CHAPTER 1

INTRODUCTION TO ECONOMICS

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There are many definitions for economics. As the subject keeps on evolving, the definition also keeps on evolving. The father of economics Adam smith studied economics as "an inquiry into the nature and causes of the wealth of nations".

Thereafter, a lot many economists defined economics in different ways based on their own research and perception. But none of them is universally accepted. So, it is better to have an idea about economics rather than having a definition. This is a study that centres on resources. The resource may be abundant or scarce; natural or manmade; monetary or non monetary.

It is said above for the reason the horizon of economics is widened. Economics deals with the scarce resources like diamond and also air a resource available in plenty. It speaks about the price of both. It points out the scarce nature of diamond as reason for its high price and as the air is available in plenty it is not priced. Adam Smith in his wealth of nations observes "The things which have the greatest value in use have frequently little or no value in exchange; and, on the contrary, those which have the greatest value in exchange have frequently little or no value in use. Nothing is more useful than water: but it will purchase scarce anything; scarce anything can be had in exchange for it. A diamond, on the contrary, has scarce any value in use; but a very great quantity of other goods may frequently be had in exchange for it."[1] He discusses about the exchange value of both water and diamond. The first one is available in plenty, the second one is scarce. So, it is clear that it studies about both plentifulness and scarcity. The causes and effects of inflation is also studied which is related with abundance of money as well as scarcity or shortage of goods and service. From this it is clear that economics studies both scarcity and abundance. But most part of the economic study is devoted for the study of scarcity as human tendency is to care for scarce resources.

It is stated as a study that centres on resources for the reason it not only study about resources but also the factors, stake holders involved in creation, extraction and consumption. It studies about the allocation of resources, allocation of factors of production, consumption pattern of factors of production, the motive and aim of factors of production, behaviour of factors of production and consumers and the psychology behind these motives and aims and behaviour and so many other things.

Factors of production mean the participants in the production process. They are Land, Labour, Capital and Entrepreneur. The land is a base to establish the production unit, transportation and sometimes the source of raw material. Labour contributes her might physically and mentally. Capital is used to purchase the men and material. Entrepreneur does bring in all other factors of production and puts in to use to produce

1 Macroeconomics, theory and policy, thoroughly revised edition, H. L Ahuja, P. 26

what best can be produced using these. The entrepreneur may be either government or private.

A STUDY UNDER CONTROLLED ATMOSPHERE

In the technical specifications of a car the mileage of the car is mentioned say for example 22 Kilometre per Litre (KMPL). It means the car runs for 22 Kilometres per litre of fuel. But when it is bought and used it may not run 22 Km per litre. Had you ever thought why does this difference arise? The difference is due to the fact that the 22 KMPL is mentioned after a thorough check under certain laboratory conditions like well laid road, perfect air pressure in tyre, traffic free atmosphere etc. but in actuality, all the roads are not well laid, and the city traffic may be heavy, the air pressure may not be maintained properly all the time. These factors reduce the mileage of the car.

Likewise, certain varieties of seeds yield a high amount of produce in laboratory or in field trial but when it comes to mass scale production by farmers, the yield may not be the same. The reasons are difference in atmospheric and other conditions of laboratory and field.

The same logic is applicable for economics. The laboratory conditions are laid in the form of assumptions when it comes to the study of Economics. The economic theories and models are created under specific conditions and assumptions. For example, the demand theory considers that demand for goods and services are based on the level of price for that particular goods and service. It says, if the price is high, the demand for the product is low and vice versa. It is said so because, the theory of demand assumes other factors that has impact on demand remain unchanged. But in actuality it is not the case. There are many other factors other than the price that has influence on the demand. The reason for making these assumptions are that the factors considered in theory are playing major role in deciding the outcome of the interplay of these factors . The other things do not have a significant influence but at the same time they cannot be ignored. The second reason for assumption is to simplify the study and build a base theory based on which further complicated study can be done by considering all other factors that have impact or influence on the issue under consideration. The assumption of other variables being unchanged is called *Ceteris paribus*. The economic Times Defines *Ceteris paribus* as "This commonly-used phrase stands for 'all other things being unchanged or constant'. It is used in economics to rule out the possibility of 'other' factors changing, i.e. the specific causal relation between two variables is focused."[2]

The way, the laboratory checked cars and seeds yield less on the field the economic

2 http://economictimes.indiatimes.com/definition/ceteris-paribus - the web page accessed on 25.1.2014

theories deliver less in practice as the world is more complicated than what was considered while building economic theories and models. But the economic theories and models do not fail the world as due care is taken while building it and framing it to make as much as closer to the realities of the world.

TWO MAIN STREAMS

There are two main streams of Economics. They are Microeconomics and Macro economics.

The term 'Micro' is used to indicate something relating to a specific area, rather a general one. The term 'Macro' is used to denote something relating to a general area rather than being detailed or specific. Likewise, the micro economics studies the specific area of economics like individuals, a smaller group like labourers, economics of a firm etc. The macro economics studies the economy of a nation as a whole.

The study of demand of individuals, the production function of a production unit which is called firm are covered under microeconomics study. At the same time the study of demand of the nation, the production or supply level of a nation, the general level of employment etc. are covered under the study of Macroeconomics.

A careful reading of the following table will give clarity on the question as to what is microeconomics and what is macroeconomics.

Issue Considered	Is it Micro?	Is it Macro?
Quantity of orange demanded by Asstha Mathur	Yes	NO
Quantity of Orange demanded by North East India	Yes	No
Quantity of Orange demanded by India	Yes	No
Quantity of all products demanded by India	No	Yes
Price of Orange in Nagpur	Yes	No
Price level of All products in India	No	Yes
Level of Employment in Iron and Steel Industry	Yes	No
Level of Employment in India	No	Yes

This book looks at Indian economy from the macroeconomic perspective. But do not dwell into theoretical aspects. It concentrates on the concepts and its practical implications.