Unit 1: Introduction

Basic Economic Issues

1. Scarcity:

Scarcity is the fundamental economic problem of having seemingly unlimited human wants in a world with limited resources. Since resources are finite, societies must decide how to allocate them efficiently.

A small island has a limited amount of fresh water. The population needs to decide how to use it: for drinking, irrigation, or industrial purposes.

2. Choice:

Due to scarcity, individuals and societies must make choices about what to produce, how to produce, and for whom to produce. Making a choice involves trade-offs.

A government with limited funds must choose between building a new hospital or a new school. Choosing one means forgoing the other.

3. Alternatives:

Alternatives refer to the different options available when making a choice. The concept of opportunity cost is central here, which is the value of the next best alternative foregone when a choice is made.

Example: A farmer choosing to plant either wheat or corn. If they choose wheat, the opportunity cost is the corn that could have been grown instead.

Definition/ Meaning of Microeconomics

- Microeconomics is defined as the branch of economics which deals with individual parts of an economy.
- In other words, it is the part of economic analysis, which is concerned with the behaviour of individual units: consumers, households and firms.
- It examines how consumers choose between goods and services, how workers choose between jobs, and how business firms decide what to produce, how to produce, how much to produce, and for whom to produce.

Features of Microeconomics

- Microeconomics studies the individual parts of an economy.
- It is concerned with the individual firms and consumers.
- It is based on the assumptions of full employment, partial equilibrium analysis and perfect competition.
- It is applicable only in the free market economy.
- The major variables of microeconomics are relative price, individual demand and supply, output of an individual firm, etc.
- It is also known as price theory because it studies how price of a product is determined.
- It is also known as the slicing method as well as microscopic analysis.
- It is like study of a particular tree of the whole forest.

Scope of Microeconomics

1. Theory of demand
2. Theory of production and cost
3. Theory of product pricing
4. Theory of factor pricing
5. Theory of economic welfare

1. Theory of Demand: Examines consumer behavior, focusing on how the quantity demanded of a good or service is influenced by its price, consumer income, preferences, and the prices of related goods.

2. Theory of Production and Cost: Analyzes how firms combine inputs (labor, capital, materials) to produce outputs, considering the costs involved and how these costs change with varying levels of production.

3. Theory of Product Pricing: Studies how prices are set in different market conditions (perfect competition, monopoly, oligopoly), based on the interaction between supply and demand.

4. Theory of Factor Pricing: Investigates how the prices of factors of production (land, labor, capital) are determined, including wages, rents, interest, and profits.

5. Theory of Economic Welfare: Evaluates how resources are allocated and distributed to maximize overall societal welfare, addressing issues of economic efficiency and equity.

Definition/Meaning of Macroeconomics

The term macro comes from the Greek word '*makros*', which means "large". Macroeconomics, thus, analyzes how entire national economy performs.

Macroeconomics is the branch of economics that studies the overall functioning and phenomena of an economy as a whole.

It focuses on large-scale economic factors and trends, such as national income, total employment, gross domestic product (GDP), inflation, and aggregate demand and supply.

Macroeconomics aims to understand and address issues like economic growth, recessions, and the impact of monetary and fiscal policies. It provides a broad perspective on how economies operate and the interrelationships among various sectors.

Features of Macroeconomics

- Macroeconomics is aggregative economics.
- Macroeconomics is concerned with the behaviour of the economy as a whole.
- Macroeconomics presupposes constant relative prices and given resource allocation.
- Macroeconomics is policy science and more normative.
- Its analytical tools are *fiscal policy* (taxes, government expenditure and government borrowing) and *monetary policy* (interest rate and money supply).
- It is also called income and employment theory.
- Its objectives are to determine aggregate output, employment and general price level and their rate of change.
- It is relatively new and developed after the publication of **Keynesian General Theory** in 1936 AD.
- Its principal or main variables are national income, total consumption, total expenditure, total saving, total investment, etc.

Scope of Macroeconomics

1. Theory of national income
2. Theory of employment
3. Theory of money
4. Theory of general price level
5. Theory of economic growth
6. Theory of international trade

1. Theory of National Income: Focuses on measuring and analyzing a country's total economic output and income. It examines how national income is distributed among different factors of production and how it influences economic well-being.

2. Theory of Employment: Studies the factors that determine the level of employment and unemployment in an economy. It includes the analysis of labor markets, wages, and the impact of economic policies on employment levels.

3. Theory of Money: Examines the role of money in the economy, including how money supply and demand influence interest rates, inflation, and overall economic activity. It also looks at the functions of central banks and monetary policy.

4. Theory of General Price Level: Analyzes the factors that determine the overall level of prices in the economy, including inflation and deflation. It looks at how changes in the price level affect purchasing power and economic stability.

5. Theory of Economic Growth: Focuses on the long-term increase in a country's productive capacity and output. It studies the factors that drive economic growth, such as capital accumulation, technological progress, and improvements in productivity.

6. Theory of International Trade: Examines the flow of goods, services, and capital across countries. It analyzes the benefits and costs of trade, the impact of trade policies, and the effects of exchange rates on the economy.

Microeconomics and Business Environment:

1. Supply and Demand: Microeconomics focuses on the study of individual markets and how the interaction of supply and demand determines prices and quantities of goods and services. For businesses, understanding these dynamics is crucial for pricing strategies and production planning.

2. Cost Analysis: Microeconomics delves into cost structures, including fixed and variable costs, marginal costs, and average costs. Businesses utilize this knowledge to optimize production processes, minimize costs, and maximize profits.

3. Market Structures: Microeconomics examines different market structures such as perfect competition, monopolistic competition, oligopoly, and monopoly. Understanding the characteristics of each structure helps businesses strategize regarding pricing, product differentiation, and market entry.

4. Consumer Behavior: Microeconomics analyzes how consumers make decisions regarding the allocation of their resources. Businesses use this knowledge to tailor marketing strategies, develop products that meet consumer preferences, and forecast demand.

5. Production Theory: Microeconomics studies the factors of production (land, labor, capital, and entrepreneurship) and their efficient allocation to maximize output. Businesses apply production theory to optimize their production processes and achieve economies of scale.

Macroeconomics and Business Environment:

1. Aggregate Demand and Supply: Macroeconomics examines the overall demand and supply in an economy. Businesses consider aggregate demand to forecast overall market conditions and adjust production levels accordingly.

2. Inflation and Deflation: Macroeconomics studies the causes and consequences of inflation (rising prices) and deflation (falling prices). Businesses monitor inflation rates to adjust pricing strategies and anticipate changes in consumer purchasing power.

3. Unemployment: Macroeconomics analyzes factors affecting unemployment rates, such as cyclical, frictional, and structural unemployment. Businesses consider unemployment levels when planning hiring strategies and forecasting consumer demand.

4. Fiscal and Monetary Policy: Macroeconomics explores government policies, including fiscal policy (government spending and taxation) and monetary policy (control of money supply and interest rates). Businesses assess the impact of these policies on interest rates, borrowing costs, and consumer spending.

5. International Trade: Macroeconomics examines global economic factors such as exchange rates, trade balances, and international capital flows. Businesses operating in international markets consider macroeconomic indicators to assess currency risks, export/import opportunities, and geopolitical factors affecting trade.

In summary, microeconomics provides insights into individual market behavior and business decision-making, while macroeconomics focuses on the overall performance of an economy and its implications for businesses operating within it. Both perspectives are essential for businesses to formulate effective strategies and adapt to changing economic conditions.