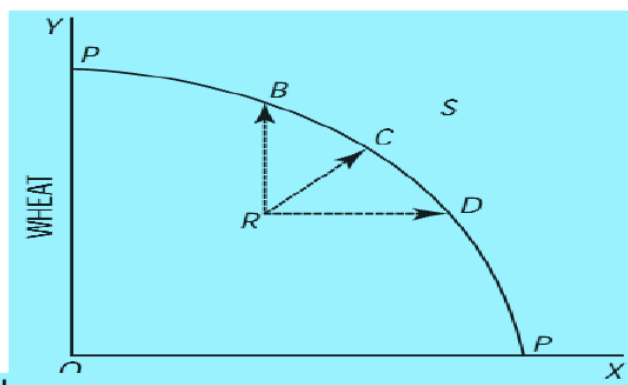
PPC- Concave to the origin-due to Increasing opportunity cost

It is this principle of increasing opportunity cost that makes the PPC concave to the origin.^{27&45} If opportunity costs were constant, **PPC would be a straight line.**

Unemployment & PPC

When an economy produces on PPC, it means that there is no unemployment and all the resources are being used efficiently. But ²⁸if an economy operates inside the PPC then there is unemployment or inefficient use of resources.

The figure given below Point ³⁶'R' inside the PPC indicate underutilization of resources. In other words economy would not be utilizing its resources fully. ²²Point 'S' indicates that an economy could not produce with the given resources and technology. Of economy moving from ^{25&26}"R" to 'B' or 'C' or 'D' points, it indicates resources which were lying unutilized are now being utilized fully.

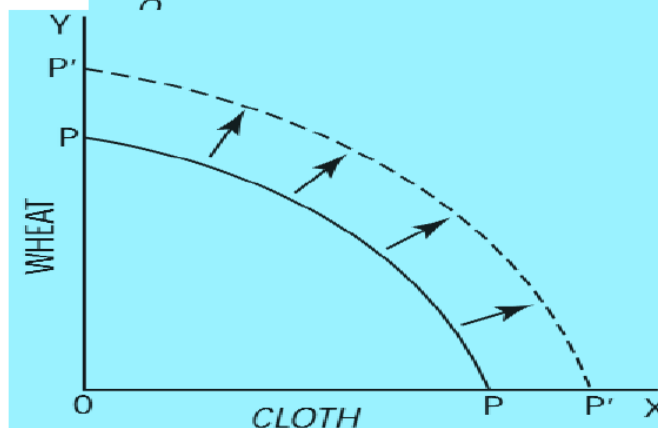
**Economic growth and shift in Production Possibility Curve**

All points on the PPC show that goods and services are produced at least cost and no resource is wasted i.e. an economy is productively efficient. But that does not mean that there is no scope of progress. When the economy makes progress in technology, that is, when scientists and engineers discover new and better ways of doing things, the production possibilities curve can shift outward and to the right (which indicates economic growth) in following circumstances-

1. ^{29&33}Improvement in overall technology
2. Greater capital formation
3. Increase in population growth/labour force/employment

In the above figure PPC curve shifts from 'PP' to 'P1P1' it indicates economic growth.

⁴⁸Sometimes PPC may shift inward when an earthquake destroys resources of the country.

**ECONOMIC SYSTEMS**

Types of

COMPLETE NOTES ON CA- CPT MICRO ECONOMIC AVAILABLE ON Rs. 490/- ONLY.

In the absence of a central planning authority to solve the problems, a capitalist economy uses the forces Of demand and supply or price mechanism to solve its problems.

(1) Deciding what to produce

The main motive of an entrepreneur is to earn profit. Therefore, to earn more profit, an entrepreneur produces only those goods that are demanded by the consumers. In a free market economy, ¹⁶allocation of resources is determined by consumer preference.

Example: ¹⁸If consumers want more motorcycles, then there will be an increase in price due to an increase in demand, which will lead to more profit. This will induce the producer to produce more motorcycles. On the other hand, if there is less demand for cars, then there will be less production of cars in the economy.

(2) Deciding how to produce

To earn more and more profits, the entrepreneur will use the technique of production in such a manner that the cost of production is minimal. There are two techniques or methods of production.

- ⁴⁰Labour intensive method: is primarily used in labour rich countries
- ³⁹Capital intensive method: is used primarily in capital rich countries

(3) Deciding for whom to produce :

In a capitalist economy goods and services will be produced for those who have the buying capacity. The buying capacity of an individual depends upon his income.

Example: BMW cars are not manufactured for the middle class of the society. It is manufactured for the upper class of the society.

(4) Deciding about consumption, savings and investment

Entrepreneurs invest and consumers save and consume. But, consumer's savings depends on interest rates. More savings is possible when the interest rates are high on saving. Decision of investment is based on rate of return. Consumers' savings depends on the rate of interest. Higher the rate of interest, higher will be the savings. Investment decisions depend upon the rate of return. Higher the rate of interest, greater will be the investment in a capitalist economy. Savings also depend on age group (generation) and disposable income. Generally, the younger generation saves less while the older generation spends less.

Merits of Capitalist economy:

- ✓ To attract the consumer, the producer will bring out **newer and finer varieties of goods**.
- ✓ ⁶²The existence of private property and the driving force of profit motive results in **high standard of living**.
- ✓ Capitalism works automatically through **price mechanism** since ¹⁷a capitalist economy uses prices as principal means of allocating resources.
- ✓ The freedom of enterprise results in **maximum efficiency in production**.
- ✓ All activities under capitalism enjoy the **maximum amount of liberty and freedom**.
- ✓ Under capitalism, ⁶⁸**freedom of choice brings maximum satisfaction to consumers**
- ✓ Capitalism preserves fundamental rights such as right to freedom and **right to private property**.
- ✓ It rewards men of **initiative and enterprise**.
- ✓ The country as a whole benefits through **growth of business** talents, development of research, etc.

Demerits of Capitalist economy:

1. In capitalism, the enormous wealth produced is apportioned by a few. This causes ¹⁹rich to become richer and poor to become poorer.
2. Welfare is not protected under capitalism, because, here, the aim is profit and not welfare of the people.

COMPLETE NOTES ON CA- CPT MICRO ECONOMIC AVAILABLE ON Rs. 490/- ONLY.

- ✓ **Absence of Consumer Choice:** Freedom from hunger is guaranteed, but consumers' sovereignty gets restricted by selective production of goods. The range of choice is limited by planned production. However, within that range an individual is free to choose what he likes most. The right to work is guaranteed, but the choice of occupation gets restricted because these are determined by some authority on the basis of certain socio-economic goals before the nation.
- ✓ **Relatively Equal Income Distribution :** A Socialist state strives to achieve economic equality, but it does not mean that everyone earns the same amount of income that there is no social differentiation. The society is divided into various functional strata. Since the requirements of

the workers from different strata are unequal, their wages cannot be equal. Skilled and unskilled workers from different strata of the society, and hence are paid different wages. **Socialism** only **guarantees equality of opportunity and equal pay for equal work.**

- ✓ **Minimum role of Price Mechanism or Market forces :** Price mechanism exists in a socialist economy but it has only a secondary role, e.g., to secure disposal of accumulated stocks. Since allocation of productive resources is done according to a predetermined plan, the price mechanism as such does not influence these decisions. In the absence of the profit motive, price mechanism loses its predominant role in economic decisions.

Merits of Socialism

- ✓ **Equitable distribution** of wealth and income and provision of **equal opportunities** for all help to maintain social justice.
- ✓ Socialist economy is a planned economy. In a socialistic economy, there will be **better utilization of resources** and it ensures maximum production.
- ✓ **Wastes** of all kinds are **avoided through strict economic planning.**
- ✓ In a planned economy, **unemployment is minimised, business fluctuation are eliminated and stability is brought about and maintained.**
- ✓ The absence of profit motive helps the community to develop a **co-operative mentality and avoids classwar.**
- ✓ Socialism **ensures right to work and minimum standard of living to people.**
- ✓ Under socialism, the **labourers and consumers are protected from the exploitation by the employer and monopolies respectively**

Demerits of Socialism

1. Socialism involves the **predominance of bureaucracy.**(daftershahi) Moreover, there may also be **corruption, favouritism,** etc.
2. It **restricts the freedom of occupation by individuals** as there is state ownership of the material means of production and state direction and control of economic activity.
3. Socialism takes **away** such right as the **right of private property.**
4. It will **not** provide necessary **incentive to hard work** in the form of profit.
5. There is **no proper** basis for cost calculation. In the absence of such practice, the most economic and scientific **allocation of resources** and the efficient functioning of the economic system are impossible.
6. **State monopolies** created by socialism will sometimes **become uncontrollable.** This will be more dangerous than the private monopolies under capitalism.
7. Under socialism, the consumers have **no freedom of choice.** Therefore, what state produces has to be accepted by the consumers
8. The extreme form (**pure**) of **socialism is not at all practicable.**

Mixed economy:

- ✓ In a mixed economy, both public and private institutions exercise economic control. The public sector functions as a socialistic economy and the private sector, as a free enterprise economy.
- ✓ All decisions regarding what, how and for whom to produce are taken by the state. The private sector produces and distributes goods and services.

COMPLETE NOTES ON

CA- CPT MICRO

ECONOMIC AVAILABLE

ON Rs. 490/- ONLY.

- ✓ Mixed economy secures the ²⁰merits of both capitalism and socialism while avoiding the evils of both.
- ✓ Mixed economy **protects individual freedom**. Under the system, individuals have the freedom of consumption, choice of occupation, freedom of enterprise and freedom of expression.
- ✓ **Price mechanism is allowed to operate** under mixed economy.
- ✓ **Reducing the inequalities of wealth and class struggle** is one of the aims of mixed economy.
- ✓ Economic **fluctuations can be avoided due to** the presence of a **centrally planned economy**.
- ✓ Mixed economy **helps under-developed countries** to have rapid and balanced economic development.

Demerits of Mixed Economy

1. Mixed economy is **difficult to operate**. Balancing and adjusting the public and private sectors is often difficult.
2. **Excessive controls and heavy taxes** are likely to prevail under mixed economy. These will discourage production in the private sector.
3. **Problems of nepotism, favouritism, officialdom**, etc. are also found in this type of economic system.
4. Mixed **economy is described by Schumpeter as "Capitalism in the oxygen tent"**. According to him it is only a trick of the capitalists to cheat the working class by offering them some temporary advantages like social security, upliftment of the depressed classes, etc.

TYPES OF ECONOMIC SYSTEM		
Capitalist	Socialist	Mixed
Right of private property	Controlled, managed & regulated by Govt.	Three sectors of Industries:- (a) Private sector (b) Public Sector (c) Combined sector
Freedom of Choice for Producers	Means of Production owned by Society	Planned Economy
Freedom of choice for customer	Guiding factor for economic activities is Social Welfare	Balanced Regional Development
Motive of Production is profit	Motive of Production social welfare	Motive of Production is profit in private sector and welfare motive in public sector
Production governs by Price mechanism	Production governs by Planning mechanism i.e. Freedom of Choice for the consumers and producers is curbed.	Production governs by both price mechanism and planning mechanism.i.e. Dual system of pricing
Competition Exists	no competition i.e. Role of market forces & competition is eliminated by law	Competition Exists only in private sector
Distribution of Income is Very Unequal	Distribution of Income is Quite Equal	Distribution of Income is Considerable inequalities exist
No role of Govt.	Complete role of Govt.	full role of Govt. in public sector and limited role of Govt. in private sector.