# CHAPTER 1 INTRODUCTION

ECONOMY:- An economy encompasses all activity related to production, consumption, and trade of goods and services in an area
An economy is a system of organizations and institutions that either facilitate or play a role in the production and distribution of goods and services in a society. Economies determine how resources are distributed among members of a society; they determine the value of goods or services; and they even determine what sorts of things can be traded or bartered for those services and goods.

ECONOMICS:-
“Economics is the science which studies human behavior as a relationship between given ends and scarce means which have alternative uses.”
Economic is a study about how individuals, businesses, and governments make choices on allocating resources to satisfy their needs. These groups determine how the resources are organized and coordinated to achieve maximum output. And they are mostly concerned with the production, distribution, and consumption of goods and services.
Economics is divided into two important sections, they are: microeconomics & macroeconomics

microeconomics focuses on individual consumers and businesses.
macroeconomics deals with the behaviour of the aggregate economy as a whole.

MICROECONOMICS
Microeconomics is defined as the study of individuals, households and firms' behavior in decision making and allocation of resources.

## Subject matter of microeconomics are as follow:

1. Product Pricing:-
The main principle in microeconomics is product pricing or price mechanism. Prices of individual commodities are determined by market forces of demand and supply.

2. Factor Pricing Theory:-
Microeconomics deals with the pricing of factors of production like land, labour, capital and entrepreneur. All factors contribute in production process. These factors get rewards in the form of rent, wages, interest and profit respectively.

3. Theory of Economics Welfare:-
Micro economics also deals with the optimum allocation of resources and maximisation of social welfare.

MACROECONOMICS

It is that part of economic theory which studies the economy in its totality or as a whole.

It studies not individual economic units like a household, a firm or an industry but the whole economic system. Macroeconomics is the study of aggregates and averages of the entire economy.

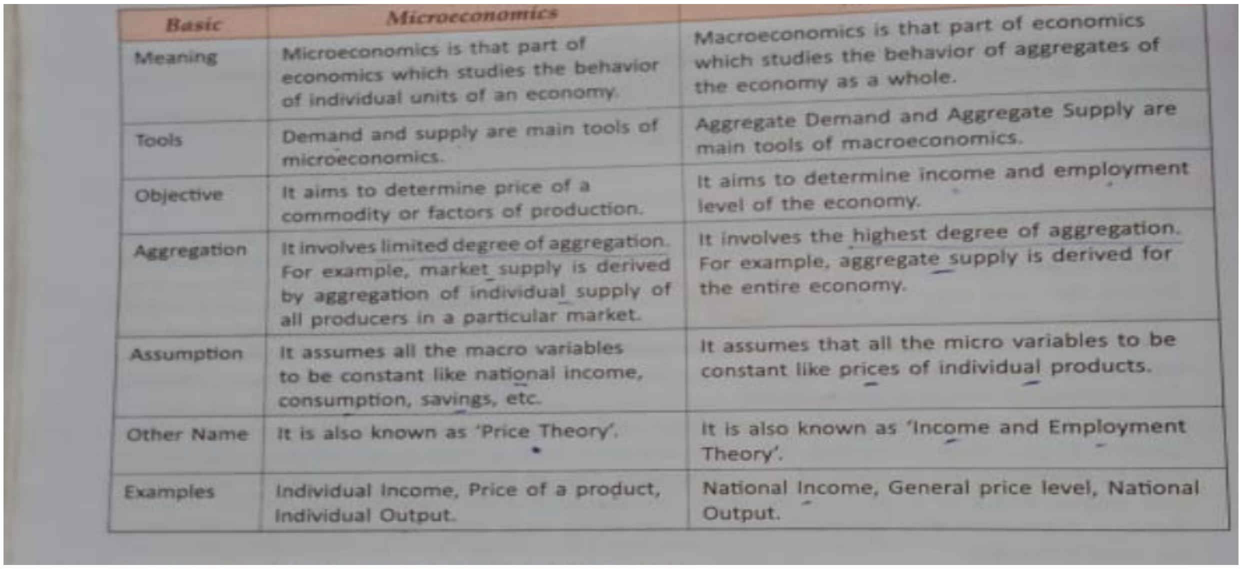
## The Subject matter of Macroeconomics

1. Macroeconomics is concerned with the behaviour of the economy as a whole. It is the study of aggregates and averages of the entire economy.
2. The subject matter of macroeconomics is income and employment, inflation, money supply,price level, investment and economic growth and development.

The purpose of macroeconomics is to present a logical framework for the analysis of these phenomena.

3. Having understood these phenomena, the aim is how to ensure the maximum level of income and employment in a country.
4. Since the subject matter of macroeconomics revolves around determination of the level of income and employment, therefore, it is also known as 'Theory of Income and Employment'.
5. Correct economic policies formulated at macro level make it possible to control business cycles (inflation and deflation) in the economy.

DIFFERENCE BETWEEN MICROECONOMICS AND MACROECONOMICS.



| Basic | Microeconomics | |
|---|---|---|
| Meaning | Microeconomics is that part of economics which studies the behavior of individual units of an economy. | Macroeconomics is that part of economics which studies the behavior of aggregates of the economy as a whole. |
| Tools | Demand and supply are main tools of microeconomics. | Aggregate Demand and Aggregate Supply are main tools of macroeconomics. |
| Objective | It aims to determine price of a commodity or factors of production. | It aims to determine income and employment level of the economy. |
| Aggregation | It involves limited degree of aggregation. For example, market supply is derived by aggregation of individual supply of all producers in a particular market. | It involves the highest degree of aggregation. For example, aggregate supply is derived for the entire economy. |
| Assumption | It assumes all the macro variables to be constant like national income, consumption, savings, etc. | It assumes that all the micro variables to be constant like prices of individual products. |
| Other Name | It is also known as 'Price Theory'. | It is also known as 'Income and Employment Theory'. |
| Examples | Individual Income, Price of a product, Individual Output. | National Income, General price level, National Output. |

(1) Microeconomics is the study of particular markets, and segments of the economy. It looks at issues such as consumer behaviour, individual labour markets, and the theory of firms. On the other hand Macro economics is the study of the whole economy. It looks at 'aggregate' variables, such as aggregate demand, national output and inflation.

(2) Microeconomics deals with various issues like demand, supply, factor pricing, product pricing, economic welfare, production, consumption, etc., Macroeconomics deals with various issues like national income, distribution, employment, general price level, money, etc.
(3) Microeconomics is applied to internal issues and Macroeconomics is environmental and external issues
(4) Microeconomics useful in regulating the prices of a product alongside the prices of factors of production (labour, land, entrepreneur, capital, etc) within the economy but Macroeconomics perpetuates firmness in the broad price level and solves the major issues of the economy like deflation, inflation, rising prices (reflation), unemployment and poverty as a whole
(5) Microeconomics is based on impractical presuppositions, i.e. In microeconomics, it is presumed that there is full employment in the community which is not at all feasible. But Macroeconomics has been scrutinized that Misconception of Composition' incorporates, which sometimes fails to prove accurate because it is feasible that what is true for aggregate (comprehensive) may not be true for individuals too

INTERDEPENDENCE OF MICRO AND MACRO ECONOMICS.

Micro and macro economics are the two sides of the same coin.There is close interdependence between the two.We cannot analyse the individual behaviour without the assuming to aggregate and likewise aggregate cannot be effective unless individual variables are kept under consideration.

1.Study of economic fluctuations:-Business cycles which are universal in every sector,are influenced by both individuals and aggregate factors.Unless we review both micro and aggregate variables,we can not provide an appropriate solution to business cycles. Therefore to study trade cycles micro and macro economics contribute significantly.
2.Basis of economic laws:-Micro economics acts as a basis macro economics because macro is an aggregate of individual units.The success and accuracy of aggregates depends on the individual units.Similarly,macro theories are used by micro economists.
3.Role in international trade:-In international trade both the approaches are used.Economists have developed their theories on the basis of micro economics presuming full employment of resources and mobility of factors of production.However,modern economists looked on the economy as a whole and recognized the role of aggregates.So general equilibrium is nothing but an extension of equilibrium of micro economics.
4.Balance of payments and interdependence:-Balance of payments problem is also a burning problem for economy.An individual sector may have favorable balance of payments whereas other sectors,unfavorable balance of payments.On the other hand.the overall position of an economy is to be assessed from aggregate position of all sectors.
5.Theory of tariffs:-Many economists have propounded that modern macro approaches of imposing tariffs with the intention of correcting balance of payments position is virtually based on the theory of monopoly.So micro economics has influenced the modern macro economics theory.

# CHAPTER 2

## THEORY OF DEMAND

### DEMAND

Demand is an economic term that refers to the amount of products or services that consumers wish to purchase at any given price level. Demand is a desire for a commodity at a given price in the given time when an individual have

(1) Ability to pay and
(2) Willingness to pay

### Quantity and Quantity Demanded;

**Demand** refers to different possible quantities to be purchased at different possible prices of a commodity.

**Quantity Demanded** refers to a specific quantity to be purchased against a specific price of the commodity

### Determinants of Demand

$$D_x = \{ P_x, M, TP, Pl, T, P_r\}$$

**Price of Good – X ($P_x$):** The law of demand states that when **prices** rise, the quantity of demand falls. That also means that when prices drop, demand will grow.

**Money Income (M):** A rise in a person's income will lead to an increase in demand a fall will lead to a decrease in demand for normal goods.

**Consumer Test and Preferences (TP):** Favorable change leads to an increase in demand, unfavorable change lead to a decrease. Personality characteristics, occupation, age, advertising, and product quality, all are key factors affecting consumer behavior and, therefore, demand.

**Population (Number of Buyers) (PL):** The more buyers lead to an increase in demand; fewer buyers lead to decrease and vice versa.

**Time:** Time also affect the demand of the commodity because seasonal variation and more reasons. Demand includes the purchasing power of the consumer to acquire a given product at a given period

**Price of related goods ($P_r$):**

*a. Substitute goods* (those goods that can be used to replace each other): price of substitute and demand for the other good are directly related. *Example:* If the price of coffee rises, the demand for tea should increase.

*b. Complementary goods* (those goods that can be used together): price of complementary and demand for the other good are inversely related. *Example:* If the price of cars rises, the demand for diesel will decrease and vice versa.

Types of Demand

- *Individual Demand:* Individual Demand is that demand of different quantities of a commodity that one particular buyer in the market is ready to buy at different possible process of the commodity at a point of time.
- *Market Demand:* market Demand is that demand of different quantities of a commodity that all buyers in the market is ready to buy at different possible process of the commodity at a point of time.
- Ex-ant demand refers to the amount of goods that consumer are willing to but during a particular time period. It is the planned or desire amount of demand.
- Ex-post Demand refers to the amount of goods that consumer actually purchased during a specific period of time. It is the amount of the goods actually bought.
- Composite demand means when the commodity demanded can be put into many uses, *e.g.,* milk may be used for drinking, making tea or coffee, making curd and sweets, etc, any extension or contraction of the commodity's uses will correspondingly change the demand.

DEMAND SCHEDULE

The table relating to price and quantity demanded is called the demand schedule. Concept of demand schedule includes.

- Individual Demand Schedule
- Market Demand Schedule

*Individual Demand Schedule:* Individual Demand Schedule is a table showing different quantities of a commodity that one particular buyer in the market is ready to buy at different possible prices of the commodity at a point of time.
It is a tabular presentation of individual demand according to their prices.

*Market Demand Schedule:* Individual Demand Schedule is a tabular presentation of market demand according to their prices.
It is a table showing different quantities of a commodity that all buyers in the market is ready to buy at different possible prices of the commodity at a point of time.

Individual demand Schedule:

| Price of the Ice Cream (Rs.) | Q.D. |
|---|---|
| 1 | 4 |
| 2 | 3 |
| 3 | 2 |
| 4 | 1 |

Market Demand Schedule:

| Price of the Ice Cream (Rs.) | A’s Demand (1) | B’s Demand. (2) | Market Demand (3 = 1 + 2) |
|---|---|---|---|
| 1 | 4 | 5 | 4 + 5 = 9 |
| 2 | 3 | 4 | 3 +4 = 7 |
| 3 | 2 | 3 | 2 + 3 = 5 |
| 4 | 1 | 2 | 1 + 2 = 3 |

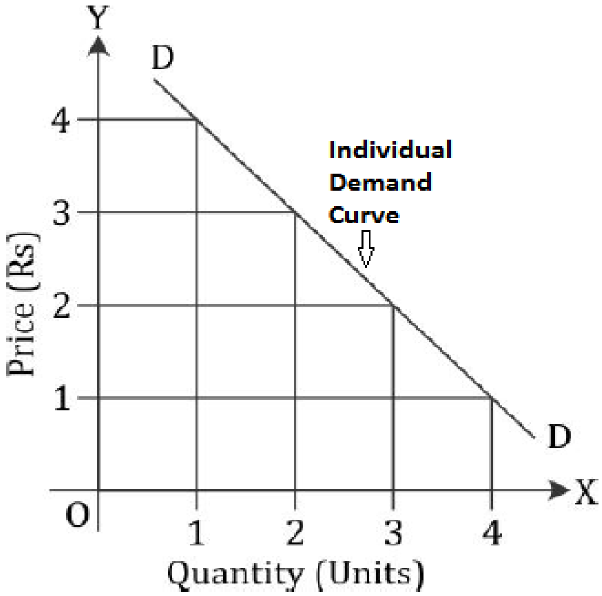
DEMAND CURVE

Demand Curve is simply a graphical presentation of the demand schedule.

(1) Individual Demand Curve

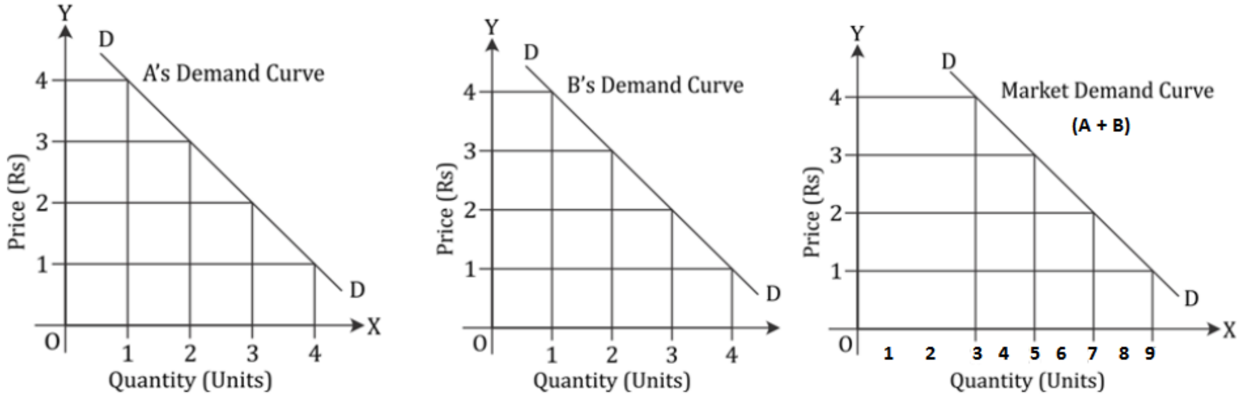
(2) Market Demand Curve

**Individual Demand Curve:** It is a graphical presentation of individual demand schedule.



*Note;* It is based on Individual Demand schedule

Market Demand Curve: It is a graphical presentation of market demand schedule. It is a horizontal summation of individual demand schedule.



*Note;* It is based on Market Demand schedule

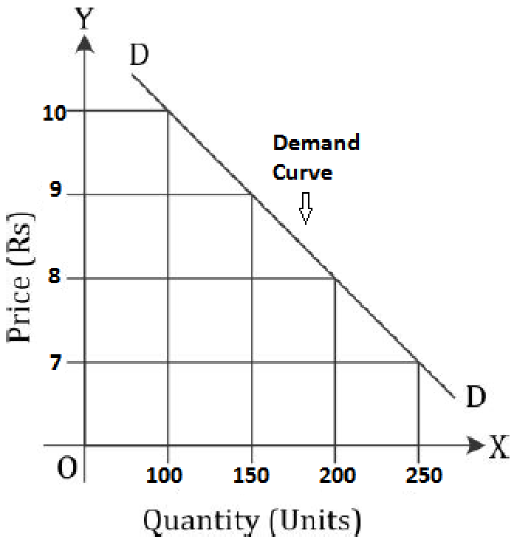
LAW OF DEMAND:

There is an inverse relationship between quantity demanded of a commodity and its own price, other things (determinants) remain constant.

Demand Schedule:

| $P_x$ (Rs) | $Q_x$ (Units) |
|---|---|
| 0 | 100 |
| 9 | 150 |
| 8 | 200 |
| 7 | 250 |

Demand Curve:

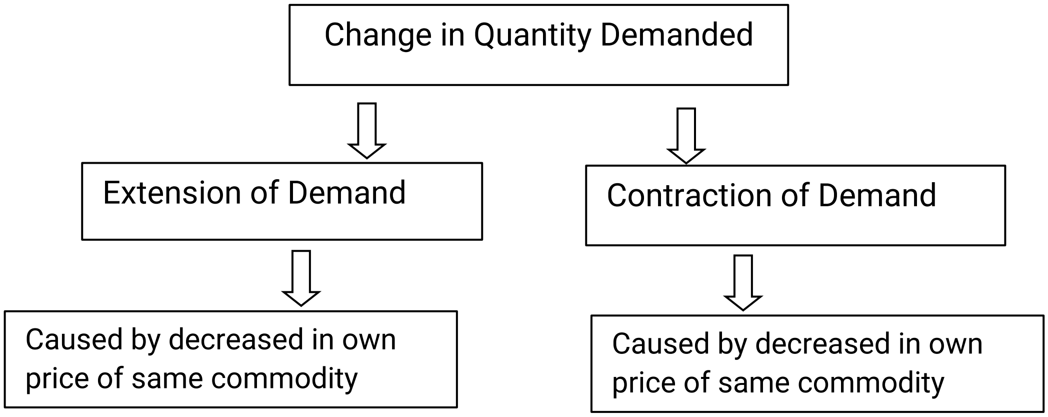


Assumptions:

- Test and preferences of the consumer remains constant.
- No change in the income of buyer.
- Price of the related goods does not change.

## MOVEMENT ALONG A DEMAND CURVE AND SHIFT IN DEMAND CURVE

- ☺ **Movement Along the Demand Curve:** It refers to extension and contraction of demand. These are caused by change in own price of the commodity.



Change in Quantity Demanded

⇩ ⇩

Extension of Demand

Contraction of Demand

⇩ ⇩

Caused by decreased in own price of same commodity

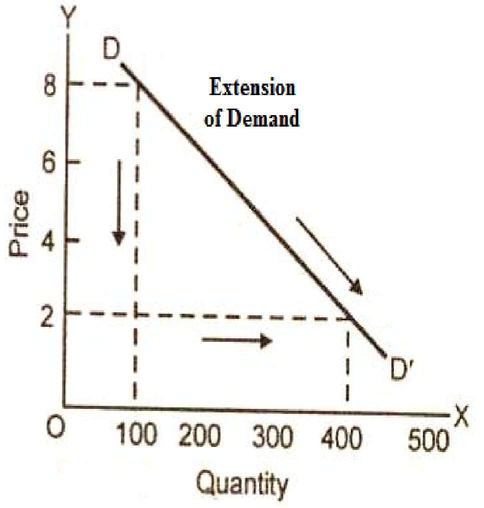
Caused by decreased in own price of same commodity

## EXTENSION OF DEMAND (MOVING DOWN THE DEMAND CURVE):

When with a fall in price, Quantity demanded of commodity raises, other things being equal. It is called Extension of Demand.

| Price (Rs.) | Quantity (Units) | Description |
|---|---|---|
| 8 | 100 | Fall in own price of the commodity<br>⇩ |
| 2 | 400 | Rise in quantity demanded |

Extension of Demand:

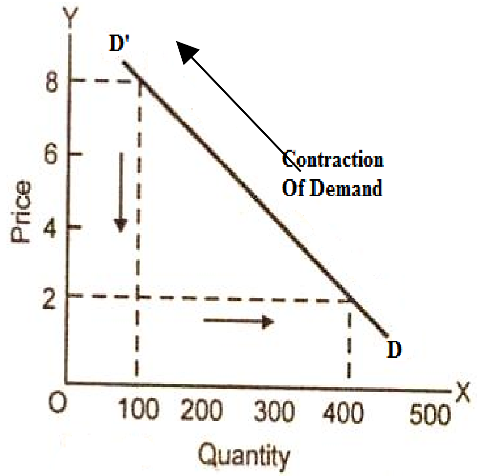


## CONTRACTION OF DEMAND (MOVING UP THE DEMAND CURVE):

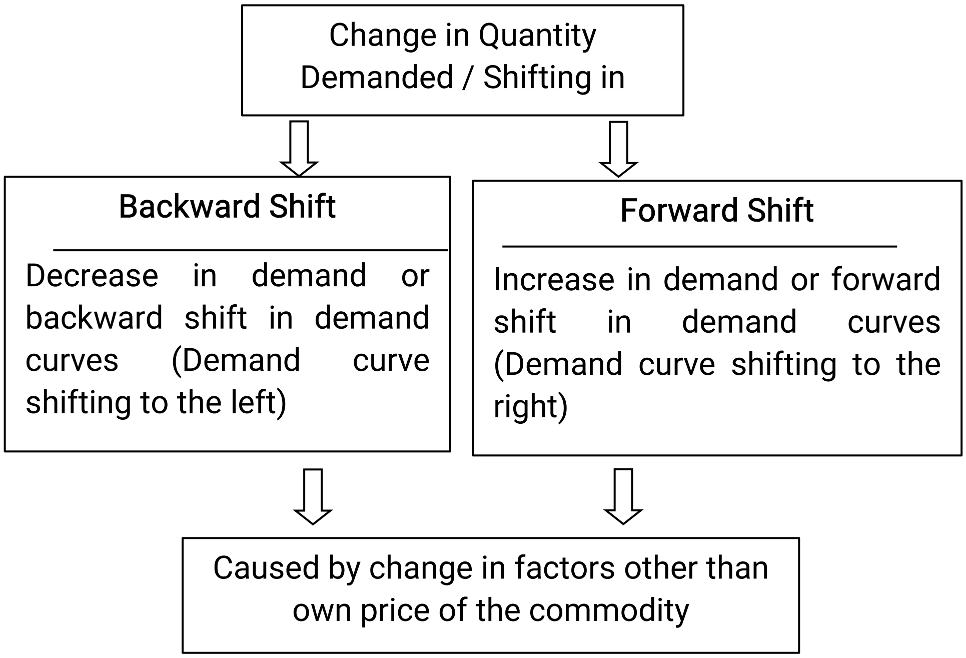
When with a rice in price, Quantity demanded of commodity decrease, other things remain same. It is called Contraction of Demand.

| Price (Rs.) | Quantity (Units) | Description |
|---|---|---|
| 2 | 400 | Rice in own price of the commodity |
| | | ⇩ |
| 8 | 100 | Fall in quantity demanded |

Contraction of Demand:



☺ **Shift in Demand Curve:** It refers to Forward and Backward shift in demand. These are caused by change in factors other than own price of the commodity.



Change in Quantity Demanded / Shifting in

**Backward Shift**

Decrease in demand or backward shift in demand curves (Demand curve shifting to the left)

**Forward Shift**

Increase in demand or forward shift in demand curves (Demand curve shifting to the right)

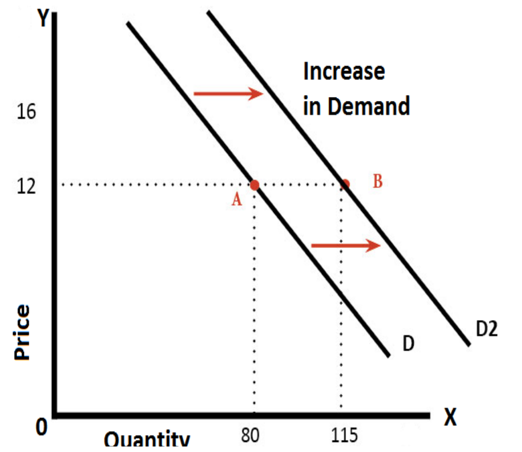
Caused by change in factors other than own price of the commodity

⇒ FORWARD SHIFT IN DEMAND CURVE – (INCREASE IN DEMAND)

It refers to a situation when quantity demanded of a commodity increase, even when own price of the quantity is constant.

| $P_x$ (Rs.) | $Q_x$ (Units) |
|---|---|
| 12 | 80 |
| 12 | 115 |

Forward Shift in Demand;



Causes of Increase in Demand:

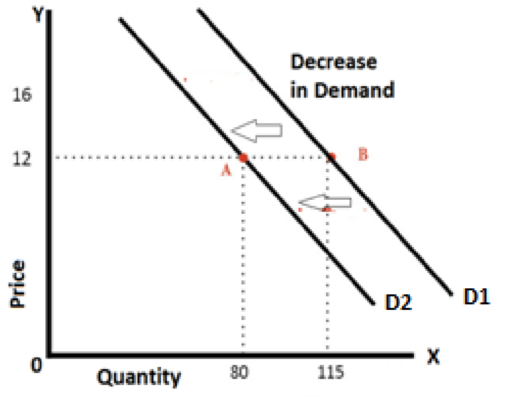
- When income of the consumer increase.
- When price of the substitute goods increase.
- When price of complementary goods falls.
- When test and preference are change due to change in fashion.

⇒ BACKWARD SHIFT IN DEMAND CURVE – (DECREASE IN DEMAND)

It refers to a situation when quantity demanded of a commodity decrease, even when own price of the quantity is constant.

Backward Shift in Demand;

| $P_x$ (Rs.) | $Q_x$ (Units) |
|---|---|
| 12 | 115 |
| 12 | 80 |



Causes of Decrease in Demand:

- When income of the consumer falls.
- When price of the substitute goods decrease.
- When price of complementary goods increase.
- When test and preference are change due to change in fashion.

REASONS FOR DOWNWARD SLOPE OF DEMAND CURVE.

(i) Law of Diminishing Marginal Utlty: Uility of a commodity is a want satisfying power of a commodity. The law of diminishing marginal utility states that when there is al continuous consumption of a commodity the additional utility derived from thei additional unit of commodity will go on decreasing thus consumers will prefer to buy larger quantity of that commodity at lower prices only.

(ii) Income Effect: with the change in the price of the commodity real income or the purchasing power of the consumer also changes due to that there will be change in thei quantity demanded of that commodity. Higher will be the price, lower will be the reall income and the quantity demanded will decrease and vice-versa.

(ii) Substitution Effect: It is the effect that the change in relative prices of substitute goods I has on quantity demanded. When there is increase in the price of a commodity keeping the price of its substitute's constant the demand for the commodity keeping the price of itsi substitute's constant the demand for the commodity decreases and if there is fall in thel price keeping the substitutes price constant the demand of the commodity increases. The sum total of income and substitution effect is known as price effect.

(iv) New Consumers: Fall in the price leads to an in crease in the quantity demanded of commodity due to increase in number of consumers of that particular commodity in the market. On the other hand, if there is increase in the price of a commodity some consumers will stop buying that commodity and then quantity demanded decreases thus i the demand curve is downward sloping.

(v) Different uses of the Commodity: The law of demand operates due to the principle of different uses. Some commodities like milk, electricity, etc. have several uses, some of which are more important than the others. When price of such a good (say, milk) increases, its uses get restricted to the most important purpose (say, drinking) and demand for less important uses (like cheese, khoya , butter etc.) gets reduced. However, i when the price of such a commodity decreases, the commodity is put to all its uses, i whether important or not.

## QUESTIONS AND ANSWERS

## (2 Marks Questions)

Q.1. What is Demand?

Ans.  Quantity of a commodity that a consumer is able and willing to purchase in a given period at a given price.

Q.2. How does demand differ form desire?

Ans. Desire is marely a wish to obtain a commodity and is not backed by the ability to pay,. Whereas demend refer to the desire which is backed by purchasing power as well as willingness to pay.

Q.3. What is meant by composite demand?

Ans. Composite demand means when the commodity demanded can be put into many uses, *e.g.,* milk may be used for drinking, making tea or coffee, making curd and sweets, etc, any extension or contraction of the commodity's uses will correspondingly change the demand.

Q.4. What are the normal goods, inferior goods, substitution goods, giffen goods, complementary goods?

Ans. NORMAL GOOD:- A normal good is one whose demand increase with increase in income.

INFERIOR GOOD:- An inferior good is one, the demand for which tends to fall with an increasein the income of the consumer.

GIFFEN GOODS:- Giffen goods are those inferior goods on which the consumer spend a large part of income. Their demand falls with fall in theit prices.

SUBSTITUTE GOODS:- Substitute goods are those goods which can be used in place of each other for the satisfaction of same type of wants. For example tea and coffee.

COMPLEMENTARY GOODS:- Complementary goods refer those goods which are jointly used to satisfy a particular want. For example pen and ink.

Q.5. What is Demand Function?

Ans. DEMAND FUNCTION:- Functional relationship between demand and it's determinants is known as demand function.

$$Dx. = f\,(px,\ pr,\ y,\ ..........n)$$

Q.6. What do you mean by demand schedule and demand curve?

Ans. DEMAND SCHEDULE:- It is a tabular presentation which shows the relationship between price of the commodity and quantity purchased.

DEMAND CURVE:- It is a graphical presentation which shows the relationship between price of the commodity and quantity purchased.

Q.7. Define ex-ante and ex-post demand.

Ans. Ex-ant demand refers to the amount of goods that consumer are willing to but during a particular time period. It is the planned or desire amount of demand.

Ex-post Demand refers to the amount of goods that consumer actually purchased during a specific period of time. It is the amount of the goods actually bought.

## (3 - 4 Marks Questions)

Q.1. Give the factors responsible for the rightward shift of the demand curve?

Ans. Demand curve shifts towards right because of:

Increase in the price of substitute goods.

Decrease in price of complementary goods

Increase in income

Increase in population

Taste in favour of the commodity

Expectation of the future increase in price.

Q.2. Give the factors responsible for the leftward shift of the demand curve.

Ans. Factors responsible for the leftward shift of the demand curve:

Fall in the income of the consumer.

Fall on the price of the substitute goods

Rise in the price of complementary goods.

Unfavorable Change in the taste and preference of the consumer.

Q.3. Give the assumptions of the law of demand.

Ans. While stating the law of demand, we use the phrase 'keeping other factors constant or ceteris paribus'. The phrase is used the following assumption on which the law of demand is based:

Price of substitute goods do not change.

Price of complementary goods remains constant.

Income of the consumer reamins constant.

Tests and preference of the consumer remains the same.