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INTRODUCTION TO THE STUDY OF ECONOMICS

Economics is a vast subject encompassing various topics related to production, consumption, saving, investment, inflation, employment and unemployment, national income, international trade, quality of life, fiscal policy, monetary policy etc so on and so forth. The list is unending. From the point of view of better understanding of the subject and finding a solution to the problem, it is imperative to know the nature of the economic issue under study and the area or branch under which the issue is dealt with.

OBJECTIVES

After completing this lesson, you will be able to:

- understand the meaning of economics;
- distinguish between positive and normative economics;
- differentiate between micro and macroeconomics and highlight their components;
- examine the significance of microeconomics and macroeconomics; and
- relate the interdependence of microeconomics and macroeconomics.

12.1 MEANING OF ECONOMICS

The term 'Economics' is derived from two Greek words **OIKOS and NEMEIN,** meaning the rule or law of the household. Economics therefore is concerned with not just how a nation allocates its resources to various uses but it ideals with the process by which the productive capacity of these resources can be further increased and with the factors which in the past have led to sharp fluctuations in the rate of utilization of resources. British economist Robbins has defined economics as follows:

"Economics is the science which studies human behaviour as a relationship between ends and scarce means which have alternative uses.

Robbins definition is comprehensive in explaining the scope of Economics. It is the problem of 'choice' which is all pervasive in areas of consumption, production and exchange. For example, a consumer has to choose that combination of goods which yields maximum satisfaction. Similarly, a firm has to choose that size of output which ensures maximum profit. **Nobel Laureate Prof. Samuelson has spelled out Economics as follows:**

"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 among various people and groups of society".

12.2 POSITIVE VS NORMATIVE ECONOMICS

While discussing the issues related to the economic conditions and trying to find solutions to economic problems, economists often talk about positive and normative nature of these issues. Positive economics deals with economic analysis which are based on facts and statistical data. When an economic phenomenon is being described with statistical support, then we call it positive economics. So positive economics relates to the phenomenon of 'what is'. On the other hand, normative economics deals with the issue of 'what ought to be'. Normative economics is based on value judgement and debate which are required to arrive at some conclusion. Issues related to framing policies for the society, mostly come under normative economics. Take the example of the issue of India's population. It is the fact that as per 2011 census, India's population was around 121 crore. Since it is based on data, the statement relates to positive economics. But when we discuss about the problems faced due to population pressure, economists and policy makers recommend several solutions such as 'India should control its population by adopting family planning' etc. such a thing comes under normative economics because these can be debate on this policy. There are lot of economic problems faced by the citizens and the economy as a whole. Data are required to justify that a problem exists which is part of positive economics. When we try to find solutions to the problem then value judgements are made and debates take place which comes under normative economics.

INTEXT QUESTIONS 12.1

1. Identify the following statements as positive on normative.
   - (i) Government should provide unemployment benefit to the unemployed youths.
   - (ii) 27 per cent of India's population belongs to poor sections of the society.
   - (iii) India should take loan from world bank to create more infrastructure.
   - (iv) RBI should increase the bank rate to curb inflation.
   - (v) RBI has increased the bank rate to 6 percent.

12.3 MICROECONOMICS VS MACROECONOMICS

Modem economics is studied in two parts- Microeconomics and Macroeconomics. Micro means small. So, when the study or the problem relates to an individual unit or part of the economy then the subject of study is micro economics. Macro means large. When the study relates to the whole economy or to aggregates relating to the whole economy then the subject of study is macro economics.

Microeconomics

Microeconomics is the study of economic activity of an economic unit or a part of the economy or a small group of more than one unit. Derived from the Greek word *micros* meaning small, it relates to the individual economic agent's behaviour and the result of such interactions in determining the price of goods and services.It is, thus, also called Price Theory.

It is the microscopic study of the economy which deals with decision making by any individual, firm,household with respect to matters of production, consumption, determination of prices in the market,determination of wage rate, and so on. The aim is to provide a framework within which the behaviour patterns and interrelationships between individual economic units can be studied and their behaviour with regards to production, exchange and distribution of goods and services can be predicted. Thus, attainment of a state of equilibrium from the point of view of individual economic units is the main aim in microeconomic analysis.

Further, micro economics also puts emphasis on behaviour patterns and role of firms and individuals in income distribution and study of conditions of efficiency in production and attainment of overall efficiency. Efficiency implies optimum allocation of resources among the consumers and producers so that there is neither excess demand nor excess supply of goods and services. The analysis of the three central problems of an economy- what goods and services to be produced, how to produce them and how they can be distributed in the economy are all subject matter of micro economics.

INTEXT QUESTIONS 12.2

Which one of the following statements is correct?

(a) Determination of price of agood

(b) What goods to be produced

(c) Bothe (a) and (b)

(d) Only (a)

Macroeconomics

Macroeconomics is the branch of economics that deals with the economic aggregates of a country as a whole. The word macro is derived from the Greek word *macros* meaning large. It has emerged after the British economist John Maynard Keynes published his famous book *The General Theory of Employment, Interest and Money* in 1936. The Great Depression of 1929 made economists think about the subject in a newer way which was holistic and macroeconomic study developed. It is also called the Theory of Income and Employment.

The content of macroeconomic analysis involves a combination of units to get a complete picture of the economic system so as to deal with economic affairs at a large scale. The focus areas are aggregate economic variables of an economy. The components of output, price level and employment operate in an economy simultaneously which indicates that they bear a close relationship with each other. This forms the basis of macroeconomic study which attempts to analyse these attributes together. It sees the economy as a combination of four components- households, firms, government and external sector.

The study area involves the analysis of effects in the market of taxation, budgetary policies, policies on money supply, role of state, rate of interest, wages, employment, and output. It is, therefore, also called *income theory* as it is concerned with the economy as a whole and seeks to study the causes and solutions for economic issues such as unemployment, inflation, balance of payment deficits and so on.

INTEXT QUESTIONS 12.3

1. Give the name of the book authored by Keynes?
2. Which of the following is the subject matter of macro economics?

   (a) Wage rate (b) monopoly

   (c) inflation (d) market price.

12.4 INTERDEPENDENCE OF MICRO AND MACROECONOMICS

Micro economics and macro economics are two parts of economics but they are not mutually exclusive. In other words, they are interrelated. A close interlink exists between macro and micro economics. All micro economic studies can help in better understanding and analysis of the macro economic variables. Such studies also help in the formulation of economic policies and programmes. As you know that the changes and processes in an economy are a result of a variety of large and small scale elements which have a capacity to affect each other and are also affected by each other. For example, increased taxes are a macroeconomic decision but their impact on savings of a firm is microeconomic analysis. Further, how this saving impacts the economy is a macroeconomic analysis.

Take another example. If we know how the price of a commodity is determined and understand the role of buyers and sellers in the process of price determination, it would help us in analysing the changes that take place in the general price level for all the commodities as a whole in the economy. A study of the process of price determination and the role of buyers and sellers in this process is a micro economic study, whereas the study of the general price level in the economy is a macro economic study. Similarly, if we want to assess the performance of an economy, we will have to find out the performance of each sector of the economy and to find out the performance of each sector we will have to find out the performance of each production unit individually or in groups. A study of each group of production unit or of each sector is a micro economic study whereas the study of all the production units or all the sectors taken together is a macro economic study. Thus, micro economics and macro economics are two interrelated parts of economics.

Therefore, the study of both is indispensable in economic study.

12.5 DIFFERENCES BETWEEN MICRO AND MACRO ECONOMICS

Significant differences exist between the two branches in the following ways:

(i) Differences in the scale of study

Macroeconomics is related to the study of the aggregate while microeconomics relates to the individual economic agents

(ii) Differences in the field of study

Macroeconomic analysis is concerned with the broadest level of policies pertaining to income, employment and growth of resources while microeconomics is concerned with problems and policies relating to the optimum allocation of resources and economic activities such a price determination.

(iii) Differences in importance given to price and income concepts

Microeconomic analysis focuses on price determination in the market for goods and serviceswhile macroeconomics focuses on income determination in the economy as a whole.Every good and service has its market where buyers and sellers interact with one another to determine its price and quantity. Since decisions are taken by the individual buyers who demand the goods and the sellers who supply the goods, it forms the part of micro economics. On the other hand, determination of income of the entire economy involves mobilisation of resources by all the sectors of the economy taken together. So it forms the part of macro economics.

(iv) Differences in the methods of study

Microeconomic study is dominated by the method called Partial Equilibrium Analysis which is focussed on significant factors related to an economic activity. Under macroeconomics, the mutual dependence of important economic aggregates is studied and this is called Quasi General Equilibrium Analysis.

(v) Differences in Analytical Factors

Microeconomics deals with the study of the behaviour of economic variables in an equilibrium position while macroeconomic analysis deals with the study of the behaviour of.economic aggregates in a disequilibrium position.

INTEXT QUESTIONS 12.4

State whether the following statements are true or false:

1. Micro economics studies the aggregates of the economy.
2. Macro economics deals with partial equilibrium analysis.
3. Macro economics addresses the issue of unemployment in the economy.
4. Economic policies are studied under micro economics.

12.6 SIGNIFICANCE OF MACRO AND MICRO ECONOMICS

Both the branches of economic analysis are complementary and supplementary to each other. The applied aspects of these relate to the fields of economics and commerce. The significant areas of microeconomic analysis lie in agricultural economics, labour economics, international economics, consumer economics, comparative economics, welfare economics, regional economics, aspects of public finance and other fields.Macroeconomic studies are applied in the fields of formulation and execution of economic policies, understanding microeconomics, studying economic development, welfare studies, inflation and deflation studies and international comparisons as well.

WHAT YOU HAVE LEANT

- Positive economics relates to the phenomenon of 'what is' which is based on facts.
- Normative economics deals with the issue of 'what ought to be' and is based on value judgement.
- Microeconomics is the study of economic activity of an economic unit or a part of the economy or a small group of more than one unit.
- macroeconomics is a branch of economics that studies the aggregates or economy as a whole.
- All macroeconomic studies can help in better understanding and analysis of the microeconomic variables. Such studies also help in the formulation of economic policies and programmes.
- Significant differences between microeconomics and macroeconomics are:
  - (i) differences in scale of study,
  - (ii) differences in the field of study,
  - (iii) differences in the importance given to price and income concepts,
  - (iv) differences in the methods of study,
  - (v) differences in the assumption,
  - (vi) differences in analytical factors.

TERMINAL EXERCISE

1. Define macroeconomics.
2. Define microeconomics.
3. What is the significance of the study of microeconomics?
4. Explain the difference between microeconomics and macroeconomics.

5. What are the fields of study in microeconomics and macroeconomics.
6. What is the significance of study of macroeconomics?
7. Distinguish between positive and normative economics with examples.

ANSWERS TO INTEXT QUESTIONS

12.1

(i) Normative

(ii) Positive

(iii) Normative

(iv) Normative

(v) Positive

12.2

(c) both (a) and (b)

12.3

1. General theory of employment interest and Money
2. (c) Inflation

12.4

1. False
2. False
3. True
4. False