

UNIT 1

Introduction to Economics

Economics – Meaning and Definitions

Economics is a social science that studies how individuals, businesses, and governments use limited resources to satisfy unlimited human wants. Since resources such as land, labour, capital, and time are scarce, people must make choices about how these resources should be allocated efficiently. Economics helps us understand production, consumption, distribution, exchange, and the overall functioning of an economy. It also provides solutions to economic problems like unemployment, inflation, poverty, and income inequality.

Different economists have defined economics from different perspectives. These are known as the **Wealth View, Welfare View, Scarcity View, and Growth View**. Each definition reflects the economic thinking of its time.

Wealth View of Economics

Definition

The Wealth View was introduced by **Adam Smith**, who is known as the **Father of Economics**. In his famous book *The Wealth of Nations* (1776), he defined economics as "**the science of wealth.**"

According to Adam Smith, economics studies how wealth is produced, accumulated, distributed, and consumed. He believed that increasing the wealth of a nation would improve the standard of living of its people. Therefore, production and accumulation of wealth became the central focus of economics.

Example

A textile company manufactures garments and sells them in domestic and international markets. The profits earned by the company increase the nation's income and create employment opportunities. According to Adam Smith's Wealth View, this production of wealth contributes to economic development.

Wants

Human wants refer to the desires or needs for goods and services that provide satisfaction. Wants arise because human beings continuously seek better living conditions and improved comfort.

Since human wants are unlimited but resources are limited, economics studies how these wants can be satisfied efficiently.

Example: Hunger is satisfied after eating a meal but returns later.

Welfare View of Economics

Definition

The Welfare View was proposed by **Alfred Marshall**. According to Marshall,

"Economics is the study of mankind in the ordinary business of life."

Marshall believed that economics should focus on **human welfare rather than wealth**. Wealth is only a means to achieve happiness and improve the quality of life.

According to this definition, economics studies how people earn income, spend money, and improve their standard of living. The objective of economic activities should be the welfare of society.

Example

A government introduces free education and healthcare for economically weaker sections. Though this increases government expenditure, it improves people's welfare. Marshall considered such activities an important part of economics.

Scarcity View of Economics

Definition

The Scarcity View was introduced by **Lionel Robbins** in 1932.

According to Robbins,

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

This definition explains that human wants are unlimited, but resources are limited. Since resources have many alternative uses, individuals and societies must make choices regarding their use.

Example

A student has ₹500. He can either purchase books, recharge his internet, or buy a calculator. Since the money is limited, he cannot buy everything. Therefore, he has to choose the most important need. This is an example of scarcity.

Another example is the government deciding whether to spend funds on healthcare, education, or defence.

Positive Economics

Positive Economics is a part of economics that contemplates the explanation and elucidation of economic occurrence. It concentrates on certainty and cause-and-effect behavioural association, and incorporates the development and trial of economics thesis.

It is the study of economics grounded on the intentional analysis. Today most economists concentrate on the positive economic analysis, which follows what is and what has been materialising in an economy as the rationality for any statement about the upcoming days. Positive economics stands in contradiction to normative economics, which uses value discernment.

Normative Economics

Normative economics is an outlook on economics that contemplates normative or ideologically dictatorial, discernment toward economic enhancement, statements, investment projects and framework. Disparate to positive economics, which depends on intentional data analysis, normative economics decisively solicitude itself with value discernment and statements of 'what has to be' rather than certitude based on cause-and-effect declarations.

Normative economics manifests ideological judgement about what may be the outcome in an economic pursuit if public policy changes are made.

Difference between Positive and Normative Economics

Basis of Difference	Positive Economics	Normative Economics
Meaning	Studies what actually exists in an economy.	Studies what ought to exist in an economy.
Nature	Objective and fact-based.	Subjective and opinion-based.
Basis	Facts, observations, and data.	Values, ethics, and beliefs.
Purpose	Explains and predicts economic behaviour.	Recommends policies to improve society.
Approach	Descriptive (explains reality).	Prescriptive (suggests improvements).
Scientific Testing	Can be tested and verified.	Cannot always be tested scientifically.
Value Judgments	Does not involve value judgments.	Involves value judgments.
Focus	Economic facts and relationships.	Economic welfare and social justice.
Decision Making	Helps analyse economic conditions.	Helps formulate economic policies.
Example	"Inflation is 6%."	"Inflation should be reduced."
Another Example	"An increase in petrol prices reduces demand."	"The government should reduce petrol prices."

Parameters	Positive Economics	Normative Economics
Meaning	A part of economics grounded on information and certainty is positive economics.	A part of economics grounded on values, perspectives, and

		discernment is normative economics.
Nature	Illustrative	Dictatorial
Outlook	Objective	Subjective
Deals with	What actually is?	What has to be?
Testing (Trial)	Statements can be tested	Statements cannot be tested
Economic problems	Evidently elucidates the economic concerns and issues	Provides a solution for the economic concerns, based on the value.

Micro Economics

Meaning

The word "**Micro**" is derived from the Greek word "**Mikros**," which means "**small**." Therefore, **Micro Economics** is the branch of economics that studies the economic behaviour of **individual units** such as consumers, households, firms, industries, and individual markets. It analyses how these economic units make decisions regarding the allocation of scarce resources.

Micro economics is often called "**Price Theory**" because it explains how prices of goods and services are determined through the interaction of demand and supply in individual markets. It also studies consumer behaviour, production decisions, costs, profits, and market structures.

Definition

According to **K. E. Boulding**,

"Micro Economics is the study of particular firms, particular households, individual prices, wages, incomes, individual industries, and particular commodities."

Macro Economics

Meaning

The word "**Macro**" comes from the Greek word "**Makros**," meaning "**large**." Therefore, **Macro Economics** is the branch of economics that studies the economy as a whole. Instead of analysing individual consumers or firms, it examines aggregate economic variables such as national income, total employment, inflation, economic growth, and government policies.

Macro economics helps governments formulate policies to maintain economic stability and improve national welfare.

Definition

According to **Gardner Ackley**,

"Macro Economics deals with the aggregates and averages of the entire economy rather than with individual units."

Basis	Micro Economics	Macro Economics
1. Meaning	Micro Economics is the branch of economics that studies the economic behaviour of individual units such as consumers, households, firms, industries, and individual markets. It focuses on how these units make decisions regarding production, consumption, pricing, and the allocation of limited resources.	Macro Economics is the branch of economics that studies the economy as a whole. It examines aggregate economic variables such as national income, employment, inflation, economic growth, money supply, and government policies that affect the entire economy.
2. Area of Study	Micro economics studies individual consumers, business firms, industries, individual products, and specific markets. It analyses how each economic unit functions independently and interacts with others in the market.	Macro economics studies the entire economy by analysing national income, Gross Domestic Product (GDP), inflation, unemployment, balance of payments, public finance, economic growth, and international trade.
3. Nature	The nature of micro economics is small-scale or individual analysis . It concentrates on specific economic units without considering the economy as a whole. It provides a detailed understanding of individual economic activities.	The nature of macro economics is large-scale or aggregate analysis . It studies the combined performance of all sectors of the economy and explains overall economic trends and national economic performance.
4. Focus	Micro economics focuses on individual decision-making . It explains how consumers maximize satisfaction, how producers maximize profits, and how prices are determined in individual markets.	Macro economics focuses on the overall economic performance of a country. It studies how government policies, investment, consumption, and international trade influence national income and economic stability.
5. Main Objective	The main objective of micro economics is to achieve efficient allocation of scarce resources, determine the prices of goods and services, maximize consumer satisfaction, and maximize producers' profits.	The main objective of macro economics is to achieve economic stability, full employment, sustainable economic growth, price stability, and balanced development of the economy.
6. Price	Micro economics studies the prices of individual goods and services . It	Macro economics studies the general price level of all goods and services in

Basis	Micro Economics	Macro Economics
	explains how the interaction of demand and supply determines the price of a particular commodity in a specific market.	the economy. It analyses inflation, deflation, and the overall movement of prices in the country.
7. Employment	Micro economics studies employment in a particular business firm, factory, or industry. It analyses factors affecting labour demand, wages, and employment decisions of individual employers.	Macro economics studies total employment and unemployment in the entire economy. It examines the causes of unemployment and formulates policies to create employment opportunities nationwide.
8. Income	Micro economics studies the income earned by individual persons, households, firms, and factors of production such as wages, rent, interest, and profit.	Macro economics studies National Income , Gross Domestic Product (GDP), Gross National Product (GNP), Per Capita Income, and overall income generated in the economy.
9. Policy	Micro economics helps business firms make decisions regarding pricing, production, marketing, investment, and resource allocation. It supports managerial decision-making and profit planning.	Macro economics helps governments formulate monetary policy, fiscal policy, taxation, public expenditure, employment policy, and development programmes for the overall economy.
10. Examples	A smartphone company analyses consumer demand, estimates production costs, and fixes the selling price of a new mobile phone. Similarly, a bakery deciding the price of bread or a retailer offering discounts are examples of micro economics because they involve individual business decisions.	The Government introduces a new budget to reduce inflation, the Reserve Bank of India changes interest rates to control money supply, or the Government launches employment schemes to reduce unemployment. These affect the entire economy and are examples of macro economics.

Meaning of Economics

The term Economics is taken from Greek words “Oikos and Nomos”. Oikos means Household and nomos means Management. So Economics means household Management.

Definition of Economics

Economics is the social science that is concerned with the production, distribution and Consumption of goods and services.

Current economic models developed out of the broader field of political economy in the late 19th century, owing to a desire to use of an empirical approach more akin to the physical science.

Definitions of Business Economics

1. Joel Dean

According to Joel Dean,

"Business Economics is the use of economic analysis in formulating business policies."

Explanation:

This definition means that business managers use economic principles and analysis to make business policies and decisions regarding production, pricing, investment, marketing, and profit.

2. Spencer and Siegelman

According to Spencer and Siegelman,

"Business Economics is the integration of economic theory with business practice for the purpose of facilitating decision-making and forward planning by management."

Explanation:

This definition explains that business economics combines economic theories with practical business activities. It helps managers make better decisions and plan for the future.

3. McNair and Meriam

According to Malcolm McNair and Edwin A. Meriam,

"Business Economics consists of the use of economic modes of thought to analyse business situations."

Explanation:

This means business economics applies economic thinking to understand and solve business problems, such as pricing, production, and marketing.

4. H. Craig Petersen and W. Cris Lewis

According to H. Craig Petersen and W. Cris Lewis,

"Business Economics is the application of economic theory and methodology to business administration practice."

Explanation:

This definition states that business economics uses economic theories and methods to improve business management and decision-making.

Business Economics

Meaning

Business Economics is a branch of **Applied Economics** that uses economic principles and theories to help business managers make better decisions. It explains how businesses can use

their limited resources such as money, labour, raw materials, and machinery efficiently to achieve their goals, like earning more profit, increasing sales, satisfying customers, and expanding the business.

In simple words, **Business Economics is the application of economic knowledge to solve business problems.** It helps managers decide **what to produce, how much to produce, how to produce, when to produce, and at what price to sell their products.**

Scope of Business Economics

1. Decision making: Managerial economics helps business organizations in taking effective decisions. It tells how management can use various quantitative tools and economic theories for formulating policies and various managerial decisions.

2. Production and cost analysis: It helps in estimating the cost of production and determines factors causing variations in cost estimates. Managerial economics properly analyses and decides production activities and costs associated with them. It ensures that all resources are efficiently utilized which reduces the overall cost.

3. Demand Analysis and Forecasting: Managerial economics enables the business in analyzing demand and forecasting future uncertainties. An accurate estimate of demand will help in preparing the right production schedules and employing resources accordingly.

4. Pricing policies: Pricing is one of the key decisions to be taken by every business organization for earning the desired profits and attaining desired growth. Managerial economics supplies all relevant data to managers for deciding the right prices for products. Key aspects covered under this area are Pricing methods, product-line pricing, differential pricing, and price determination in various market forms.

5. Profit management: Managerial economics helps in managing the profit of business organizations. Profit is the main measure for the success or growth of firm in the long run. It helps in making correct estimates of all cost and revenue at different levels of outputs which helps in earning the desired profit.

6. Capital management: Capital investment decisions is one of the most challenging and complex tasks before every manager. Managerial economics helps in planning and managing all capital expenditures of business which requires huge investment. It properly analyses investment avenues before investing any amount into it to ensure the profitability of an investment.

Importance of Business Economics

1. Informed Decision-Making

Business economics helps managers make **rational and informed decisions** instead of relying on guesswork or intuition. It provides tools such as **demand forecasting, cost analysis, break-even analysis, and market analysis** to evaluate different business alternatives. These tools enable managers to choose the best course of action regarding production, pricing, investment, expansion, and marketing.

2. Optimum Resource Allocation

Resources such as **money, labour, raw materials, machinery, and time** are limited. Business economics helps organizations allocate these scarce resources efficiently to maximize output and minimize wastage. Efficient resource allocation improves productivity and reduces operational costs.

3. Effective Pricing Decisions

Pricing is one of the most important business decisions. Business economics helps managers determine the **right selling price** by analysing production costs, customer demand, competitor prices, and market conditions. A proper pricing strategy enables businesses to remain competitive while earning satisfactory profits.

4. Risk Management and Forecasting

Business organizations operate in an environment of uncertainty due to changes in consumer preferences, inflation, government policies, technology, and competition. Business economics helps managers forecast future market trends and identify potential risks. This allows businesses to prepare suitable strategies and reduce losses.

5. Profit Planning and Business Growth

The primary objective of every business is to earn profits. Business economics helps firms analyse costs, revenues, demand, and market conditions to maximize profits. It also supports long-term business growth by helping managers prepare business plans, evaluate investment opportunities, and expand into new markets.

Business economics combines both **microeconomic analysis** (such as pricing and production decisions) and **macroeconomic analysis** (such as inflation, interest rates, and government policies) to develop effective growth strategies.

Key Concepts of Economics

Along with the meaning and the definition of economics, it is important to understand the basic economic terms and concepts in detail to get the awareness of maintaining a proper budget for the house or task or any organization. We have five fundamental economic concepts in general. They are as follows-

1. Supply and demand
 2. Scarcity
 3. Opportunity cost
 4. Time value of money
 5. Purchasing power
- **Supply and Demand:** - It is one of the basic economic concepts and theories. Supply and demand can be seen everywhere in our daily life. To understand this concept more clearly, let's take a common example like food products. If we take food and drinks,

they need to travel from the farmer to the consumer with multiple mediators. So, the price may vary. The price of a particular product depends upon the supply and demand of that product.

- **Scarcity:** - This is also the basic concept of economics, which also acts as a factor of demand and supply. Because the supply doesn't meet the demand, then the condition is termed as a scarcity of that particular [utility](#), whether it is food or product or money or any other.
- **Opportunity Cost:** - It is one of the 5 basic concepts of economics. It is like a trade-off market. It is also termed as an exchange policy like if we want something we need to give others in the form of cash or product or whatever it is. We are creating an opportunity to sell our goods in return for getting our requirements.
- **Value for Money:** - It is one of the important concepts in economics because the value of money may vary from time to time based on different factors. It refers to utility that is derived from every money a consumer spends.
- **Purchasing Power:** - Another fundamental economic concept is the purchasing power of consumers because if we take gold as an example, even though the price of gold is reduced, the buyer may not have the ability to purchase food at that particular time. If he can purchase some amount of gold, the price may increase. That ability of the consumer is called the purchasing power.

These are some basic concepts of economics. As it is a wide concept, its scope spreads broadly and can derive several definitions in different scenarios.

Factors of Production

Factors of Production are the basic resources or inputs required to produce goods and services. Every business uses these resources to manufacture products or provide services. Without these factors, production cannot take place.

According to economists, there are **four factors of production**:

1. **Land**
2. **Labour**
3. **Capital**
4. **Organisation (Entrepreneurship)**

Each factor plays a unique role in the production process and receives a specific reward.

Factor of Production	Reward
Land	Rent
Labour	Wages
Capital	Interest
Organisation (Entrepreneur)	Profit

1. Land

In economics, **Land** refers to **all natural resources provided by nature** that are used in the production of goods and services. It includes not only agricultural land but also forests, rivers, lakes, oceans, mountains, minerals, sunlight, climate, and all natural resources available on the earth.

Land is the **primary factor of production** because every production activity requires land or natural resources in some form. Its supply is fixed and cannot be increased by human effort.

Characteristics of Land

- It is a **free gift of nature**.
- It has a **fixed and limited supply**.
- It is **immovable**.
- It is a **passive factor** because it cannot produce anything without labour and capital.
- Its quality and fertility differ from place to place.

Reward of Land

The income earned by the owner of land is called **Rent**.

Example

A farmer uses agricultural land to cultivate paddy. The landowner receives **rent** for allowing the farmer to use the land.

Another example is a mining company using land rich in iron ore to extract minerals.

2. Labour

Labour refers to **all physical and mental efforts made by human beings** in producing goods and services. It includes both skilled workers (such as doctors, engineers, and teachers) and unskilled workers (such as construction workers and agricultural labourers).

Labour is an **active factor of production** because it uses knowledge, skill, and effort to transform raw materials into finished products.

Characteristics of Labour

- It involves **physical and mental effort**.
- It is an **active factor of production**.
- Labour is **perishable**, as unused labour time cannot be stored.
- It is **inseparable** from the worker.
- Labour productivity varies according to education, training, experience, and health.

Reward of Labour

The payment made to labour for its services is called **Wages**.

Example

Workers in a textile factory operate sewing machines to produce garments and receive **wages** for their work.

Other examples include teachers teaching students, doctors treating patients, and software engineers developing computer applications.

3. Capital

Capital refers to **man-made resources** that are used in the production of goods and services. It includes machinery, buildings, tools, equipment, computers, vehicles, and financial resources. Capital is created through saving and investment and helps increase the productivity of labour.

Unlike land, capital is produced by humans and can be increased through investment.

Characteristics of Capital

- It is **man-made**.
- It is a **productive asset** used for further production.
- It is **mobile** and can be transferred from one place to another.
- It increases the efficiency and productivity of labour.
- It is subject to depreciation over time.

Reward of Capital

The income earned on capital is called **Interest**.

Example

A textile factory purchases modern sewing machines, computers, and factory buildings to manufacture clothes efficiently. The money invested in these assets is called **capital**, and the lender or investor receives **interest**.

Another example is a transport company purchasing buses to provide passenger services.

4. Organisation (Entrepreneurship)

Organisation, also called **Entrepreneurship**, is the ability to **organise and coordinate the other three factors of production—land, labour, and capital—to produce goods and services efficiently**. The entrepreneur plans the business, arranges finance, hires workers, purchases machinery, makes important business decisions, introduces new ideas, bears business risks, and manages the entire organisation.

The entrepreneur is considered the **driving force** behind every business because they bring together all the resources needed for production.

Characteristics of Organisation (Entrepreneurship)

- Combines land, labour, and capital.

- Makes important business decisions.
- Bears business risks and uncertainties.
- Introduces innovations and new ideas.
- Coordinates all business activities.
- Plans and manages the business effectively.

Reward of Organisation

The reward earned by the entrepreneur is called **Profit**.

Example

A person starts a bakery by renting a building (land), hiring employees (labour), purchasing baking machines (capital), arranging finance, and managing the business. The entrepreneur earns **profit** for taking risks and successfully running the business.

Another example is an entrepreneur establishing a software company by combining technology, skilled employees, investment, and management to provide software services.