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शक्तिउत्थानआश्रमलखीसरायबिहार

Class 11 commerce Sub. ECO/A Date 1.9.2020

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Introduction to Economics

What Economics is All About?

The science of economics was born with the publication of Adam Smith's An Inquiry into the Nature and Causes of Wealth of Nations in the year 1776. Adam Smith is known as the father of Economics. At its birth, the name of economics was 'Political Economy'. Towards the end of the 19th century there was a definite change from use of word 'Political Economy' to 'Economics'.

The word 'Economics' was derived from two Greek words oikou (a house) and nomos (to manage). Thus, the word economics was used to mean home management with limited funds available in the most economical manner possible. Lionel Robbins defines economics as a science of scarcity. Prof. Robbins in his book Nature and Significance of Economic Science states, "Economics is the science which studies human behaviour as a relationship between ends and scarce means which have alternative uses". Paul A. Samuelson defines economics as "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 future among various people and groups of society." This definition emphasises growth over time. It is modern and wider in scope. The definition takes into account consumption, production, distribution and exchange of goods. Hence, it is most satisfactory definition of economics. This definition has been accepted universally.

Microeconomics and Macroeconomics

Subject-matter of Economics

Before 1930, there was only one 'economics'. Ragnar Frisch coined the words 'micro' and 'macro' in 1933 to denote the two branches of economic theory, namely, microeconomics and macroeconomics.

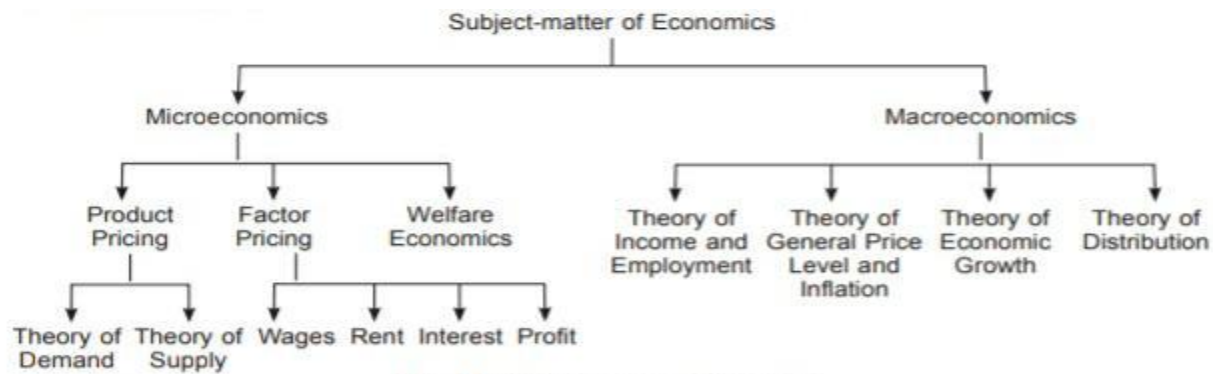


Fig. 1.1 Subject-matter of Economics

1.2.2 Microeconomics

Meaning and Subject-matter of Microeconomics

The word 'Micro' is derived from the Greek word *mikros* meaning small. *Microeconomics deals with small segments of the society. Microeconomics is defined as the study of behaviour of individual decision-making units, such as consumers, resource owners and firms.* It is also known as **Price Theory** since its major subject-matter deals with the determination of price of commodities and factors.

Microeconomics has both theoretical and practical importance. **It solves the three central problems of an economy, i.e., what, how and for whom to produce.** Subject-matter of microeconomics is vast and includes the following topics as shown in Fig. 1.2.

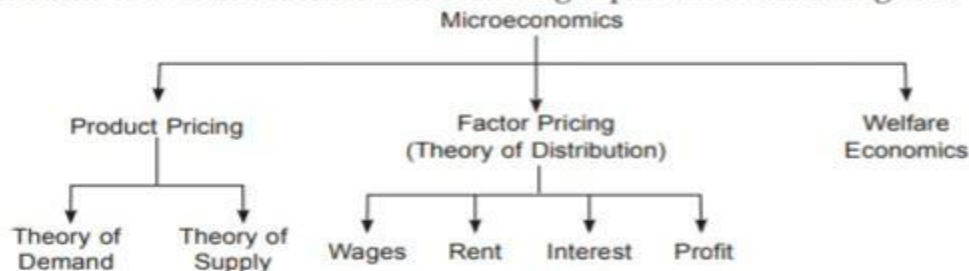


Fig. 1.2 Subject-matter of Microeconomics

Importance of Microeconomics

Microeconomics has both theoretical and practical importance. It is clear from the following points:

1. Microeconomics helps in formulating economic policies which enhance productive efficiency and results in greater social welfare.
2. Microeconomics explains the working of a capitalist economy where individual units (*i.e.*, producers and consumers) are free to take their own decision.
3. Microeconomics describes how, in a free enterprise economy, individual units attain equilibrium position.
4. It helps the government in formulating correct price policies.
5. It helps in efficient employment of resources by the entrepreneurs.
6. It helps business economist to make conditional predictions and business forecasts.
7. It is used to explain gains from trade, disequilibrium in the balance of payment position and determination of international exchange rate.

Limitations of Microeconomics

Microeconomics fails to explain the functioning of an economy as a whole. It cannot explain unemployment, poverty, illiteracy and other problems prevailing in the country.

1.2.3 Macroeconomics

Meaning and Subject-matter of Macroeconomics

The word 'Macro' is derived from the Greek word *makros* meaning large. Macroeconomics deals with aggregative economics. **Macroeconomics is defined as the study of overall economic phenomena, such as problem of full employment, GNP, savings, investment, aggregate consumption, aggregate investment, economic growth, etc.** It is also known as **Theory of Income and Employment** since its major subject-matter deals with the determination of income and employment.

The study of macroeconomics is used to solve many problems of an economy like, monetary problems, economic fluctuations, general unemployment, inflation, disequilibrium in the balance of payment position, etc. The scope or subject-matter of macroeconomics includes the following topics as shown in Fig. 1.3.

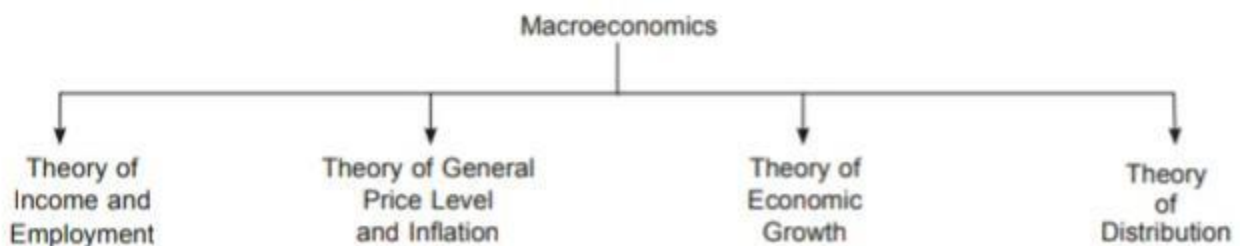


Fig. 1.3 Subject-matter of Macroeconomics

Importance of Macroeconomics

Macroeconomics has emerged as the most challenging branch of economics. In the words of [Samuelson](#), "... no area of economics is today more vital and controversial than macroeconomics."

The importance of macroeconomics on theoretical and practical reasons is clear from the following points:

1. It gives an overall view of the growing complexities of an economic system. It provides powerful tools to explain the working of the complex economic systems.
2. It provides the basic and logical framework for formulating appropriate macroeconomic policies (*e.g.*, for inflation, poverty, unemployment, etc.) to direct and regulate economy towards desirable goals.
3. It helps in analysing the reasons for economic fluctuations and provide remedies.