1 INTRODUCTION TO MICROECONOMICS

WHAT ECONOMICS IS ALL ABOUT?

Economics is about economizing; that is, about choice among alternative uses of scarce resources. Choices are made by millions of individuals, businesses, and government units. Economics examines how these choices add up to an economic system, and how this system operates. (L.G. Reynolds)

Scarcity is central to economic theory. Economic analysis is fundamentally about the maximization of something (leisure time, wealth, health, happiness—all commonly reduced to the concept of utility) subject to constraints. These constraints—or scarcity—inevitably define a trade-off. For example, one can have more money by working harder, but less time (there are only so many hours in a day, so time is scarce). One can have more apples only at the expense of, say, fewer grapes (you only have so much land on which to grow food—land is scarce). Adam Smith considered, for example, the trade-off between time, or convenience, and money. He discussed how a person could live near town, and pay more for rent of his home, or live farther away and pay less, "paying the difference out of his convenience".

Economics as a subject came into being with the publication of very popular book in 1776, "An Enquiry into the Nature and Causes of Wealth of Nations", written by Prof. Adam Smith. At that time it was called Political economy, which remained operational at least up to the middle part of the 19th century. It is since then that the economists developed tools and principles using inductive and deductive reasoning. In fact, the 'Wealth of Nations' is a landmark in the history of economic thought that separated economics from other social sciences.

The word 'Economics' was derived from the Greek words 'Oikos' (a house) and 'Nemein' (to manage), which meant managing a household, using the limited money or resources a household has.

Let us explain a few important definitions frequently referred to in the economic theory.

Ref – Intro to Economics, By *Dutta*, New Age Pub

Adam Smith (June 5, 1723-July 17, 1790) was a Scottish political economist and moral philosopher. His 'Inquiry into the Nature and Causes of Wealth of Nations' was one of the earliest attempts to study the historical development of industry and commerce in Europe. That work helped to create the modern academic discipline of Economics and provided one of the best-known intellectual rationales for free trade and capitalism.

At the age of about fifteen, Smith proceeded to the University of Glasgow, studying moral philosophy under "the never-to-be-forgotten" (as Smith called him) Francis Hutcheson. In 1740 he entered the Balliol College of the University of Oxford, but as William Robert Scott has said, "the Oxford of his time gave little if any help towards what was to be his lifework," and he left the university in 1746. In 1748 he began delivering public lectures in Edinburgh under the patronage of Lord Kames. Some of these dealt with rhetoric and *belles-lettres*, but later he took up the subject of "the progress of opulence," and it was then, in his middle or late 20s, that he first expounded the economic philosophy of "the obvious and simple system of natural liberty" which he was later to proclaim to the world in his *Inquiry into the Nature and Causes of the Wealth of Nations*.

Wealth Definition

The early economists like J.E. Cairnes, J.B.Say, and F.A.Walker have defined economics as a science of wealth. Adam Smith, who is also regarded as father of economics, stated that economics is a science concerned with the nature and causes of wealth of nations. That is, economics deal with the question as to how to acquire more and more wealth by a nation. J.S.Mill opined that it is the practical science dealing with the production and distribution of wealth. The American economist F.A.Walker says that economics is that body of knowledge, which relates to wealth. Thus, all these definitions relate to wealth.

However, the above definitions have been criticized on various grounds. As a result, economists like Marshall, Robbins and Samuelson have put forward more comprehensive and scientific definitions. Emphasis has been gradually shifted from wealth to man. As Marshall puts, it is *"on the one side a study of wealth; and on the other, and more important side, a part of the study of man."*

Alfred Marshall (July 26, 1842- July 13, 1924), born in Bermondsey, London, England, became one of the most influential economists of his time. His book, *Principles of Political Economy* (1890) brought together the theories of supply and demand, of marginal utility and of the costs of production into a coherent whole. It became the dominant economic textbook in England for a long period.

Marshall grew up in the London suburb and was educated at the Merchant Taylor's School and St. John's College, Cambridge, where he demonstrated an aptitude in mathematics. Although he wanted early on, at the behest of his father, to become a clergyman, his success at Cambridge University led him to take an academic career. He became a professor in 1868 specializing in political economy. He desired to improve the mathematical rigor of economics and transform it into a more scientific profession. In the 1870s he wrote a small number of tracts on international trade and the problems of protectionism. In 1879, many of these works were compiled together into a work entitled *The Pure Theory of Foreign Trade: The Pure Theory of Domestic Values.* Marshall began work on his seminal work, the Principles of Economics, in 1881, and he spent much of the next decade at work on the treatise. His most important legacy was creating a respected, academic, scientifically-founded profession for economists in the future that set the tone of the field for the remainder of the twentieth century. Marshall's influence on codifying economic thought is difficult to deny. He was the first to rigorously attach price determination to supply and demand functions; modern economists owe the linkage between price shifts and curve shifts to Marshall. Marshall was an important part of the "marginalist revolution;" the idea that consumers attempt to equal prices to their marginal utility was another contribution of his. The price elasticity of demand was presented by Marshall as an extension of these ideas. Economic welfare, divided into producer surplus and consumer surplus, was contributed by Marshall, and indeed, the two are sometimes described eponymously as 'Marshallian surplus.' He used this idea of surplus to rigorously analyze the effect of taxes and price shifts on market welfare. Marshall also identified quasi-rents.

Welfare Definition

Thus according to Marshall, economics not only analysis the aspect of how to acquire wealth but also how to utilize this wealth for obtaining material gains of human life. In fact, wealth has no meaning in itself unless it is used to purchase all those things which are required for our sustenance as well as for the comforts necessary for life. Marshall, thus, opined that wealth is a means to achieve certain ends.

In other words, economics is not a science of wealth but a science of man primarily. It may be called as the science which studies human welfare. Economics is concerned with those activities, which relates to wealth not for its own sake, but for the sake of human welfare that it promotes. According to Cannan, *"The aim of political economy is the explanation of the general causes on which the material welfare of human beings depends."* Marshall in his book, "Principles of Economics", published in 1890, describes economics as, *"the study of mankind in the ordinary business of life; it examines that part of the individual and social action which is most closely connected with the attainment and with the use of the material requisites of well being".*

On examining the Marshall's definition, we find that he has put emphasis on the following four points:

(a) Economics is not only the study of wealth but also the study of human beings. Wealth is required for promoting human welfare.

(b) Economics deals with ordinary men who are influenced by all natural instincts such as love, affection and fellow feelings and not merely motivated by the desire of acquiring maximum wealth for its own sake. Wealth in itself is meaningless unless it is utilized for obtaining material things of life.

(c) Economics is a social science. It does not study isolated individuals but all individuals living in a society. Its aim is to contribute solutions to many social problems.

(d) Economics only studies 'material requisites of well being'. That is, it studies the causes of material gain or welfare. It ignores non-material aspects of human life.

This definition has also been criticized on the ground that it only confines its study to the material welfare. Non-material aspects of human life are not taken into consideration. Further, as Robbins said the science of economics studies several activities, that hardly promotes welfare. The activities of producing intoxicants, for instance, do not promote welfare; but it is an economic activity.

Lionel Charles Robbins (1898-1984) was a British economist of the 20th century who proposed one of the early contemporary definitions of economics, "Economics is a science which studies human behavior as a relationship between ends and scarce means which have alternative uses."

Robbins's early essays were very combative in spirit, stressing the subjectivist theory of value beyond what Anglo-Saxon economics had been used to. His famous work on costs (1930, 1934) helped bring Wieser's "alternative cost" theorem of supply to England (which was opposed to Marshall's "real cost" theory of supply). It was his 1932 Essay on the Nature and Significance of Economic Science where Robbins made his Continental credentials clear. Redefining the scope of economics to be "the science which studies human behavior as a relationship between scarce means which have alternative uses".

Scarcity Definition

Lionel Robbins challenged the traditional view of the nature of economic science. His book, "Nature and Significance of Economic Science", published in 1932 gave a new idea of thinking