1.1 Economic needs, economic benefits and economic resources. The problem of economic choice
1.2 The subject of economic theory
1.3 Methods and functions of economic theory

Subject and method of economic theory

Economics

- **Economics** is the study of how scarce, or limited, resources are used to satisfy people's unlimited wants and needs. In other words, economics is concerned with how people make decisions in a world of scarcity.

Scarcity

- Without **scarcity** there would be no reason to study economics. Scarcity means that there are not enough, nor can there ever be enough, goods and services to satisfy the wants and needs of all individuals, families, and societies.

- Since it is impossible to satisfy all of the wants and needs of individuals, businesses, nonprofits, government units, and societies, decisions must be made about what to satisfy and how to use limited resources. Anytime we make a choice, there are **tradeoffs**(giving up one thing for something else) and consequences. Decisions usually involve a **value judgment**, which is the relative importance that a person assigns to an action or alternative.

Efficiency and Equity

- In dealing with the basic problem of scarcity – not enough goods and services to satisfy everyone's wants and needs – there are two important concepts to consider: efficiency, and equity.
- Efficiency is concerned with using resources effectively, or getting the most from scarce resources. Efficiency occurs when goods and services of a desired quality are produced at the lowest possible cost.
- There is the issue of what is a fair, just, or equitable distribution of goods and services among the members of a society. Equity, or justice and fairness, raises two basic questions: Should a fair distribution of goods and services be economic goal for a society? If it is, how is a fair distribution defined and achieved?

Factors of production

- Think about all of the thousands of different types of resources, or factors of production, that are used to produce goods and services, from the lighting fixtures in a mall to the skilled hands of a neurosurgeon to the air filter on a plane. To bring order and manageability to any discussion about resources, economists classify them into four groups: **labor, capital, land, and entrepreneurship.**
- Labor includes all human effort, both physical and mental, going into the production of goods and services.
- Capital includes warehouses, machinery and equipment, computers, office furniture, and all other goods that are used in the production of goods and services.
- Land includes all inputs into production that originate in nature and are not human-made – oil, iron ore and fertile soil to name a few.
- Entrepreneurship is the function of organizing or bringing other factors together and taking the risk of success or failure.

Resource Owners

- Land
- Labor
- Capital
- Entrepreneurship

Producers

- Transform Resources into Goods and Services to Satisfy

Society

- Wants and Needs

Producers transform factors of production that they get from resource owners into goods and services to satisfy society's wants and needs.

Factors and income

- People who own resources provide them for production because they expect a return. Although the return may be personal satisfaction, such as a positive feeling from community service, most often people expect to be paid, or to receive an income., there are different types of income:
- Wages – income for labor,
- Interest – income for capital,
- Rent – income for land resources,
- Profit – income for carrying out the entrepreneurial function.

- Although large numbers of resources may be available in an absolute sense, they are scarce relative to the wants and needs their use attempts to satisfy. People's wants always continue to outrun the economy's ability to satisfy them.

Economic theory and policy

- As households, businesses and governments go about conducting their economic affairs, it is helpful to have an understanding of some basic economic cause-and-effect relationships.
- An Economic theory is a formal explanation of the relationship between economic variables.
- Economic theory – is a systematically organized knowlegde applicable in a relatively wide variety of circumstances: especially, a system of assumptions, accepted principles, and rules of procedure devised to analyze, predict, or otherwise explain the nature or behavior of a specified set of phenomena.

- In order to obtain a valid and predictable relationship between economic variables, theories are explored within the framework of a model (the setting within which an economic theory is presented). This model framework includes several elements:
- Variables to be explored,
- Assumptions concerning the model,
- Data collection and analysis,
- Conclusions

Components of theoretical model

- Variables – considerations on which the model focuses
- Assumptions – conditions held to be true in the model
- Data – information used to describe the behavior of the variables
- Conclusions – results of the model

Economic policy

- An economic policy sets a guide for a course of action. Usually an economic policy is created to address an economic problem or change an economic condition. A legislated tax decrease to speed up the economy, mandatory clean air measures, and restrictions on imports of foreign-produced food are all examples of economic policies.

Tools of the economist

- Words – is a verbal presentations, or descriptive statement
- Graphs – picture illustrating the relationship between two variables
- Mathematical equations

EVOLUTION OF ECONOMICS

- The term economics is derived from two words of greek language, namely,oikos(household) and nemein(to manage), meaning hereby household management. It is used to be called as political economy.INDIAN STATESMAN,CHANAKYA OR KAUTILYA IN HIS FAMOUS BOOK , "ARTH-SHASTRA"HAS EXAMINED BOTH KIND OF ACTIVITIES economic and political. Great greek philosopher aristotle had used the term economics to mean the management of the family and the state.The term economics was first of all used by
- Dr. Alfred marshall in 1890 in his famous book "principle of economics". Economists like prof. Schumpeter,k.E. Boulding etc. Have given it the name of economic analysis. Adam smith was founder of modern economics. His famous book "an equiry into the nature and causes of wealth of nations" was published in 1776.

Classical Economists:till The End Of The 18 Th And 19 Th Century(1776-1850), Several Economists Like David Ricardo, Malthus, J.B.Say Etc. Had Fully Supported The Thoughts Of Adam Smith.

Neo-classical Economics:- From The Middle Of The 19 Th Century To The First Three Of The 20 Th Century (1850-1930) Economists Like Menger, Walras, Cournot, Marshall, Pigou Etc. Had Made Significant Contributions Of The Development Of The Study Of Economics Were Great Mathematicians. Making Use Of The Principles Of Mathematics, The Technique They Adopted To Analyse Economic Problems Is Popularly Known As Mariginal Economic Analyis.These Economists Are Known As Neo-classical Economics.

in 1933, prof. Ragnar frisch, the famous economists of Oslo university, Norway, divide the study of economics into two parts:-

1. micro economics(price theory)
2. macro economics(theory of income and employment).

development of macro economics took place after publication in 1936 of the well known book, "the general theory of employment, interest and money" by Lord J.M. Keynes. follower of the philosophy of lord J.M.Keynes, such as Hansen and Hicks etc. are popularly called keynesian economists. in the post-world war –ii era, several economists like Paul. A. Samuelson, K.E. Boulding, Friedman, Patinkin etc.have modified and re-formulated keynesian economics and neo-classical theories. the economists of this era are referred to as post-keynesian economics.

DEFINITION OF ECONOMICS

- Economics is the study of those activities of human being which are concerned with satisfaction of unlimited wants by utilizing limited resources.

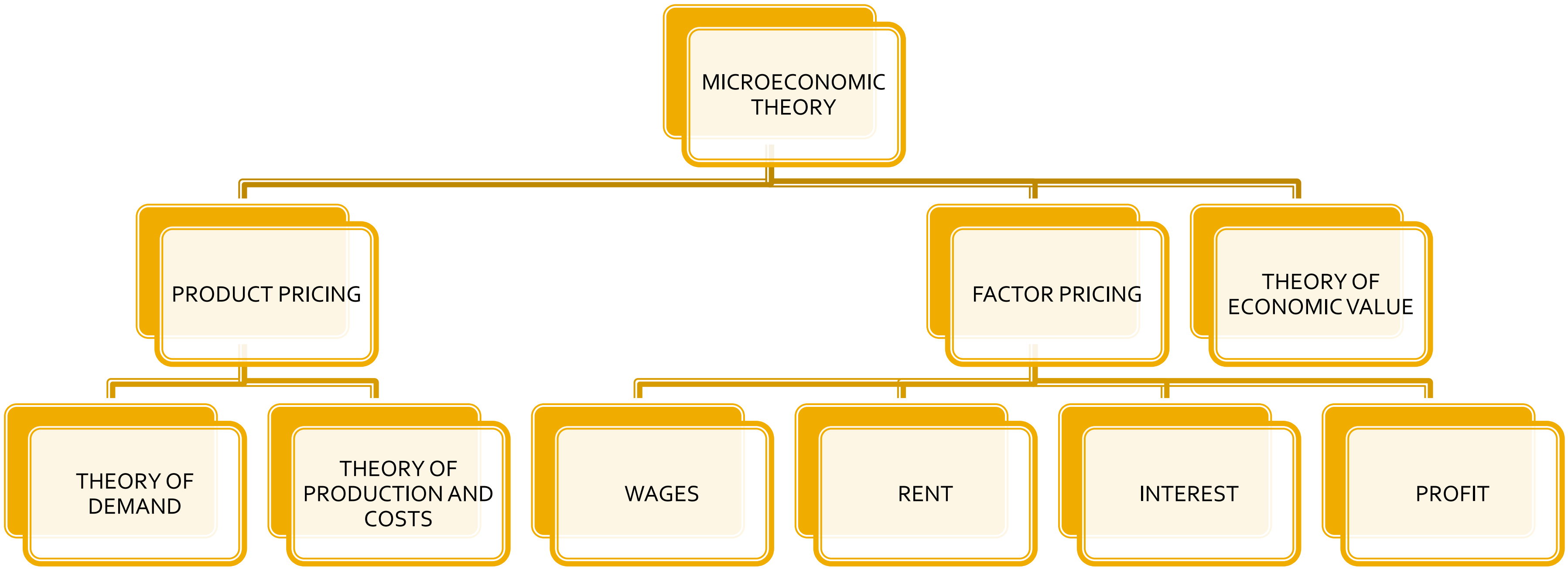
- In the words of Seligman, " Economics has suffered more than any discipline from the malaise of polemics and definitions."
- In this respect, Barbara Wotton's remark, "whenever six economists gather there are seven opinions."
- According to Zuthen, " Economics is a unifinished science."

MICROECONOMICS V/S MACROECONOMICS

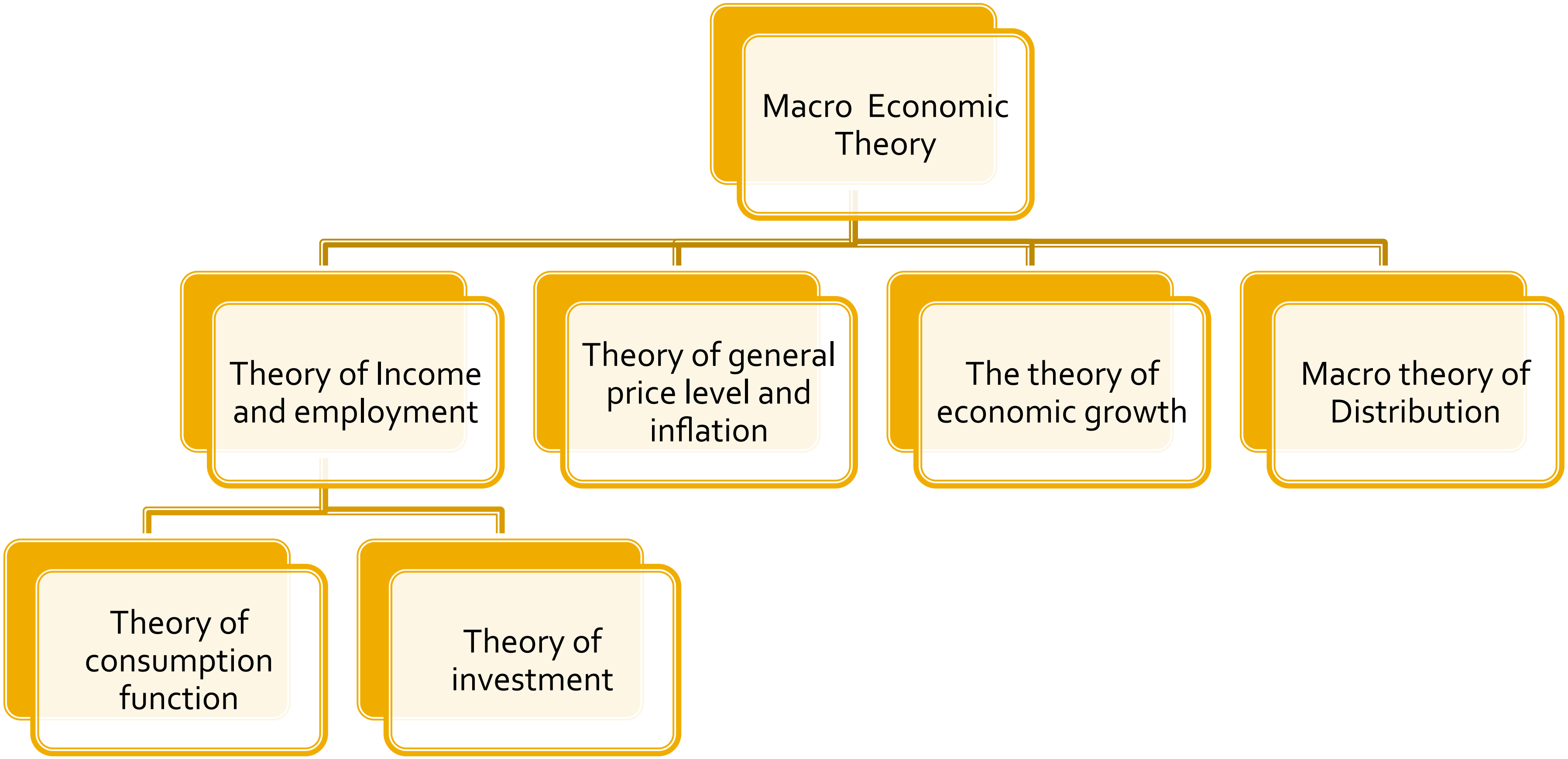
- The term microeconomics is derived from the greek word “mikros”, meaning “small” and the term “macros” meaning “large or aggregate economy as a whole.” Thus micro economics related to the study of individual economic units while the latter is a study

of the study of the economy as a whole.

MICRO ECONOMIC THEORY



MACRO ECONOMIC THEORY ANALYSIS



Modeling scarcity

- As we know, theories are explored within the context of a model that includes variables, assumptions, data and conclusions. Here we will develop a model to explore scarcity in an economy by examinig the production of two goods using that economy's resources. Although this hypothetical economy has the potential for producing a large assortment of goods and services, in this model all the economy's resources will be diverted to the production of only two goods: cell phones and garden tractors. These two goods are the variables in our model.In a short period of time will be used the following assumptions.
- 1. all resources, of factors of production are held constant. There are no changes in the available amounts of the economy's labor, machinery, trucks, or other factors.
- All resources are fully employed. Everyone who wants a job has one, and all other resources (such as factories and transportation equipment) available for use are being used. There is no involuntary unemployment of resources.
- The existing technology is held fixed, no new inventions or innovations occur.

- The data for this model are provided in table 1, which lists some possible combinations of cell phones and garden tractors that could be produced in the economy given the assumptions made. Because the table provides possible levels of production, it is termed a **production possibilities table** (gives the various amounts of two goods that an economy can produce with full employment and fixed resources and technology).

Table 1

Cell phones (millions)	Garden tractors (hundred of thousands)
25	0
24	2
20	4
15	6
9	8
0	10


Production possibilities curve
Cell Phones
30
25
20
15
10
5
0
0
2
4
6
8
10
12
Production possibilities curve
Garden Tractors

Interpreting the model

- The basic conclusion of the production possibilities model is a restatement of the scarcity problem. Even with the full employment, limited resources allow only limited production of goods and services.
- the production possibilities model also emphasizes the concepts of tradeoff and opportunity cost.
- If the assumption of full employment is dropped and it is assumed that some resources availlable for production are not used, or these is **unemployment (**resources availble for production are not being used) then the economy cannot produce as mush as it does under condition of full employment.
- When we drop the assumptions of fixed resources and fixed technology, this model can also be used to illustrade **economic growth**, which is an increase in an economy's full employment level of output over time.
- So the model is used to evaluate the choices an economy can make between producing **capital goods**, such as machinery and equipment, which are used to produce other goods and services, and **consumer goods**, such as food and household furniture, which are produced for final buyers.