

MICRO ECONOMICS

UNIT – I

INTRODUCTION

★ ECONOMICS :-

- Economics is concerned with the study of individual and social choice in situations of scarcity.
- According to Adam Smith , “ Economics is a subject concerned with an enquiry into the nature and causes of wealth of Nations.”
- Our activities to generate income are termed as Economic Activities, which are responsible for the origin and development of economics as subject. Economic Activities are - Production , Consumption , Exchange and Distribution .
- Adam Smith, the father of economics, defined economics as ‘Science of wealth.’

In 1933, Prof. Ragnar Frisch, divided the study of economics into two branches – Micro Economics and Macro Economics. In 1936, with the publication of J. M. Keynes book ‘The General Theory of Employment, Interest and Money,’ Study of two different branches –

1. MICRO ECONOMICS :-

Micro economics is that part of economics which deals with the individual parts of a system. It study of individual units like individual household, pricing of a firm, wages of a worker, profit of an entrepreneur and so on.

➤ **Scope of Micro Economics : –**

- (a) Theory of demand
- (b) Theory of Production & cost
- (c) Price determination
- (d) Theory of distribution (Factor pricing)
- (e) Theory of economic welfare.

2. MACRO ECONOMICS :-

Macro economics is the study of aggregate facts of the economy. It is the study of relation between economic aggregates. It is concerned with total output, total employment and total spending for all goods and services.

- ##### ➤ **Scope of Macro Economics : –**
- (a) National Income
 - (b) Full Employment
 - (c) Aggregate demand & supply
 - (d) Aggregate saving and investment
 - (e) Utilisation of economy’s resources
 - (f) Price level
 - (g) Total output

★ DIFFERENCE BETWEEN MICRO ECONOMICS AND MACRO ECONOMICS

MICRO ECONOMICS	MACRO ECONOMICS
1. It is concerned with the study of individual house holds.	1. It is the study of relations between aggregates.
2. The purpose of micro economics is to study about the different allocation of resources.	2. The purpose of macro economics is to study about full employment of resources.
3. It has very narrow scope.	3. It has very wide scope.
4. Main instrument is individual demand and supply	4. Main instrument is aggregate demand and aggregate supply.

★ ECONOMY :-

“Economy is the sum total of all economic activities .” In other words , “All those activities of human beings which are concerned with Production , Consumption , Exchange and Distribution of goods and services “.

➤ Types of Economy :-

1. **Socialist Economy** _ Socialist Economy is that system in which means of production are controlled and regulate by Government. Production decisions are based upon social welfare.
Or,
Planned Economy
2. **Capitalist Economy** _ Capitalist Economy is that system in which means of production are controlled and regulate by private organization . Production decisions are based upon profit maximisation .
Or,
Market Economy
3. **Mixed Economy** _ Mixed Economy is a mixture of Capitalist Economy and Socialist Economy . Under this economy , freedom of economic activities and Government interference for the sake of social welfare .
4. **Open Economy** _ An economy which has imports and exports of goods and services from rest of world sector , is known as an open economy .
5. **Closed Economy** _ An economy which has imports and exports of goods and services does not involve rest of world sector , is known as an closed economy .

★ MAJOR SECTOR OF AN ECONOMY :-

According to the macroeconomic point of view there are four major sectors –

- (1) **Household** : - Household means a single individual who takes decisions relating to her own consumption or a group of individuals for whom decision relating to consumption are jointly determined.
- (2) **Firm** : - In macro economics production units which is organized under capitalist economy are called firm.
- (3) **Government** : - The role of govt. includes framing laws, enforcing them and delivering justice.
- (4) **External Sector** : - It means the other countries of the world which are engaged with our trade.

★ FEATURES OF A CAPITALIST ECONOMY –

- (i) There is private ownership of means of production.
- (ii) Production takes place for selling the output in the market.
- (iii) There is sale and purchase of labour services at a price which is called the wage Rates.
- (iv) There is no govt. interference in trade.

★ ECONOMIC PROBLEM :-

The problem of choice arising from the use of limited resources to satisfaction of various ends is known as economic problem.

★ Why does an economic problem arise?

- (1) **Unlimited Wants** :- In real life human wants are unlimited as we satisfy one want many more new wants come up. If human wants are limited then no economic problem would have arisen.
- (2) **Scarcity of Resources** :- Scarcity means limited availability of resources in relation to demand. Due to scarce resources economy face the problem of choice concerning what wants are to be satisfied on higher priority.
- (3) **Alternative uses of resources** :- Resources can be used to product various types of goods. Here also we face the problem of choice as to which of the resources should be used for which type of work.

✦ CENTRAL PROBLEM OF ECONOMY: -

The problem of choice making arising out of limited resources and unlimited wants is called economic problem. Every economy has to face the economic problem. These are known as central problems of economy. Main central problems are –

(1) Allocation of resources :-

Production of goods requires resources for their production. If it is decided to produce a good, the resources need to be allocated for that. It includes following three problems –

(i) What to Produce ?

Every demand of every individual in the economy can not be satisfied, so the economy has to decide what commodities should be produced and in what quantities. Goods produced in an economy can be classified as Consumer goods and Capital goods.

(ii) How to Produce?

This means with what combination of factors a economy decides to produce goods. A combination of factors means technique of production. There are two types of techniques –

(a) Capital – intensive Technique –

A capital – intensive technique uses relatively more capital than labour.

(b) Labour - intensive technique –

A labour – intensive technique uses relatively more labour than capital.

Labour – intensive technique is generating employment but it produced goods of low quality at a higher cost. On the other hand , Capital – intensive technique promotes mechanisation, increase quantity and improves quality of production.

However optimum allocation of resources require maximum possible quantity with least possible costs.

(iii) For whom to Produce ?

This problem is concerned with the distribution of output or national income. Goods and services produced in the economy are consumed by its citizens. Therefore, a economy has to decide who should get how much from the total output of goods and services.

Distribution of national income should be on the basis of –

(A) All people should get equal incomes.

(B) In capitalist economy distribution depends on the money income of a person; Everybody should get according to the contribution he makes to the national product.

(C) In Socialist economy such decision depends upon the requirement of the society. i.e. from each according to his ability, to each according to his needs.

(2) Full Employment of Resources :-

The under – utilization or unemployment of a resources is the wastage of limited and scarce resources, so they properly used. The problem with the economy is how to use its available resources, so that maximum production with minimum efforts & wastage be made possible.

(3) Growth of Resources :-

If an economy grows at a faster rate standard of living of its people will rise rapidly. Therefore every economy wants to have a higher growth rate.

★ SOLUTION OF CENTRAL PROBLEMS :-

(1) Market (Price) Mechanism :-

Under capitalism, central problems is decided by the free working of demand & supply. Since the producer are guided by profit motive, they produced those good the prices of which are relatively high. In this system, resources of production are the private property. Individual & private companies undertake the work of production. The consumer have freedom to buy the goods they wants.

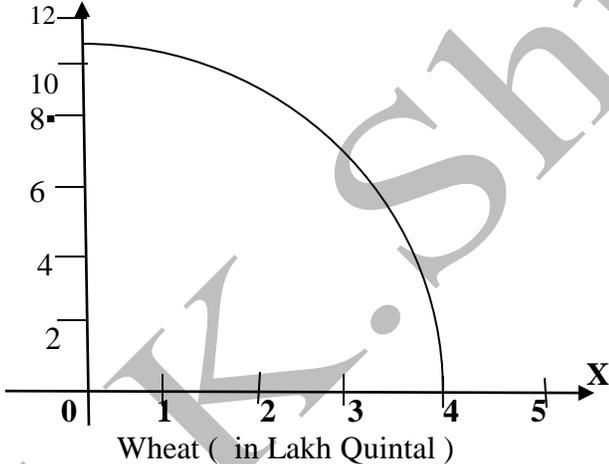
(2) Economic Planning :-

Under socialism, for taking major economic decisions , Govt. set – up a central planning authority, which is called the planning commission. In this system resources of production are collectively owned by the society and work of production is organized by govt. Consumer generally lose their freedom to choose goods for his consumption.

PRODUCTION POSSIBILITY CURVE Or PRODUCTION POSSIBILITY FRONTIER

Production Possibility curve is a graphic presentation which shows alternative production possibilities with the use of given resources and techniques of production. In other words, A production possibility curve indicates all the combinations of two goods X and Y ; whose maximum production is possible in a society when all the resources fixed and fully employed and the technical state of production is given.

In this situation, if we want to increase the production of a particular commodity (x – good), then we have to reduce the production of some other commodity (y – good) so, it is also known as **Transformation curve**. This is shown in the following table & diagram –



Production Possibilities	X – Good (Wheat (In Lakh quintal)	Y – Good (Machines) (' 000)
A	0	11
B	1	10
C	2	8
D	3	5
E	4	0

● From the above schedule and diagram, it is clear that with given resources and techniques of production, the various combination of wheat and machines that can be produced are A, B, C, D and E. Country has to choose out of these various alternative production possibilities.

★ Assumption of PP – Curve:

- (i) Factors of Production are fixed.
- (ii) Factors can be transferred from one production to another production.
- (iii) Production Technology remains constant.
- (iv) Factors are fully and efficiently utilized in the economy.
- (v) Only two goods are produced in the economy.

★ Characteristics of PP- curve :-

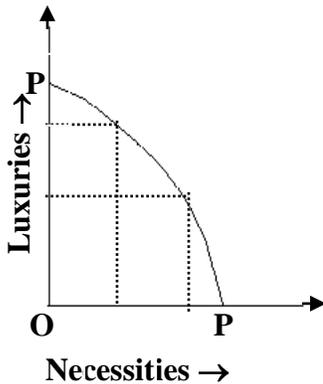
- (i) PP – curve slope downward to the right; because MRT goes on increasing.
- (ii) Production possibility curve is concave to the origin because there applies law of increasing opportunity cost.
- (iii) Rightward shift of production possibility curve means growth of resources.
- (iv) PP – curve always touches both axes.

★ Why is pp-curve Concave towards origin ?

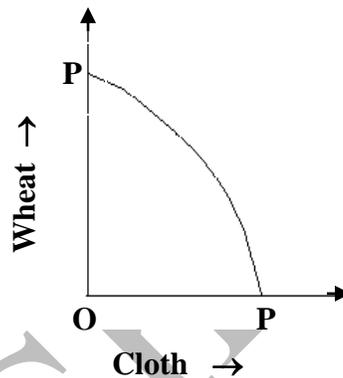
PP-Curve is concave to the origin which signifies that if we want to increase production of one goods (X-goods), then we have to sacrifice production of second goods (Y-goods). The sacrifice of Y-goods for every additional X-goods will continuously increases . In other words ,PP-Curve is concave due to increasing Marginal Opportunity Cost (MOP) i.e. , Marginal Rate of Transformation (MRT).

★ Production Possibility curve & central problems :-

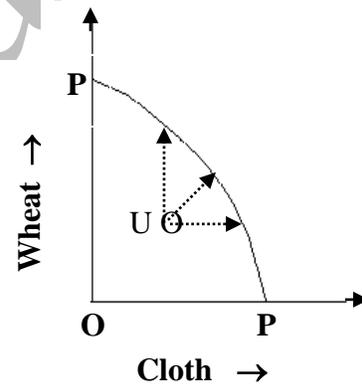
1. Allocation of Resources



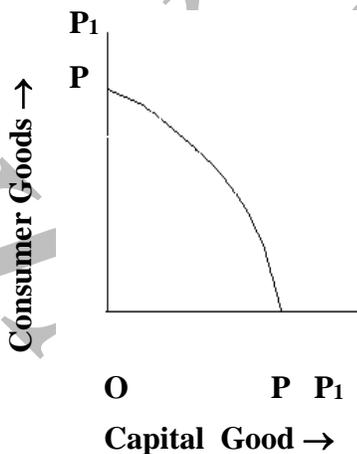
2. Full Employment of Resources Or, Efficient use of Resources



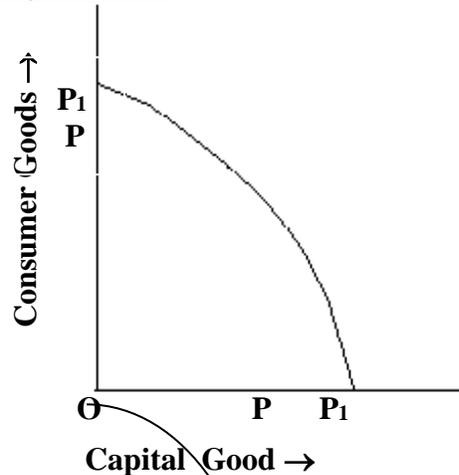
3. Under Utilisation of Resources Or, Inefficient use of Resources



4. Scarcity of Resources



5. Growth of Resources

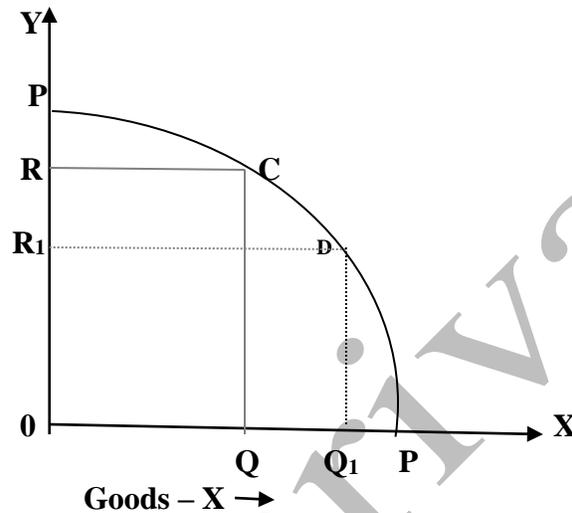


★ OPPORTUNITY COST :-

Opportunity cost of anything is the next best alternative that could be produced instead of producing a particular commodity by the same factors or by equivalent group of factors, costing the same amount of money. In other words, opportunity cost is the value of next best alternative good that is given up for it. It is also called the Transfer earning of the factor.

e.g. If a student spends an amount on the purchase of cinema – ticket, by postponing the purchase of a pen, the sacrifice of a pen is the opportunity cost of a cinema ticket.

It is better explained with the help of production possibility curve and schedule –



In above figure, PP is production possibility curve. If we choose combination (D) instead of combination (c) on PP – curve, then opportunity cost of producing more of good – X as QQ_1 instead of good-- Y is RR_1 .

Here, sacrifice of RR_1 amount of good – Y in order to produce more of QQ_1 amount of good – X.

★ Marginal Opportunity Cost (MOC)

OR

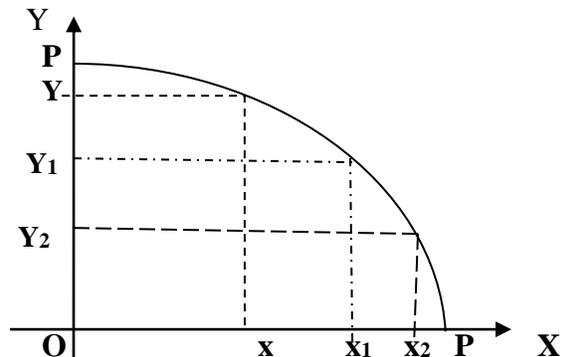
Marginal Rate of Transformation (MRT) :-

Marginal Opportunity Cost (or, MRT) of a particular good is the amount of sacrificed of the other good for per unit increase in the production of the good.

$$\text{MOC} = \frac{\Delta Y}{\Delta X}$$

Or,

$$\text{MOC} = \frac{\text{Loss in Production}}{\text{Gain in Production}}$$



UNIT - I

INTRODUCTION

1. According to whom , Economics is a science of human welfare ? [2012 , 15 , 18 ,]
(A) Marshall (B) J.S.Mill (C) Adam Smith (D) P.Samuelson
2. Mention the nature of the curve which shows economic problem : [2012 , 14 , 19]
(A) Production Curve (B) Production Possibilities Curve
(C) Demand curve (D) Indifference Curve
3. Which is a Central Problem of an Economy ? [2012 , 14 , 16 , 18 ,]
(A) Allocation of Resources (B) Optimum Utilisation of Resources
(C) Economic Development (D) All of these
4. Who was the father of Economics ? [2012 , 14 ,]
(A) Adam Smith (B) Marshall (C) Robbins (D) Malthus
5. “Economics is a logic of choice” Who said it ? [2012 ,]
(A) Hicks (B) Marshall (C) Keynes (D) Robinson
6. The slope of Production Possibilities Curve falls : [2017 ,]
(A) From left to right (B) From right to left
(C) From top to bottom (D) From bottom to top
7. Who said , “Economics is a science of wealth.” ? [2013 , 19 ,]
(A) Marshall (B) Adam Smith (C) Robbins (D) J.K.Mehta
6. Which of the following is a type of Economic Activities ? [2013 ,]
(A) Production (B) Consumption (C) Exchange (D) All of these
7. Which of the following is studies under micro economics ? [2016 ,]
(A) Individual Units (B) Economic Aggrigates (C) National Incom (D) None of these
8. ‘Micros’, which means ‘Small’, has originated from which of the following languages: [2013]
(A) Arabic (B) Greek (C) English (D) German
11. Which of the following is a source of production ? [2017 ,]
(A) Land (B) Labour (C) Capital (D) All of these
12. Which of the following is studies under Micro Economics ? [2018 ,]
(A) Individual family (B) Individual firm
(C) Individual Industries (D) All of these All of these
13. To which factor is economic problem basically related to ? [2019A ,]
(A) Choice (B) Consumer’s Selection (C) Firm’s Selection (D) None of these
14. The word ‘Micro’was firstly used by :
(A) Ragner Frish (B) Marshall (C) Keynes (D) Boulding
15. Which economist divided Economics in two branches of micro and macro on the basis of economic activity ?
(A)) Ragner Frish (B) Marshall (C) Ricardo (D) Non of these
16. Production Possibilities Curve is :
(A) From left to right (B) From right to left
(C) From top to bottom (D) From bottom to top

- # Define Economics .
- # Define Closed Economy .
- # Define Mixed Economy .
- # Define Economic Problem .
- # What is meant by scarcity of resources ?
- # Define 'Micro Economics' .
- # Define 'Macro Economics' .
- # What is Production ?
- # What is Consumption ?
- # What is Exchange ?
- # What is an economic activities ?
- # Define Marginal Opportunity Cost.
- #

- # What is an Economy .
- # Define Open Economy .
- # Give two example of micro economic variable .
- # Give the meaning of problem 'How to Produced' ?
- # Give the meaning of problem 'For whom to Produced' ?
- # What is production possibilities curve ?
- # What is Opportunity Cost ?
- # Define Capitalist Economy ?
- # Define Socialist Economy ?
- # Define Planned Economy ?
- # Is economic problem is basically a problem of choice ?
- # Define Marginal Rate of Transformation .
- # Give one reason for a rightward shift of a pp-curve .

2020

* End of Unit I *
