Commerce CLASSES

Micro Economics Notes PDF

On

Introduction to Micro Economics

(Class – 11)

Study of Economics is divided into two branches:
(a) Micro economics
(b) Macro economics

Microeconomics studies the behaviour of individual economic units. Ex-Consumer equilibrium, producers equilibrium, product pricing, factor pricing etc. Micro economics is also called price theory.

Importance of Microeconomics:
Microeconomics has both theoretical and practical importance. It is clear from the following points:
1. Microeconomics helps in formulating economic policies which enhance productive efficiency and results in greater social welfare.
2. Microeconomics explains the working of a capitalist economy where individual units (i.e., producers and consumers) are free to make their own decisions.
3. Microeconomics describes how, in a free enterprise economy, individual units attain equilibrium position.
4. It helps the government in formulating correct price policies.
5. It helps in efficient employment of resources by the entrepreneurs

Macroeconomics studies the behavior of the economy as a whole. Ex- National income, aggregate demand, aggregate supply, general price level, Inflation etc. Macroeconomics is also called theory of income and employment.

Importance of Macroeconomics:
The importance of macroeconomics on theoretical and practical reasons is clear from the following points:
1. It gives an overall view of the growing complexities of an economic system. It provides powerful tools to explain the working of the complex economic systems.
2. It provides the basic and logical framework for formulating appropriate macroeconomic policies (e.g., for inflation, poverty, unemployment, etc.) to direct and regulate economy towards desirable goals.
3. It helps in analysing the reasons for economic fluctuations and provides remedies.

Difference between Microeconomics and Macroeconomics

BASIS	**MICRO ECONOMICS**	**MACRO ECONOMICS**
Meaning	Microeconomics is that part of economic theory which studies the behaviour of individual units of an economy	Macroeconomics is that part of economic theory which studies the behaviour of aggregates of the economy as a whole.
Tools	Demand and Supply	Aggregate Demand and Aggregate Supply
Main Objective	It aims to determine the price of a commodity or factors of production.	It aims to determine income and employment levels of the economy.
Basic Assumptions	It assumes all the macro variables to be constant, i.e., it assumes that national income, consumption, saving, etc. is constant.	It assumes that all the micro variables, like decisions of households and firms, prices of individual products, etc. are constant.
Other Name	It is also known as 'Price Theory'	It is also known as 'Income and Employment Theory'.

POSITIVE OR A NORMATIVE SCIENCE

Economics as a Positive Science:
Positive Economics deals with what are the economic problems and how are they actually solved . It deals with ‘things as they are’ example: - India is an overpopulated country where prices are constantly rising .

Economics as a Normative Science:
Normative economics deals with what ought to be on how the economic problems should be solved . It tells us ‘what ought to be '. Example: India should not be an overpopulated country where prices should not rise .

ECONOMY

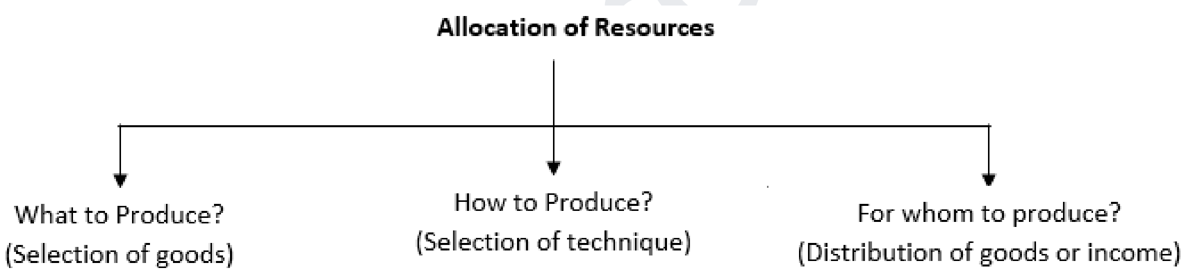
It is a system in which people earn a living to satisfy their wants through the process of production, consumption, investment and exchange.

Economic problem: It is the problem of choice arising from use of limited means which have the alternative use for the satisfaction of various wants.

Causes of economic problems are:

(a) Unlimited Human Wants- Human wants are never ending and differ in priorities (intensities). This increases the use of resources that are already scarce.
(b) Scarcity of resources - Resources are limited in relation to their demand and the economy can't produce all what people want.
(c) Alternative uses of Resources- Resources are not only scarce, but they can also be put to various uses. Thus, the economy has to make a choice between the alternative uses of the given resources .

Central Problems of an Economy:



(A) What to produce: It refers to which goods and services will be produced in an economy and in what quantities. An economy has to produce those goods and services where there will be maximum social utility. This problem is studied under price theory.

(B) How to produce: It refers to what technique of production (i.e.., labour intensive or capital intensive) should be used to produce goods. An economy has to select that technique which maximizes the output at minimum cost. This problem is studied under the theory of production.

(C) For whom to produce: It is related to distribution of produced goods and services (i.e., income and wealth) among factors of production in the form of rent, wages, interest and profit. This is explained under the theory of distribution.

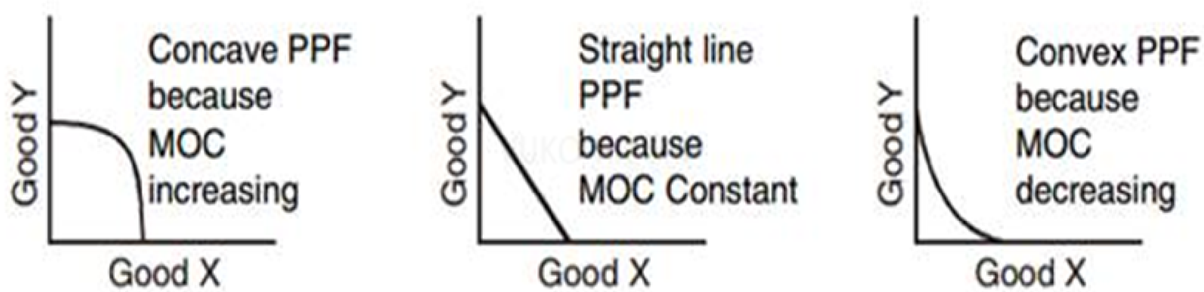
PRODUCTION POSSIBILITY FRONTIER OR CURVE (PPC/PPF)

Production Possibility Set and Curve:
Production possibility set refers to different possible combinations of two goods that can be produced from a given amount of resources and a given level of technology.

Production possibility frontier or production possibility curve shows all possible combinations of two set of goods that an economy can produce with available resources and given technology, assuming that all resources are fully and efficiently utilized.

Assumption for PPF:
1. The amount of resources in an economy is fired.
2. with the help of a given amount of resources, only 2 goods can be produced.
3. The resources are fully utilized
4. Resources are not equally efficient in production of all products.
5. The level of technology is assumed to be constant.

Production Possibility Frontier or Curve Features:
(a) Slopes downward from left to right because if production of one commodity is to be increased then production of other commodity has to be sacrificed as there is scarcity of resources.
(b) Concave to the origin because of increasing marginal opportunity cost or (MRT)



The Production possibility curve will shift under following two conditions:
(a) Change in resources, (b) Change in technology of production for both the goods.

SHIFT IN PPF

1. **Rightward shift of PPF** shows increase in resources or improvement in technology. Ex- Labour becoming more skilled, improvement in technology, increases in productivity of land.
2. **Leftward shift of PPF** shows the decrease in resources or degradation of technology in the economy.
3. **The Production possibility curve will rotate outward under following two condition:**

(a) Improvement in technology in favour of one commodity
(b) Growth of resources for the production of one commodity

OPPORTUNITY COST
Opportunity cost is defined as the cost of alternative opportunity given up or surrendered.

Marginal opportunity Cost (Moc) - Moc refers to the number of units of a commodity sacrificed to gain one additional unit of another.

Marginal Rate of Transformation (MRT) – It is the amount of one commodity that is to be sacrificed to increase the production of other commodities by one unit.

MARGINAL RATE OF TRANSFORMATION: MRT is the ratio of units of one good sacrificed to produce one more unit of other good.

$$MRT = \frac{\text{Unit of good Y sacrificed}}{\text{Unit of good X produced}} = \frac{\Delta y}{\Delta x}$$

(Marginal= at the border or adjacent/next to/adjoining)
(Transformation= a change in form, shape appearance or size)