NOTES
BBA
ECONOMICS

KATNI ARTS & COMMERCE COLLEGE
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1 | INTRODUCTION TO ECONOMICS

Why do people work ?

A former ploughs his field in the midst of rain and sun, a labourer works hard in a factory, A shopkeeper sells his goods in shop, a clerk work in office and so on If you ask the question to any one of them, you will get a very simple and straightforward answer - We work to earn our livelihood (or bread and butter). It suggests that all people in this world work to satisfy their wants and desires.

When we watch the activities of a man, we find that most of the time he remains engaged in the work for satisfaction of his wants; and in order to satisfy his numerous wants, he requires various types of goods and services.

Goods which are not command any market price are called *non-economic goods* or free goods. For example : air, sunshine, rain etc. Goods which are scare and command price are called *economic goods*. Example: wheat, cloth, car, tea, milk, pen, ink etc

ECONOMIC ACTIVITIES Vs NON-ECONOMIC ACTIVITIES

ECONOMIC ACTIVITIES

Activities which are performed with a view to earn wealth or income are known as economic activities. Human activities concerning production, consumption, exchange and distribution of economic goods are called economic activities. The activities of farmers, Labour, Teachers, shopkeepers, Advocate etc is the example of Economic Activities.

NON-ECONOMIC ACTIVITIES

Activities which do not have earning of wealth as their motive are non-economic activities. Play football for health, Singing for self-entertainment, Teaching his own children by the teacher, etc; are examples of non-economic actvities.

There cannot be any water-tight division between economic and non economic activities. The same activity can be economic or non economic, depending on the motive of the activity. Since similar type of activity can be an economic or non-economic at different points of time. It is easier to observe an activity but it is quite difficult to know whether it has wealth motive.

In the opinion of Robbins, all human activities cannot be separated and classified as economic, political social or religious activities. Truly speaking, every activity has an economic aspect. Hence an activity which looks as non-economic at the very outset may also be possessing an economic aspect.

In spite of all these difficulties, we can classify and distinguish between economic and non-economic activities. Activities which have earning of wealth as their prime objective are economic activities and activities which do not have earning of wealth as their main objective are non-economic activities.

2 | DEFINITION OF ECONOMICS

The word of economics has been derived from two Greek words Oikos (meaning a house) and Nemein (meaning to manager). Economics meant managing a household with the limited fund available in the house in a economical manner, alternatively, economics is the study of how a society chooses to use its limited resources to produce, exchange and consume goods and services.

Economics has been defined by various economist. Various definitions are grouped under four heading:

1. **Wealth definition** – Adam Smith
2. **Welfare Definition** – Alfred Marshall
3. **Scarcity definition** – Lionel Robbins
4. **Growth and development definition** – Paul A. Samuelson

WEALTH DEFINITION

For the first time in 1776 Adam smith wrote a book on economics and provide it a status of separate "science." That is why Adam Smith is known a the **"Father of Economics".** Title of his book – " **An Enquiry into the Nature and Causes of the Wealth of Nations**".

Adam Smith

"**Economics inquires into the factors that determine wealth of the country and its growth**."The definition emphasizes production and expansion of wealth".

J.B.Say

"**Economics is the science which deals with wealth**".

Other economists of this group (J.B.say, J.S.mill, Walker etc) has also given similar definition. In all these definitions, wealth has given the central and prime place. They presumed the existence of an economic man who always works only for wealth.

Criticism

- Narrow meaning of wealth.
- More importance to wealth
- Wrong presumption of economic man

WELFARE DEFINITION

Alfred Marshall was the first economist who shifted 1980 the emphasis from wealth to welfare in the definition of economics.

Redefining the subject of economics by Prof. Alfred Mashall in his famous book published in 1980 **"Principles of Economics"** In this task Prof. Pigou, Cannon, Chapman, Fairchild etc also supported Prof. Marshal. While defining this subject these economist gave importance to the material **welfare of human beings**.

Alfred Marshall

"Political economy or economics is the study of man's action in the ordinary business of life. It is enquires how he gets his Income and how he spends it.. Thus 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"

Further in his second book Principles of Economics he defined economics in these words:

"Economics is the study of mankind in the ordinary business of life; it examines that part of individual and social action which is most closely connected with the attainment and with the use of material requisites as well being."

The main features are Marshall's definition:

- Economics is a social science and it is studies economic activities of a social, normal and real man
- Wealth is a means while its end is human welfare i.e. wealth is for man and man is not for wealth.
- The central point in the study of economics is man's material welfare.

Criticism

- Wrong concept of material goods.
- Economics has no relation with the material welfare.
- Wrong division of human activities
- It is *classificatory*, here we find many categories but the distinction between them is not clear

SCARCITY DEFINITION

Prof Lionel Robbins in his book NATURE AND SIGNIFICANCE OF ECOOMIC SCIENCE in 1932 defined economics as –

> **"Economics is the science which studies human behavior as a relationship** between ends and scarce means which have alternative uses"

Robbins' definition of economics is based on logic and reasoning. It accepts the facts of life and on the basis of those arrives at a definition. The definition is based on two facts:

(1) Human wants are unlimited, and
(2) The means to satisfy these wants are limited and they can be put to several uses.

Thus, unlimited wants and limited means with alternative uses give rise to the problem of choice.

We face this problem of choice at all levels – be it Individual, social, National and International. The problem of choice arises because of scarcity. And this is the main focal point of study in Economics.

Evaluation of definition:

i. The definition is more precise and comprehensive as compared to earlier definition.
ii. Definition explain realistic situations. He considers economics as a positive science. i.e. economics is neutral between ends.
iii. The definition is widened the scope of economics. The subject taken up is a logical exercise between scarce means with alternative uses and endless wants.

Criticism

- Allocation of scare resources will bring welfare of the people. So, the concept of welfare is implicit in the definition but it is not explicitly mentioned
- The definition makes economics a human science instead of social science.
- The definition is narrow and restricted in scope.

GROWTH DEFINITION

Paul A. Samuelson's definition of economics includes dynamic changes taking place both in the means as well as the ends with the laps of time.

"Economics is the study of how men and society choose, with or without the use of money, to employ scarce productive resources which could have alternative uses, to produce various commodities over time and distribute them for consumption now and in the future amongst various people and groups of society".

The features of this definition are:

1. The definition stresses on the problem of scarcity of resources in relation to unlimited ends and alternative uses of resources.
2. The definition has an element of time in it which gives it dynamic dimensions. It is clear from phrases like "now and in future".
3. The definition touches upon economic growth and welfare aspects also.

3 | IS ECONOMICS A SCIENCE OR AN ART

Economics is science in its methodology and an art in its application, because it has theoretical as well as practical aspects.

What is Science?

Science is a systematized body of knowledge ascertainable by observation and experiment. It is a body of generalizations, principles, theories or laws which traces out a casual relationship between causes and results

What is Art?

Art is the practical application of scientific laws, principles and theories

Economics is a science because:

Firstly, economists collect the facts.

Secondly, they analyze them and derive result.

Thirdly, they determine the relationship between facts and results.

Finally, they give a title to the relationship

Economics is an art because:

Economists suggest policies along with their implementation procedures to solve the economic problem

Thus, Economics is a Science as well as an Art.

4 | A POSITIVE OR NORMATIVE SCIENCE

Read carefully -

- ✓ India is an overpopulated country.
- ✓ A fall in the price of goods leads to a rise in its quantity demanded.
- ✓ Prices have been rising in India.
- ✓ Minimum wage law increase unemployment.
- ✓ Air is a mixture of gases.
- ✓ Increase in real per capita income increase the standard of living of people.

These are example of **Positive Science**

In a positive economics we study human decisions as *Fact Which Can Be Verified With Actual Data*.
Prof. Robbins held that economics was purely a positive science. According to him, economics should be neutral or silent between ends, i.e. there should be no desire to learn about ethics of economic decision.

In Normative Economics gives Prescriptive statement. Examples are:

- ❑ Government should guarantee a minimum wage for every worker.
- ❑ India should not take loans from foreign country.
- ❑ India should spend more money on defense.
- ❑ Rich people should be taxed more.
- ❑ Free education should be given to the poor.

Difference Between Positive and Normative Economics

Positive Economics	Normative Economics
It expresses what is	It expresses what should be
It is based on cause and effect of fact.	It is based on ethics
It deals with actual or realistic situation.	It deals with idealistic situation.
It can be verified with actual data.	It cannot be verified with actual data.
In this value judgments are not given. It is neutral between ends.	In this value judgments are given.

Interdependence of Positive and Normative science:

In reality, Economics has developed along both positive and normative lines. The role of an economist is essential for a healthy and rapid growth of an economy.

Examples of statement which contain both positive and normative economics are:

1. **A rise in the price of goods leads to a fall in its quantity demanded; therefore, Government should check rise in price.**
2. **Rent Control Act provides accommodation to the needy people; therefore, the act should be honestly implemented.**
3. **Indian economy is a developing economy, the Government should make it developed through correct planning.**

In the above three examples, the first part of the statement is positive giving facts and the second part is normative based on value judgments.

5 | METHOD OF CONSTRUCTING AN ECONOMIC THEORY

Economic Theory is a hypothesis that has been successfully tested. Its purpose is to predict and explain. Economic theory includes all those laws and principles which explain, analyse, predict and establish the cause and effect relationship among economic variables. It is derived logically in a scientific way.
Two methods used in construction of an economic theory are:

1. Deductive Method 2. Inductive Method

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1- Deductive Method (from general to particular)

The deductive method is also named as analytical, abstract or prior method. The deductive method consists in deriving conclusions from general truths. It takes a few general principles and applies them to draw conclusions.

For instance, if we accept the general proposition that man is entirely motivated by self-interest. John is a man therefore, the inference will be drawn that John is motivated by self-interest. In applying the deductive method of economic analysis, we proceed from general to particular.

In deductive method, we start with general assumptions and then make particular predictions through a process of logical deduction.

The predictions are made on the basis of certain assumptions. Once predictions are empirically tested and verified for their accuracy, they are accepted as an economic theory. Otherwise, predictions are either amended or rejected.

MERRITS OF DEDUCTIVE METHOD

(i) It is simple method which does not involve much collection of data.
(ii) It is based on basic facts of human nature and is, thus universally applicable.
(iii) It brings accuracy and exactness to economic generalizations with the use of logic and mathematics.

DEMERRITS OF DEDUCTIVE METHOD

(i) The conclusions have limited applicability as the underlying assumptions keep on changing.
(ii) The results are not dependable.
(iii) Conclusions drawn are generally not based on facts. Thus, there is every possibility that they may not exist in real life.

2- Inductive Method (from particular to general)

In inductive method, we start with particular facts and then make general theory based on the analysis of facts. Method involves use of the following three steps in a systematic order:

COLLECTION OF DATA --------- ANALYSIS OF DATA ------ FORMULATION OF GENERAL PRINCIPLE

In this method, data is collected about a certain economic phenomenon. These are systematically arranged and the general conclusions are drawn from them.

For example, we observe 200 persons in the market. We find that nearly 195 persons buy from the cheapest shops. Out of the 5 which remains, 4 persons buy local products even at higher rate just to patronize their own products, while the fifth is a fool. From this observation, we can easily draw conclusions that people like to buy from a cheaper shop unless they are guided by patriotism or they are devoid of commonsense.

The main steps involved in the application of inductive method are:**(i)** observation **(ii)** formation of hypothesis **(iii)** generalization and**(iv)** verification.

MERITS OF INDUCTIVE METHOD.

1. It is based on facts as such the method is realistic.
2. In order to test the economic principles, the method makes use of statistical techniques. The inductive method is, therefore, more reliable.
3. Inductive method is dynamic. The changing economic phenomenon is analyzed and on the basis of collected data, conclusions and solutions are drawn from them.
4. Induction method also helps in future investigations.

DEMERITS OF INDUCTIVE METHOD:

1. If conclusions are drawn from insufficient data, the generalizations obtained may be faulty.
2. The collection of data itself is not an easy task. The sources and methods employed in the collection of data differ from investigator to investigator. The results, therefore, may differ even with the same problem.
3. The inductive method is time-consuming and expensive.
4.

Conclusion:

The above analysis reveals that both the methods have weaknesses. We cannot rely exclusively on any one of them. Modern economists are of the view that both these methods are complimentary. They are partners and not rivals. Alfred Marshall has rightly remarked, **"Inductive and Deductive methods are both needed for scientific thought, as the right and left foot are both needed for walking"**. We can apply any of them or both as the situation demands.

6| METHOD OF CONSTRUCTING AN ECONOMIC THEORY

Human beings have wants which are unlimited. Wants get satisfied by consuming goods and services, but new wants keep cropping up. The amount of goods and services that can be produced depends on the amount of resources available.

Resources are scare, i.e. they are available in limited quantities

Resources are not only limited but they also have alternative uses

All this necessitates a choice between which wants to satisfy first, where to use the resources and what quantity.

Economic Problem is the Problem of choice. It is the problem of utilizing the limited resources to satisfy the maximum number of wants.

The clash between the limitations of nature and the unlimited and non-saturating human wants is the basic of economic problems.

This fundamental economic problem is reflected in an economy in the form of three problems which are called the Central Problems of an economy.

Any economy – whether capitalist, socialist, agricultural, mixed, undeveloped etc.- has to face these problems.

According to P.A.Samuelson there are three fundamental and interdependent problems in an economic organisation – what, how and for whom.

What Goods to Produce and How much to Produce

This is the ***Problem of allocation of resources.*** Due to limited resources, every economy has to decide what goods to produce and what quantity. In economics, the problem of what to produce is situated under ***Price Theory***.

How to Produce

It is the question of ***Choice of technique of production.*** Since resources are scare, an inefficient technique of production, which would lead to wastage and high costs, cannot be applied**.** A technique of production which would maximise output or minimise cost should be used. Every Economy has to choose the most efficient technique of producing a commodity. In economics, the problem of choice of technique of production is studied under the ***Theory of production***

For Whom to Produce

It is the question of ***How to distribute the national product among various sections of society.*** National product is total output generated by the firm. Total output ultimately flows to the households in the form of income, i.e. wages, rent, profits and interest.

There are millions of people in a society. Each on cannot get sufficient income to satisfy all this wants. This raises the problem of distribution of national product among different house holds.

In economics, the problem of distribution of national product is studied under the ***Theory of Distribution.***