Revision Notes

Class - 12 Micro Economics

Chapter 1 - Introduction

Economy:

- The economy of a society is a web of organisations and institutions that help or hinder the production and distribution of goods and services.
- The distribution of a society's resources, the value of goods and services, and even what can be traded or bartered in exchange for those services and goods are all determined by the economy.

Different types of economy:

1. Centrally Planned Economy: A centrally planned economy is one in which the government or a central authority plans all the economy's major activities. All major decisions regarding the production, exchange, and consumption of goods and services are made by the government. The central authority attempts to achieve a specific resource allocation and also the distribution of the final combination of goods and services that is deemed desirable for the society as a whole. The primary goal is social welfare.

2. Market Economy: All economic activities in a market economy are organised through the market. Free interaction of individuals who pursue their respective economic activities takes place in a market.
In other words, a market is a collection of arrangements in which economic agents freely exchange their endowments or products with one another. Also, no interference of government takes place, and there exists the influence of the private sector. The forces of demand and supply, as well as the behaviour of economic participants determines the economy. The main objective is profit maximisation

3. Mixed Economy: The economy in which both the government and the private sector own and operate production factors. Profit maximisation in the private sector and social welfare in the public sector are the primary goals. The central planning authority and the price mechanism solve central problems.

Economics:

- It is a branch of social science that studies the production, distribution, and consumption of goods and services.

- The origin of economics can be traced back to Adam Smith's 1776 book, 'An Inquiry into Nature and Causes of Wealth of Nature.' Economics was defined as managing a home with limited funds in the most cost-effective way possible.
- It aims to solve the scarcity problem, which occurs when human wants for goods and services outnumber available supplies.
- The term 'economics' is derived from two Greek words: 'eco', which means 'home', and 'nomos', which means 'accounts.'
- The topic has evolved from how to keep the family accounts to the wide-ranging subject at present.

The Real Meaning of Economics:

- It is the actual study of scarcity and choices.
- It seeks ways to reconcile unlimited wants with limited resources.
- Economics explains community living problems in terms of underlying resource costs and consumer benefits.
- Economics is concerned with the coordination of activities that result from specialisation.

Definition of Economics:

- The formal definition of economics can be traced back to the great Scottish economist Adam Smith (1723-90). Adam Smith and his followers, following the mercantilist tradition, regarded economics as a science of wealth that studies the processes of wealth production, consumption, and accumulation.
- The emphasis in Alfred Marshall's book "Principles of Economics," published in 1890, was on human activities or welfare rather than wealth. "A study of men as they live, move, and think in the ordinary business of life," Marshall defines economics. He claimed that economics is a study of wealth on one hand and a study of man on the other.

Difference between Microeconomics and Macroeconomics:

S.no	Basis of Difference	Microeconomics	Macroeconomics
1.	Origin	The word 'micro' comes from the Greek word 'micros,' which means	The word macro originated from the Greek 'makros,' which means 'large.' It's also

		'small.' It's also known as Price theory.	known as the Income and Employment Theory.
2.	Study Matters	It investigates individual economic relationships or issues such as households, businesses, and consumers.	It investigates the economy as a whole.
3.	Objective	Its main goal is to examine the principles, issues, and policies that can be used to achieve the goal of optimal resource allocation.	It looks into the principles, issues, and policies that go into achieving full employment and expanding productive capacity.
4.	Deals with	It is concerned with how consumers and producers make decisions based on their budget and other factors.	It examines how different economic sectors, such as households, industries, the government, and the international community, make decisions.
5.	Method	It employs the partial equilibrium method, which involves achieving equilibrium in only one market.	It employs the general equilibrium method, which ensures that all markets in an economy are in equilibrium.
6.	Variables	Price, individual consumer demand, wages, rent, profit, revenues, and other microeconomic variables are important.	Aggregate price, aggregate demand, aggregate supply, inflation, unemployment, and other macroeconomic variables are important.

7.	Theories	• Consumer Behaviour and Demand Theory. • Producer Behaviour and Supply Theory. • Price Determination Theory under various Market Situations. • Factor pricing/distribution theory. • Economic Welfare Theory.	• National Income Theory. • Money Theory. • General Price Level and Inflation Theory. • Employment Theory • International Trade Theory. • Macro-distribution Theory. • Economic Growth Theory.
8.	Main Problem	Its main issues are price determination and resource allocation.	Its main issue is determining the economy's level of income and employment.
9.	Popularised by	Alfred Marshall	John Maynard Keynes

Difference between Positive and Normative Economy:

S.No	Positive Economy	Normative Economy
1.	It is concerned with what is and what was.	It deals with what ought to be.
2.	It is based on the cause-and-effect relationship between facts.	It is based on moral principles.
3.	Actual data can be used to verify it.	Actual data cannot be used to verify it.

4.	The value of judgement is not given in this case.	This is where the value of judgement is given.

Problems of an Economy:

- The basic economic problem is one of choice, which is exacerbated by resource scarcity.
- It's also known as the problem of resource economization, or the problem of making better and more efficient use of limited resources to meet the needs of the greatest number of people.
- Natural resources, such as land and air, human resources, such as labour, capital resources, such as machines and buildings, and entrepreneurial resources, such as a person willing to take risks, are all examples of factors of production.
- Unlimited human wants, limited economic resources, and alternative uses of resources are the main causes of central problems.

Central Problems of an Economy:

a) What to produce: An economy has an infinite number of wants and a finite number of resources that can be put to other uses. The economy is unable to produce all types of goods, such as consumer and producer goods. As a result, the economy must decide what types of goods and services will be produced and in what quantities.

b) How much to produce: It's a problem of deciding on a production technique. There are two types of production techniques:
i. Labor-Intensive Technique: This is a production technique in which labour is used more than capital.
ii. Capital-Intensive Technique: Capital is used more than labour in this technique.

c) From whom to produce: It is a problem involving the distribution of manufactured goods among various social groups. It has two aspects:
i. Personal distribution: When the national income is distributed according to who owns the production factors.
ii. Functional distribution: When the national income or production is distributed among various factors of production such as land, labour, capital, and entrepreneurship for the purpose of providing their services in terms of rent, wages, interest, and profit.

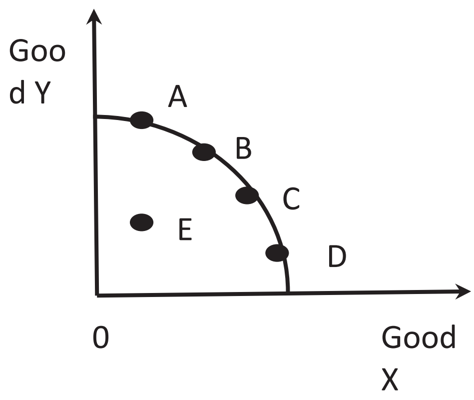
Problem relating to the efficient use and fuller utilisation of resources:
Production efficiency refers to producing the greatest amount of goods and services possible with the resources available. Resources are already scarce in comparison to the demand for them, so an economy must ensure that its resources are not wasted by remaining underutilised.

Problem relating to resource growth:
It has to do with increasing the economy's production capacity in order to increase the quantity of output.

Production possibility frontier:
- The production possibility frontier is a curve that depicts all possible combinations of two goods that can be produced in a given economy with given resources and technology.
- The production possibility frontier is also known as the transformation curve or the production possibility curve.
- Due to scarce and finite resources, the production of a commodity could only be increased if there is a reduction in the other commodity. Hence, the PPC curve is concave.

Assumptions
The PP curve concept is founded on the following assumptions:
- The economy's resource base is fixed.
- The technology is pre-installed and unmodified.
- The resources are effective and fully utilised.
- In the production of all goods, all resources are not equally efficient.

Diagram:



In the diagram, there are different combinations of good X and good Y, that is combination A,B,C and D which could be produced when the the resources in the economy are optimally and fully utilised. Any point on or below the production possibility frontier gives a combination of goods that could be produced given the resources and technology, however any combination under the PPC (Point E) signifies the underutilization or wasteful utilisation of resources.

Shifts in Production Possibility Curve.

Reasons:

- Changes in resources.
- Changes in manufacturing technology for both goods.

Rightward shift:

Production Possibility Curve shift to the right indicates an increase in resources or technological advancement. Example skilled labour, technological advancements, and increased land productivity are all factors that are contributing to increased productivity.

Leftward shift:

Production Possibility Curve shift to the left indicates a decrease in resources or a deterioration in technology in the economy. Example unskilled labour, technological obsolescence, and decreased land productivity are all factors that are contributing to decreased productivity.

Methods for resolving fundamental issues in capitalistic and planned economies include:

The market mechanism solves the fundamental problems in a capitalist or market-oriented economy.

- The market forces of demand and supply have an impact on price. These forces assist us in determining what, how, and for whom we should produce.
- In a planned economy, the government makes all of the economic decisions about what, how, and for whom to produce.
- The price mechanism is replaced by economic planning. The state sets the prices for various products, which are referred to as administered prices.