

ECONOMICS IS ALL ABOUT:

- ✓ **Choice-Making** in the Presence of scarcity of Resources ($D > S$).
- ✓ **Rationality** i.e. one's choice must be consistent (Similar) to one's goal.
- ✓ **Economising of Resources** i.e. making best use of available resources without any wastage.



ORIGIN OF ECONOMICS

- ✓ The word '**Economics**' derived from the Greek word **OIKONOMIA** which means household or household management.

DEFINITION OF ECONOMICS

- ✓ Wealth Definition was given by **Adam Smith** in his book '**The Wealth of Nation**' (1776).
- ✓ Material Welfare Definition was given by **Alfred Marshall** in his book '**Principles of Economics**' (1890).
- ✓ Choice Making Definition was given by **L. Robbins** in his book '**Nature and Significance of Economics**' (1931).
- ✓ Dynamics Growth & Development Definition was given by **Paul A. Samuelson** in his book '**The Economics**' (1948).

MICRO ECONOMICS VS MACRO ECONOMICS

- ✓ **Micro Economics** is a narrow concept whereas **Macro Economics** is a wider concept.
- ✓ **Micro Economics** is the study of Individual units i.e. In **Micro Economics**, we study the Economy in small-small parts because the word 'MICRO' is derived from Greek word 'MYKROS' which means "SMALL or PART" whereas **Macro Economics** is the study of Aggregate units i.e. In **Macro Economics**, we study the economy as a whole because the word 'Macro' is derived from the Greek word "MAKROS" which means "Large or Aggregates".
- ✓ **Micro Economics** is also known as 'Price Theory' or 'Theory of Price Determination' whereas **Macro Economics** is also known as 'Income & Employment Theory' or 'Theory of Income & Employment Determination'.
- ✓ The main subject matter of **Micro Economics** are Demand & Supply whereas the main subject matter of **Macro Economics** are Aggregate Demand & Aggregate Supply.
- ✓ **Micro Economics** studies Equilibrium of only one market at a time assuming other things remaining same therefore calculations are relatively simple whereas **Macro Economics** can study equilibrium of all the market simultaneously without assuming other things remaining same therefore calculations are relatively complex moreover macro economics can also study spill over effects and feedback effects of other markets.
- ✓ The central problem of 'Allocation of resources' is studied under **Micro Economics** whereas the central problem of 'What provisions are made for Economic Growth & Progress' is studied under **Macro Economics**.

EXAMPLES OF MICRO ECONOMICS VS MACRO ECONOMICS

We mainly study the following in Micro-Economics:

- ✓ Product pricing;
- ✓ Consumer behaviour;
- ✓ Factor pricing;
- ✓ The economic conditions of a section of people;
- ✓ Behaviour of firms; and
- ✓ Location of industry.

We mainly study the following in Macro-Economics:

- ✓ National Income and National Output;
- ✓ The general price level and interest rates;
- ✓ Balance of trade and balance of payments;
- ✓ External value of currency;
- ✓ The overall level of savings and investment; and
- ✓ The level of employment and rate of economic growth.

POSITIVE SCIENCE & NORMATIVE SCIENCE

- ✓ **P.S.** studies the things as they are in reality whereas **N.S.** studies the things as they ought to be.
- ✓ **P.S.** deals with what was in reality, what is in reality & what will be in reality whereas **N.S.** deals with what should have been, what should be fair/better or what ought to be.
- ✓ **P.S.** relates to cause and effect relation, principles, analysis, historical facts, universal facts, current problem & challenges, truth, reality, description etc. whereas **N.S.** relates to suggestions, policy, rules, values, ethics, morality, what is better, what is fair, value judgements, solutions, prescriptions etc.
- ✓ **P.S.** is also known as descriptive science based on facts whereas **N.S.** is also known as prescriptive science based on suggestion and value judgements.

EXAMPLES OF POSITIVE SCIENCE & NORMATIVE SCIENCE

Positive Science

- ✓ Planned Economics allocate resources via government departments.
- ✓ Most transitional economies have experienced problems of falling output and rising prices over the past decade.
- ✓ There is greater degree of consumer sovereignty in market economies than planned economies.

Normative Science:

- ✓ Reducing inequality should be a major priority for mixed economies.
- ✓ The government ought to guarantee that income of farmers will not fall during bad monsoon.
- ✓ Minimum wage should be raised to 200 per day.

MEANING & DEFINITION OF BUSINESS ECONOMICS

- ✓ **Business Economics** may be defined as the use of economic analysis to make business decisions involving the best use of an organization's scarce resources.
- ✓ **Joel Dean** defined **Business Economics** in terms of the use of economic analysis in the formulation of business policies. **Business Economics** is essentially a component of Applied Economics as it includes application of selected quantitative techniques such as linear programming, regression analysis, capital budgeting, break even analysis and cost analysis.
- ✓ **Business Economics** is also known as Managerial Economics or Applied Economics which integrate economic theory with business practices for sound business decision making to achieve objectives efficiently and effectively.

NATURE OF BUSINESS ECONOMICS

The following points will describe the nature of Business Economics:

- ✓ **Business Economics is a Science:** Science is a systematized body of knowledge which establishes cause and effect relationships. Business Economics integrates the tools of decision sciences such as Mathematics, Statistics and Econometrics with Economic Theory to arrive at appropriate strategies for achieving the goals of the business enterprises. It follows scientific methods and empirically tests the validity of the results.
- ✓ **Business Economics is an art** as it involves practical application of rules and principles for the attainment of set objectives.
- ✓ **Business Economics is largely based on Micro Economics:** Business Economics is based largely on Micro-Economics. A business manager is usually concerned about achievement of the predetermined objectives of his organisation so as to ensure the long-term survival and profitable functioning of the organization. Since Business Economics is concerned more with the decision making problems of individual establishments, it relies heavily on the techniques of Microeconomics.
- ✓ **Business Economics also incorporates elements of Macro Analysis:** A business unit does not operate in a vacuum. It is affected by the external environment of the economy in which it operates such as, the general price level, income and employment levels in the economy and government policies with respect to taxation, interest rates, exchange rates, industries, prices, distribution, wages and regulation of monopolies. All these are components of Macroeconomics. A business manager must be acquainted with these and other macroeconomic variables, present as well as future, which may influence his business environment.
- ✓ **Business Economics uses of Theory of Markets (D & S) and Private Enterprises (Self interest):** Business Economics largely uses the theory of market and private enterprise. It uses the theory of the firm and resource allocation in the backdrop of a private enterprise economy.
- ✓ **Business Economics is Pragmatic in Approach:** Micro-Economics is abstract and purely theoretical and analyses economic phenomena under unrealistic assumptions. In contrast, Business Economics is pragmatic in its approach as it tackles practical problems which the firms face in the real world.
- ✓ **Business Economics is Interdisciplinary in nature:** Business Economics is interdisciplinary in nature as it incorporates tools from other disciplines such as Mathematics, Operations Research, Management Theory, Accounting, marketing, Finance, Statistics and Econometrics.
- ✓ **Business Economics is less positive & more normative in Nature:** Economic theory has developed along two lines – positive and normative. A positive or pure science analyses cause and effect relationship between variables in an objective and scientific manner, but it does not involve any value judgement. In other words, it states ‘what is’ of the state of affairs and not what ‘ought to be’. In other words, it is descriptive in nature in the sense that it describes the economic behaviour of individuals or society without prescriptions about the desirability or otherwise of such behaviour. As against this, a normative science involves value judgements. It is prescriptive in nature and suggests ‘what should be’ a particular course of action under given circumstances. Welfare considerations are embedded in normative science. Business Economics is generally normative or prescriptive in nature. It suggests the application of economic principles with regard to policy formulation, decision-making and future planning. However, if the firms are to establish valid decision rules, they must thoroughly understand their environment. This requires the study of positive or descriptive economic theory.
- ✓ **Business Economics combines** the essentials of normative and positive economic theory, the emphasis being more on the former than the latter.

SCOPE OF BUSINESS ECONOMICS

The scope of Business economics is quite wide. It covers most of the practical problems. There are two categories of business issues to which economic theory can be applied.

1. Micro Economics is applied to operational or Internal Issues like

- ✓ Demand Analysis and forecasting
- ✓ Production and cost analysis
- ✓ Inventory management
- ✓ Market structure and pricing policies
- ✓ Resource Allocation
- ✓ Theory of capital and investment decisions
- ✓ Profit analysis
- ✓ Risk and uncertainty Analysis etc.

2. Macro Economics is applied to environmental or External Issues like (Environmental factors have significant influence upon functioning and performance of Business. The Macro Economic factors relate to:

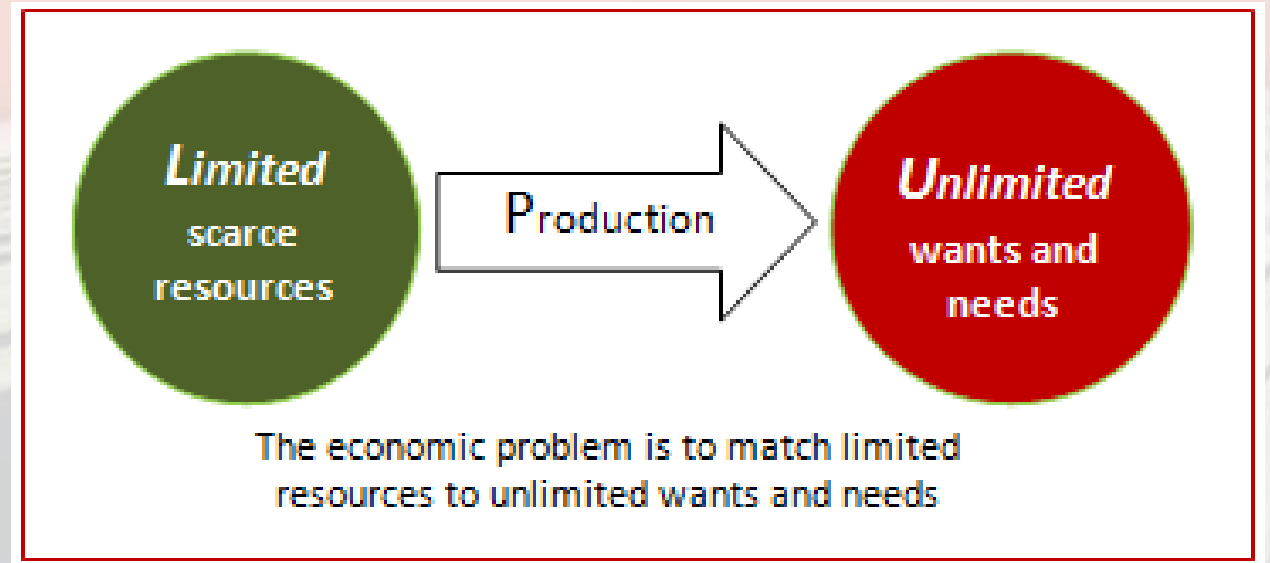
- ✓ The type of Economics System i.e. capitalism, socialism or mixed economic system
- ✓ Stage of Business cycle (Boom, slowdown, recession and recovery)
- ✓ The general trends in National Income Employment, general prices, savings and Investment
- ✓ Government's Economic Policies like Industrial Policy, Competition Policy, Monetary Policy of Central Bank, Fiscal Policy of Govt., Price Policy, Foreign Trade Policy (EXIM policy), and Globalisation Policy.
- ✓ Working of financial sector and capital market.
- ✓ Socio-economic organizations like Trade Unions, Producer's and consumer's unions, and co-operatives
- ✓ Social and Political environment

→ Business Decisions can not be taken without considering these present and future environmental factors. As the management of the firm has no control over these external factors, it should fine-tune its policies to minimize their adverse effects.

ECONOMIC PROBLEM

Economic problem means problem of choice - making which arises due to

- ✓ Unlimited wants
- ✓ Scarcity of Resources
- ✓ Alternative use of Resources.



ECONOMICS PROBLEM

Four central problems of an Economy are Allocation of Resources:

- ✓ What to produce:- Means What types of goods are to be produced & in what Qty.?
- ✓ How to produce:- Means problem of choice of technology?
- ✓ For Whom to Produce:- Means problem of distribution of income & wealth.
- ✓ What provision are to be made for Economic Growth & development of Resources

ECONOMY

Economy is a system which provides livelihood to the people.



ECONOMY

Capitalist Economy

| Features | Merits | Demerits |
|---|---|--|
| <ul style="list-style-type: none">✓ PVT. Sector✓ Profit maximization✓ Freedom of consumption✓ Freedom of production✓ Price - mechanism solve all central problem✓ Equilibrium price fixed by D & S✓ Competition exist in market✓ Inequality of Y & wealth✓ Law of inheritance✓ Optimum use of Resources due to self - Interest | <ul style="list-style-type: none">✓ It results in high standard of living.✓ Capitalism works automatically through price mechanism.✓ Maximum efficiency in production.✓ It rewards men of initiative and enterprise. | <ul style="list-style-type: none">✓ Rich becomes richer and poor becomes Poorer.✓ Welfare is not protected✓ Economic instability✓ Class conflict arises between employer and employee.✓ Productive resources are misused.✓ Formation of monopolies.✓ There is no security of employment. |

ECONOMY

Socialist Economy

| Features | Merits | Demerits |
|---|--|--|
| <ul style="list-style-type: none">✓ Only Government sector✓ Social - Welfare maximization✓ No freedom of consumption✓ No freedom of Production✓ Economic planning by planning commission solve central problem✓ Administered price fixed by Government✓ No competition✓ Relatively Equal Distribution of Y & wealth✓ No Law of Inheritance✓ Wastage of resources due to lack of self - Interest. | <ul style="list-style-type: none">✓ Equitable distribution of wealth and income✓ Planned economy, Better utilization of resources✓ Unemployment is minimized, business fluctuation are eliminated✓ Avoids class war.✓ Labourers and consumers are protected. | <ul style="list-style-type: none">✓ Predominance of bureaucracy. There may also be corruption, redtapism, favoritism, etc.✓ It restricts the freedom of individuals.✓ It will not provide necessary incentive to hard work in the form of profit.✓ State monopolies created by socialism will sometimes become uncontrollable.✓ The extreme form of socialism is not at all practicable. |

ECONOMY

Mixed Economy or Economy of third world (India, Nepal, Pakistan etc.)

| Features | Merits | Demerits |
|--|--|--|
| <ul style="list-style-type: none">✓ Co - existence of Pvt. sector and Govt. sector✓ Co - existence of Profit maximization in Pvt. Sector & social welfare maximization in Govt. sector.✓ Co - existence of Price - mechanism in Pvt. Sector & economic Planning in Govt. sector to solve central problems.✓ Co - existence of Freedom in Pvt. Sector & no Freedom in govt. sector for constant.✓ Co - existence of Freedom in Pvt. Sector & no Freedom in govt. sector for Production.✓ Co - existence of competition in Pvt. sector & no competition in govt. sector & No Competition in govt. sector.✓ Co - existence of Equilibrium Price in Pvt. Sector & Administered Price in Government sector. | <ul style="list-style-type: none">✓ Merits of both capitalism and socialism while avoiding the evils of both.✓ Mixed economy protects individual freedom.✓ Price mechanism is allowed to operate under mixed economy.✓ Reducing the inequalities of wealth and class struggle is one of the aims.✓ Economic fluctuations can be avoided. | <ul style="list-style-type: none">✓ Mixed economy is difficult to operate.✓ Excessive controls and heavy taxes are likely to prevail under mixed economy.✓ Problems red-tapism, nepotism, favouritism, officialdom, etc.✓ Described by Schumpeter as "Capitalism in the oxygen tent". It is only a trick of the capitalists to cheat the working class by offering them some temporary advantages like social security, upliftment of the depressed classes, etc. |

PRICE MECHANISM

It solve all central problems of private sector:

- ✓ What to produce (by demand)
- ✓ How to produce (by supply)
- ✓ For whom to produce (by equilibrium of demand and supply.)
- ✓ What provisions are made for economic growth (by cost benefit analysis).

