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**1.1**

**Economics as a Science of Wealth/Classical View:**

**Definition of Economics By Adam Smith:**

There is no one definition of ***Economics*** which has a general acceptance. The formal roots of the scientific framework of economics can be traced back to classical economists. The pioneers of the science of economics defined economics as the science of wealth.

**Adam Smith** (1723 -1790), the founder of economics, described it as a body of knowledge which relates to wealth. Accordingly to him if a nation has larger amount of wealth, it can help in achieving its betterment. He defined economics as:

“The study of nature and causes of generating of wealth of a nation”.

Adam Smith in his famous book, *“An Enquiry into the Nature and Causes of the Wealth of Nations”* emphasized the production and expansion of wealth as the subject matter of economics.

**Ricardo**, another British classical economist shifted the emphasis from production of wealth to the distribution of wealth in the study of economics.

**J.B. Say,** a French classical economist, described economics as:

“The science which treats of wealth”.

**J.S. Mill** in the middle of 19th century looked upon economics isas:

"Practical science of production and distribution of wealth”.

According to **Malthus**:

“Man is motivated by self Interest only. The desire to collect wealth never leaves him till he goes into the grave”.

The main points of the definitions of *economics* given by the above classical economists are that:

(i) Economics is the study of wealth only. It deals with consumption, production, exchange and distribution aspects of wealth.

(ii) Only those commodities which are scarce are Included In wealth. Non-material goods such as air, services etc., are excluded from the category of wealth.

**Criticism on the Classical Definition of Economics:**

The definitions given by Adam Smith and other classical economists were severely criticized by social reformers and men of letters of that time Ruskin and Carlyle. They dubbed economics as a ‘dismal science’ and a 'science of getting rich'. The main criticisms on these definitions are as under:

**(i) Too much importance to wealth:** The definitions of economics give primary importance to wealth and secondary importance to man. The fact is that the study of man is more importance than the study of wealth.

**(ii) Narrow meaning of wealth:** The word ‘wealth’ in the classical economist’s definitions of economics means only material goods such as chair, book, pen, etc. These do not include services of doctors, nurses, soldiers etc. In modern economics, the word ‘wealth’ includes material as well as non-material goods.

**(iii) Concept of economic man:** According to wealth definitions, man works only for his self-interest Social interest is ignored. Dr. Marshall and his followers were of the view that economics does not study a selfish man but a common man.

**(iv) No mention of man’s welfare:** The 'Wealth' definitions ignore the importance of man’s welfare. Wealth is not be all and the end all of all human activities.

**(v) It does not study means:** The definitions of economics lay emphasis on the earning of wealth as an end in itself. They ignore the means which are scare for the earning of wealth.

**(vi) Defective logic:** The definitions economics given by classical economists were unduly criticized by the literacy writers of that time. The fact is that what Adam Smith wrote in his book ‘Wealth of Nations' (1776*)*still holds well. The central argument of the book that market economy enables every individual to contribute his maximum to the production of wealth of nation still not only holds good but is also being practiced and advocated throughout the capitalistic world. Since the word 'wealth' did not have clear meaning, therefore the definitioneconomics became controversial. It was regarded unscientific and narrow. At the end of 19th century, Dr. Alfred Marshall gave his own definition of economics and therein he laid emphasis on man and his welfare.

# 1.2

# Economics as a Science of Material Welfare/Neo-Classical View:

## Marshall’s Definition of Economics:

The neo-classical school led by **Dr. Alfred Marshall** gave economics a respectable place among social sciences. He was the first economist who lifted economics from the bad repute it had fallen. Dr. Alfred Marshall (1842 - 1924) in his book, *'Principles of Economics'* defined Economics as:

“Study of mankind in the ordinary business of life; it examines that part of individual and social actions which is closely connected with the attainment and with the use of material requisites of well being”.

This definition clearly states that Economics is on the one side a study of wealth and on the other and more important side a part of the study of man. Marshall’s followers like **Pigou**, **Cannon** and **Baveridge** (the Neo-classical writers) have also defined Economics as:

“Study of causes of material welfare”.

For example, according to Cannon, the aim of Political Economy is the explanation of the general cause’s which the material welfare of the human being depends.

## Characteristics:

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The definitions given by Welfare School of Economists have the following main **features of Economics as Material Welfare:**

**(i) Wealth is not the be all and the end all of human activities:** Economics does not regard wealth as the be all and the end all of the human activities. It is only a mean to the fulfillment of an end which is human welfare. Welfare and not wealth is; therefore, of primary importance to man.

**(ii)** **Study of an ordinary man:** Economics is a study of an ordinary man who lives in free society. A person who is cut away from the society is not the subject of study of Economics.

**(iii) It does not study all activities of man:** Economics does not study all the activities of man. It is concerned with those actions which can be brought directly or indirectly with the measuring rod of money.

**(iv) Study of material welfare:** Economics is concerned with the ways in which man applies his knowledge, skill to the gifts of Nature for the satisfaction of his material welfare.

For a long time, the definition of Economics given by Alfred Marshall was generally accepted. It enlarged the scope of economics by taking emphasis that its studies wealth and man rather than wealth alone.

However, Marshall’s definition was criticized by **Lionel Robbins**. He in his book “Essay on the Nature and Significance of Economic Science” gave a critical review of the welfare definitions of economics. These criticisms are summed as under:

## Robbins's Criticism:

**(i) Narrows down the scope of economics:** According to Robbins, the use of the word “Material” in the definition of Economics considerably narrows down the scope of Economics. There are many things in the world which are not material but they are very useful for promoting human welfare. For example, the services of doctors, lawyers, teachers, dancers, engineers, professors, etc., satisfy our wants and are scarce in supply. If we exclude these services and include only material goods, then the sphere of economics study will be very much restricted.

**(ii) Relation between economics and welfare:** The second objection raised by Robbins on welfare definition is on the establishment of relation between Economics and Welfare. According to him, there are many activities which do not promote human welfare, but they are regarded economic activities, e.g., the manufacturing and sale of alcohol goods or opium, etc. Here Robbins says, “Why talk pf welfare at all? Why not throw away the mask altogether”?

**(iii) Welfare is a vague concept:** The third objection levied by him was on the concept of ‘welfare’. In his opinion welfare is a vague concept. It is purely subjective. It varies from man to man, from place to place and from age to age. Moreover, he says what is the use of a concept which cannot be quantitatively measured and on which two persons cannot agree as to what is conducive to welfare and what is not. For example, the manufacturing and sale of guns, tanks and other war heads, production of opium, liquor etc., are not conducive to welfare but these are all economic activities. Hence, these cannot be excluded from the study of economics.

**(iv) Impractical:** The definition of welfare is of theoretical nature. It is not possible in practice to divide man’s activities into material and non-material.

**(v) It involves value judgment:** Finally, the word ‘Welfare' in the definition involves value judgment and the economists according to Robbins, are forbidden to pass any verdict.

# 1.3

# Economics as a Science of Scarcity and Choice:

## Robbins Definition of Economics:

Marshall’s definition of economics remained an article of faith with all economists from 1830 to 1932. However, with the publication of **Robbins**book *'Nature and Significance of Economic Science'* (1932), there developed a fresh controversy in regard to the definition of economics. Lionel Robbins, after criticizing the definitions given by the Classical and Neo-classical economists, gave his own definition of Economics. According to him:

**Firstly,** the definition of Economics given by him is superior to that of others because it does not contain any reference of the term material or welfare. **Secondly,** it applies as much to the case of an isolated individual as to the complicated net working of society. **Thirdly,** it raises the status of Economics to that of Science. **Fourthly,** it makes Economics a positive science which deals only with facts, It forbids the economists to pass any value judgment of what is good or bad, right or wrong, etc.

**Lionel Robbins** claiming his definition Economics precise, scientific and superior, defines Economics book ‘*Nature and Significance of Economics Science*' (Published in 1932):

"A science which studies human behavior as a relationship between ends and scarce means which have alternative uses".

This definition is based on the following five pillars:

## Main Pillars of Robbins's Definition:

**(i) The Human wants or ends are unlimited but one want at a time can be fulfilled:** Human wants referred to as ends by Robbins are unlimited. They increase in quantity and quality over a period of time. They vary among individuals and overtime for the same individual. It is not possible to find a person who will say that his wants for goods and services have been completely satisfied. This is because of the fact that when one want is satisfied, it is replaced by another and there is then no end to it.

**(ii) The ends or wants vary in importance:** The ends or wants are of varying importance. They are ranked in order of importance as: (a) necessaries (b) comforts and (c) luxuries. Man generally satisfies his urgent wants first and less urgent afterwards in order of their importance.

**(iii) Scarcity of resources:** Resources are the inputs used in the production of things which we need. The resources (Land, labor, capital and entrepreneurship) at the disposal of man are scarce. They are not found in as much quantity as we need them. Scarcity means that we do not and cannot have enough income or wealth to satisfy our every desire. Scarcity exists because human wants always exceed what can be produced with limited resources and time that Nature makes available to man at any one time. Scarcity is a fact of life. It occurs among the poor and among the rich. The richest person on earth faces scarcity because he too cannot satisfy all his wants with the limited time available to him.

**(iv) Economic resources have alternative uses but one resource can be used in a single use at a particular time:** The fourth important proposition of Robbins definition is that the scarce resources available to satisfy human wants have alternative uses. They can be put to one use at one time. For instance, if a piece of land is used for the production of sugarcane, it cannot be utilized for the growth of another crop at the same time. Man, therefore, has to choose the best way of utilizing the scarce resources which have alternative uses. The scarcity resources and choices are the key problems confronting every society.

**(v) Economic Problem**

**According to Robbins:** the unlimited ends and the scarce resources provide a foundation to the field of Economics. Since the human wants are innumerable and the means to satisfy them are scarce or limited in supply, therefore, an economic problem arises. If all the things were freely available to satisfy the unlimited human wants, there would not have arisen any scarcity, hence no economic goods, no need to economic and no economic problem. Scarcity, thus, can be defined as the excess of human wants over what can be actually produced in the economy.

The choices to be made by it are:

* What goods shall be produced and in what quantity?
* How should the various goods and services be produced?
* How should the goods and services be distributed?

**Summing up** the foundation of economic science according to Robbins, is based on satisfaction of human wants with scare resources which have alternative uses.

## Merits of Robbins's Definition of Economics:

There are many admirers of Robbins definition. It has the following merits:

**(i) Status of a positive science:**Robbins tries to make economics a more exact science. According to him, economics has nothing to do with ends. They may be noble or ignoble, material or non-material. Economics is not concerned with them as such.

**(ii) An analytical definition:** Robbins definition makes study of economics analytical. It studies the particular aspect of human behavior which is imposed by the influence of scarcity.

**(iii) A universal definition:** Robbins definition is applicable everywhere. It is concerned with unlimited wants and limited resources which is the problem facing every economy socialistic or capitalistic.

**(iv) Clear on the nature and scope of economics:** Robbins definition serves to specify the nature, scope and subject matter of economics. According to him, an economic problem is characterized by the possibility of exercising choice between ends an which have alternative uses.

**(v) Valuation is the central problem:** According to Robbins, valuation is the central problem of economics. Wherever the ends are unlimited and the resources scare, they give rise to an economic problem Marshall’s definition does not identity this valuation process.

## Criticism on Robbins Definition of Economics or Demerits:

Robbins definition of economics has been bitterly criticized by eminent writers Hicks, Longe, Durbin, Frazer, etc., on the following grounds:

**(i) Reduced economics merely to a theory of value:** Robbins’s definition restricts the scope of economics by treating it as a positive Science only while in reality it is both a positive and a normative science.

**(ii) Scope of economic has been widened:** Robbins’s definition has widened the scope of economics by covering the whole of economic life, while it is concerned with that part of human life which is connected with the market price.

**(iii) Economics has become a colorless science:** Robbins’s made economics colorless, impersonal and abstract. It is in fact a definition of economics for economist only.

**(iv) Study of economic growth:** The study of economic growth process remains outside the scope of economics while it is through economic growth that living standards improve.

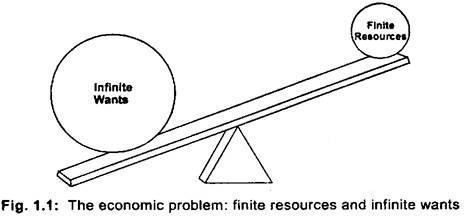
**Summing up:** The definition of economics given by Robbins has doubt certain flaws. However, it is more comprehensive in describing the problem of resource utilization.

# 1.3.1 Economics Problems:

[Economic](http://www.economicsconcepts.com/economics_as_a_science_of_growth_and_efficiency.htm) problem of mankind owes its origin to the fact that human wants are numerous and of different kinds. The resources to satisfy the multifarious human wants are limited or scarce.

## Diagram/Figure:

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If the time or resources at our disposal are unlimited so that we could satisfy all our wants, then no economic problem would have arisen at all. Or If we had Aladdin’s lamp with us so that we could satisfy all our wants by rubbing it, then there would have been no economic problem. The economic problem has arisen simply because as one want is satisfied, another want appears on the scene. We can liken this to a see-saw with on one hand the finite or limited resources and on the other hand the unlimited or infinite wants.

As wants are unlimited and the means to satisfy them limited, therefore, in order to get maximum satisfaction we are to choose our wards by fixing up a list of priority. So the two foundation stones on which the subject of Economics rests are:

(1) Multiplicity of human wants.

(2) Scarcity of resources. This scarcity of means or resources creates two kinds of problems. One is the allocation of resources to the best use so that the maximum satisfaction is achieved. This can only be done if we arrange our wants in a scale of preferences. Ordinarily, necessaries are satisfied first, comforts are next and luxuries at the end.

The second problem is to eliminate waste. If in a country the resources are not fully utilized and they are lying idle, this will mean the maximum satisfaction is not being derived from the limited available resources and being wasted for nothing.

The resources are not only scared but have alternative uses. So a decided has to be made between them. The decision to make choices between alternative uses has to be made by all of us. Even the richest nation has distributed its resources in such a manner so as to be able to source maximum satisfaction with minimum cost.

## Importance of Economics:

Every economy has to solve the following five inter related problems:

(1) What goods to be produce?

(2) How to produce?

(3) How to distribute income?

(4) How to ensure growth?

(5) Flow to ration the limited supplies?

These problems are now discussed in brief:

**(i) What goods to be produce?** The first function of the society is to decide which goods are to be produced and in how much quantity. Since the resources at the disposal of the society are scarce, it has to make a choice between “guns or butter”, or a choice between necessities and luxuries. The decision about the allocation of resources between consumer goods and capital goods; their quality and quantity is of utmost importance from the point of view of economic growth.

**(ii) How to produce?** There are various alternative methods or techniques of producing goods. The society has to choose the least cost combination of producing the goods. For instance, cloth can be produced with either handlooms (labor intensive technique) or power looms (capital intensive technique). The society, depending upon its resources and the state of technology available toit should usethe most efficient method of production.

**(iii) How to distribute the national income?** The distribution of national income among the members of the community is a burning issue both in the field of economics and politics. The socialists are of the view that all the people should get fair share by redistribution of national income. The other view is that, in a free enterprise economy, each individual should get his share from the total output of goods according to the income available to him through his genuine efforts.

**(iv) How to ensure growth?** The economic growth can be attained by (a) increasing the rate of investment (b) replacement of capital goods and (c) by improving the technical processes of production, A society, therefore, shall have to take timely decisions for allocating scarce resources for investment, replacement and technological progress. In case a part of the resources are not diverted for capital accumulation and technological progress, the rate of growth will go down. The standard of living of the people will fall.

We, thus, conclude that economic problem arises because of scarcity of resources that people want for the satisfaction of goods. The scarcity of resources involves the problems of choice or allocation of resources among the competing ends. Economics, in short, is a science of efficiency in the use of scarce resources.

# 1.4

# Economics as a Science of Growth and Efficiency:

If we define Economics as a science of administration of scare resources, then its scope becomes too wide and includes the whole of economics life and not merely that part of it which is connected with the market price.

## Latest/Modern Definition of Economics:

The modern economist’s define economics as:

"A science of growth and efficiency".

According to **Samuelson:**

"Economics is the study of how people and society end up closing, with or without the use of money, to employ scarce productive resources that could have alternative uses, to produce various commodities and distribute them for consumption now or in the future among various persons and groups in society".

It analyses the cost and benefits of improving patterns of resource allocation.

In the words of**C.R. McConnell:**

“Economics can be defined as a science of efficiency in the use of resources so as to attain the greatest or maximum fulfillment of society’s unlimited wants. Efficiency here implies technical efficiency and economic efficiency in the use of scarce resources for producing a given level of output. The term efficiency also relates to the efficiency of whole economics system. If one section of the society is made better off without making the other section worse off, we can say the economic system is operating efficiently".

After considering the various definitions, ***Economics***can be defined as:

**“A social science which is concerned with the proper use and allocation of resources for the achievement and maintenance of growth with stability and efficiency”.**

# 1.5

# Is Economics Neutral Between Ends:

In economics the term **‘*ends*’** means the goals which a man wishes to achieve in the economic aspects of his life. The **‘*means*’** are the sources which are used to achieve the ends. For example, the ends or goals of the people are to achieve a rising standard of living, to protect themselves through social security schemes when they are out of job etc. The question whether [economics](http://www.economicsconcepts.com/economics_as_a_science_of_growth_and_efficiency.htm) is concerned with means or ends or with both has remained under debate. We, briefly, discuss the views of the economists in this regard.

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## Views of Classical Economists:

There is a difference of opinion among economists regarding the neutrality of Economics. The controversial point is whether Economics is concerned with the means or with the ends or with both. The classical economists are of the views that:

"Economics is purely a science".

According to them, the main function of an economist is to study the causes and effects of an economic phenomenon. They are also of the opinion that Economics is concerned with means and the study of ends lies outside its scope.

For example, **Cairnes** considered that:

“Political Economy stood neutral as regards ends, as mechanics stand neutral between rival schemes of railway construction”.

***Senior***, speaking on the nature of the economic conclusions says:

“Whatever be their generality and their truth, they do not authorize man in adding a single syllable of advice”.

Thus we find that according to classical economists Economics is not concerned at all with the value judgments or ends. The ends may be moral or immoral social or anti-social, Wise or foolish, good or bad, the economist has no direct concern with them. For example, if the government cuts taxes, imports will rise. The policy of increasing government expenditure will reduce unemployment and raise inflation etc., are positive statements. These are positive statements and can be checked against the evidence and proved correct or incorrect. The economists as scientists cannot pass value judgments and say that taxes should be reduced to increase imports.

## 

## Neo-classical View:

The above mentioned traditional of describing Economics as neutral science was opposed by Neo-classical economists. They introduced the concept of “welfare” in the study of Economics. According to them, Economics is a social science and has also a normative aspect. It studies manes activities in relation to wealth which he tries to produce in order to promote his welfare.

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## Lionel Robbins’s View:

Lionel Robbins has upheld the view of the classical economists. He is not in favor of including welfare considerations in the study of Economics as welfare is purely subjective in character and cannot to exactly measure. Moreover, human welfare does not simply depend upon material goods, also depends upon services as well. There are certain activities which are not conductive tohuman welfare such as manufacture and sale of wine but they are regarded economic activities because the economist cannot arrogate to himself the role of a moralist.

Robbins is, therefore, of the view that the interpretation subjective things admitted to scientific discussions. He believes that Economics is concerned merely with the utilization of scarce means far the satisfaction of multiple ends. As our ends are unlimited and the means to satisfy them are limited, therefore a problem of choice arises for selecting the uses to which the scarce resources can be effectively applied.

According to him, the duty of the economist is to study the use of the means for the realization of particular ends. As regard the ends, he has nothing to do with them. They may be noble or ignoble. Economics entirely neutral between them **J.M. Keynes** has also supported Robbins’s view. He says:

“The theory of Economics does not furnish a body of settled conclusions immediately applicable to policy. It is a method other than doctrine, apparatus of mind and technique of thinking which helps its possessor to draw correct conclusion”.

In short, according to **Keynes** also, Economics is a pure science.

Though many economists right from Classical School to **J.M. Keynes** have described economics a neutral science but the fact is that none of them have been able to adopt the neutral attitude of mere scientist. Robbing, chief exponent of the view could not retrain attacking the Government planning. He advised the Government to adopt *l****aissez-faire policy***. J.M. Keynes who is often charged as a depression economist, has birds suggested many measures to counteract cyclical fluctuations.

It is now increasingly recognized among economists that economics is not merely a pure simple science but has an applied aspect too. **Friedman** has also emphasized the fact that not concerned with theeconomic problems in the abstract. It studies how a particular society its economic problems.

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## Conclusion:

We may, therefore, conclude that Economic deal with means as well as with ends If we exclude ends from the study of Economics, then there will be no use of studying “Economic”.

For example, if a low paid person worried about the fast increasing prices of commodities comes to an economist to know its causes and he (economist) being The follower of Robbins simply discusses the causes of inflation in the country and refuses to discuss with him its consequences and suggesting remedies; naturally the poor man will not be satisfied and he will be too much disgusted with the subject of Economics. He will rather hate it. **Frazer** is right when he says that “an economist who is only an economist is a poor pretty fish”. The modern economists being more realistic also include the normative aspect in the study of Economics.

# 2. Scope of Economics:

The ***scope of economics*** is the area or boundary of the study of [economics](http://www.economicsconcepts.com/economics_as_a_science_of_growth_and_efficiency.htm). In scope of economics we answer and analyze the following three main questions:

(i) What is the subject matter of economics?

(ii) What is the nature of economics?

(iii) What are the limitations of economics?

### (i) Subject Matter of Economics:

There is a difference of opinion among economists regarding the subject-matter of economics. **Adam Smith**, the father of modern economic theory, defined economics as a subject, which is mainly concerned with the study of nature and causes of generation of wealth of nation.

**Marshall** introduced the concept of welfare in the study of economics. According to Marshall; economics is a study of mankind in the ordinary business of life. It examines that part of individual and social actions which is closely connected with the material requisites of well being. In this definition, Marshall has shifted the emphasis from wealth to man. He gives primary importance to man and secondary importance to wealth.

The**Robbinsian’s** concept of the subject-matter of economics is that:“economics is a science which studies human behavior as a relationship between ends and scarce means which have alternative uses”**.** According to Robbins (a) human wants are unlimited (b) means at his disposal to satisfy these wants are not only limited, (c) but have alternative uses. Man is always busy in adjusting his limited resources for the satisfaction of unlimited ends. The problems that centre round such activities constitute the subject-matters of economics.

**Paul and Samuelson,**however, includes the dynamic aspects of economics in the subject matter. According to them, "economics is the study of how man and society choose with or without money, to employ productive uses to produce various commodities over time and distribute them for consumption now and in future among various people and groups of society”.

### (ii) Nature of Economics:

The economists are also divided regarding the nature of economics. The following questions are generally covered in the nature of economics.

(a) Is economics a science or an art?

(b) Is it a positive science or a normative science?

### (iii) Economics As a Science or An Art:

Economics is both a science and an art. Economics is considered as a science because it is a systematic knowledge derived from observation, study and experimentation. However, the degree of perfection of economics laws is less compared with the laws of pure sciences.

An art is the practical application of knowledge for achieving definite ends. A science teaches us to know a phenomenon and an art teaches us to do a thing. For example, there is inflation in Pakistan. This information is derived from positive science. The government takes certain fiscal and monetary measures to bring down the general level of prices in the country. The study of these fiscal and monetary measures to bring down inflation makes the subject of economics as an art.

After arriving at a conclusion that economics is both a science as well as an art. Here arises another controversy. Is economics a positive science or a normative science?

### (iv) Economics is Positive or Normative Science:

There again difference of opinions among economists whether economics is a positive or normative science. Lionel Robbins, Senior and Friedman have described economics as a positive science. They opined that economics is based on logic. It is a value theory only. It is, therefore, [neutral between ends](http://www.economicsconcepts.com/is_economics_neutral_between_ends.htm).

Marshall, Pigou, Hawtrey, Keynes and many other economists regard economics as a normative science. According to them, the real function of the science is to increase the well-being of man. They have given suggestions in their works for promotion of human welfare.

For example, Malthus has given suggestions of checking the rising population. M. Keynes has suggested measures to remove unemployment.

We agree with Mr. Frazer, that an economist who is only an economist is a poor pretty fish. An economist must come forward to give advice to the problems facing the human being like depression, unemployment, high prices, etc.,for increasing his welfare.

Economics, to conclude, has both theoretical as well as practical side. In other words, it is both a positive and a normative science.

# 3. Micro and Macro Analysis:

In recent years, the subject matter of economics is divided into two broad areas. One of them is called ***Microeconomics*** and the other is called ***Macroeconomics***. These two terms microeconomics and macroeconomics were first coined and used by ***Ranger Frisco*** in 1933. In recent years, division of economic theory into two separate parts has gained much importance.

## Distinction/Difference Between Micro and Macro Economics:

The ***distinction/difference between Micro economics and Macroeconomics*** is made clear below:

## (1) Microeconomics:

### Definition:

***Microeconomics*** is a Greek word which means small.

"Microeconomics is the study of specific individual units; particular firms, particular households, individual prices, wages, individual industries particular commodities. The microeconomic theory or price theory thus is the study of individual parts of the economy".

It is economic theory in a microscope. For instance, in microeconomic analysis we study the demand of an individual consumer for a good and from there we go to derive the market demand for a good (that is demand of a group of individuals for a good). Similarly, in microeconomic theory we study the behavior of individual firms the fixation of prices output. In the words of**Samuelson:**

“Microeconomics we examine among other things how individual prices are set, consider what determines the price of land and capital and enquire into the strength and weaknesses of market mechanics”.

In the words of **Leftwitch**:

“Microeconomic theory or price theory deals with the economic behavior of individual decision making units such as consumers, resources owners, business firms as well as individuals who are too small to have an impact on the national economy".

### Explanation:

**(i) Microeconomics and allocation of resources.** The microeconomic theory takes the total quantity of resources as given. It seeks to explain how they are allocated to the production of goods. The allocation of resources to the production of goods depends upon the price of various goods and the prices of factors of production. Microeconomics analyses how the relative prices of goods and factors are determined. Thus the theory of product pricing and the theory of factor pricing (rent wages, interest and profit) fall within the domain of micro economics.

**(ii) Micro economics and economic efficiency.** The microeconomic theory seeks to explain whether the problems of scarcity and allocation of resources so determined are efficient. Economic efficiency involves (a) efficiency in consumption (b) efficiency in production and distribution and (c) over all economic efficiency. The price theory shows under hat conditions these efficiencies are achieved.

### Importance:

Before Keynesian revolution, the body of economics mainly consisted of micro economics. The classical economics as well as the neo-classical  
economics belonged to the domain of micro economics.

The importance and uses of micro economics in brief are as under.

**(i) Helpful in understanding the working of private enterprise economy.** The micro economics helps us to understand the working of free market economy. It tells us as to how the prices of the products and the factors of production are determined.

**(ii) Helps in knowing the conditions of efficiency.** Micro economics help in explaining the conditions of efficiency in consumption, production and in distribution of the rewards of factors of production.

**(iii) Working economy without central control.**The micro economics reveals how a free enterprise economy functions without any central control.

**(iv) Study of welfare economy.** Micro economic involves the study of welfare economics.

### Limitations:

Microeconomics despite its many advantages is not free from limitations. They in brief are:

(i) Assumption of full employment in the economy which is unrealistic.

(ii) Assumption of liaises fair policy which is no longer in practice in any country of the world.

(iii) It studies part of the economy and not the whole.

**Summing up,** microeconomics is the study of the decisions people and businesses and the interaction of those decisions in the market. It analyses the ‘trees’ of the economy as distinct from the ‘forest’.

## (2) Macroeconomics:

### Definition:

The term macro is derived fromthe Greek word ‘***uakpo***’ which means large. Macroeconomics, the other half of economics, is the study of the behavior of the economy as a whole. In other words:

"***Macroeconomics*** deals with total or big aggregates such as national income, output and employment, total consumption, aggregate saving and aggregate investment and the general level of prices". In the words of***Boulding*:**

“Macroeconomics deals not with individual quantities as such but with aggregates of these quantities, not with individual i.e., but with the national Income, not with individual prices but with the price level, not with Individual outputs but with the national output. It studies determination of national output and its growth overtime. It also studies the problems of recession, unemployment inflation, the balance of international payments and the policies adopted by the governments to deal with these problems".

### Explanation:

The main issues which are addressed in macro economics are in brief as under:

**(i) It helps understanding determination of income and employment.** Late J.M. Keynes laid great stress on macro-economic analysis. In his revolutionary book, “General Theory, Employment interest and Money" brought drastic changes in economic thinking. He explained the forces or factors which determine the level of aggregate employment and output in the economy.

**(ii) Determination of general level of prices.** Macro economic analysis answers questions as to how the general price level is determined and what is the importance of various factors which influence general price level.

**(iii) Economic growth.** The macro-economic models help us to formulate economic policies for achieving long run economic growth with stability. The new developed growth theories explain the causes of poverty in under developed countries and suggest remedies to overcome them.

**(iv) Macro economics and business cycles.**It is in terms of macroeconomics that causes of fluctuations in the national income are analyzed. It has also been possible now to formulate policies for controlling business cycles i.e. inflation and deflation.

**(v) International trade.** Another important subject of macro-economics is to analyze the various aspects of international trade in goods, services and balance of payment problems, the effect of exchange rate on balance of payment etc.

**(vi) Income shares from the national income.** Mr. M. Kalecki and Nicholas Kelder, by making departure from Ricarde theory, have presented a macro theory of distribution of income. According to these economists, therelative shares of wages and profits depend upon the ratio of investment to national income.

**(vii) Unemployment.** Another macro economic issue is to explain the causes of unemployment in the economy. Stagflation is another important issue of modern, economics. The Keynesian and post Keynesian economists are putting lot of efforts in explaining the causes of cyclical unemployment and high unemployment coupled with inflation and suggesting remedies to counteract them.

**(viii) Macro Economic Policies.** Fiscal and monetary policies affect the performance of the economy. These two major types’ policies are central in macro economic analysis of the economy.

**(ix) Global Economic System.** In macro economic analysis, it is emphasized that a nation’s economy is a part of a global economic system. A good or weak performance of a nation’s economy can affect the performance of the world economy as a whole.

### Limitations:

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The main limitations of macro economics are as follows:

(i) The macro economies ignore the welfare of the individual. For instance, if national saving is increased at the cost of individual welfare, it is not considered a wise policy.

(ii) The macro economics analysis regards aggregates as homogeneous but does not look into its internal composition. For instance, if the wages of the clerks fall and the wages of the teachers rise, the average wage may remain the same.

(iii) It is not necessary that all aggregate variables are important. For instance, national income is the total of individual incomes. If national income in the country goes up, it is not necessary that the income of all the individuals in the country will also rise. There is a possibility that the rise in national income may be due to the increase in the incomes of a few rich families of the country.

## Interdependence of Micro and Macro Economics:

The classical approach to macro economics is that individuals and firms act in their own best interest. The wages and prices adjust quickly to achieve equilibrium in the free market economy.

The Keynesian approach to macro economics is that wages and prices do not adjust rapidly and unemployment mayremain high for a long time. The Keynesians are of the view that government intervention in the economy can help in improving economic performance.  
  
**Conclusion:**

The ***micro and macro economics are interdependent***. They are complementary and not conflicting. We cannot put them in water tight compartments. Both these approaches help us in analyzing the working of the economy. If we study one approach and neglect the other, we are considered to be only half educated.

We should integrate the two approaches for the successful analysis of the working of economic system. The macro approach should be applied where aggregate entities are involved and micro approach when individual cases are to be examined. If we ignore one and lay emphasis on the other, it will lead to wrong or inadequate conclusions.

# 4.

# Nature of Economic Laws:

Economics, like all other sciences, has drawn its own set of generalizations or laws. Economic laws are nothing more than careful conclusions and inferences drawn with the help of reasoning or by the aid of observation of human and physical-nature. In everyday life, we see man is always busy in satisfying his unlimited wants with limited means. In doing so, it acts upon certain principles. These principles or generalizations which an average man usually follows when he is engaged in economic activity are named **“*Economic Laws*”**.

[Economic](http://www.economicsconcepts.com/economics_as_a_science_of_growth_and_efficiency.htm) laws the statements of general tendencies. In the words of **Marshall:**

“Economic laws are those social laws which relate to branches of conduct, which the strength of motive chiefly concerned can be measured by money prices”.

**(1)**   **Laws of economics are less exact.** The ***nature of economic laws*** is that they are less exact as compared to the laws of natural sciences like Physics, Chemistry, Astronomy, etc. An economist cannot predict with surety as to what will happen in future in the economic domain. He can only say as to what is likely to happen in the near future. The reasons as to why economic laws are not as exact as that of natural sciences are as follows:

**First,** Natural sciences deal its matter which lifeless. While economics, we are concerned with man who is endowed with a freedom of or he may act in whatever manner he likes. Nobody can predict with certainty his future actions. This element of uncertainty in human behavior results in making the laws of economics less exact than the laws of natural sciences.

**Secondly,** in economics it is very difficult to collect factual data on which economic laws are to be based. Even if the data is collected it may change at any moment due to sudden changes in the tastes of the people or their attitudes.

**Thirdly,** there are many unknown factors which its affect the expected course of action and thus can easily falsify the economic predictions. Dr. Marshall has devoted one chapter in his famous book “Principles of Economies” in discussing the nature of economic laws. He writes, that laws ofeconomics are to be compared with the laws of tides rather than with the simple and the exact law of gravitation.

The reason for comparing the laws of economics with the laws of tides by Marshall is that the laws of tides are also not exact. The rise of tides cannot be accurately predicted. It can only be said that the tide is expected to rise at a certain time. It may or may not rise. Strong wind may change its direction to opposite side. They instead of rising may fall. So is the case with the laws of economics.

**(2)** **Economic laws areessentially hypothetical.** Economic laws,writes Seligman, are essentially hypothetical. They are true under certain given conditions. If these conditions are fulfilled, the conclusions drawn from them will be true and exact as those of the laws of physical sciences. From this statement that laws of economics are hypothetical, we should not conclude that, they are useless or unreal.

The hypothetical element is also there in the laws of physical sciences. Take for instance, the law of gravitation. It states that bodies tend to-fall to the ground but the bodies may not fall immediately. Their fall may be retarded by atmospheric pressure. So is the case with the laws of Economics. Take for instance, the [law of diminishing marginal utility](http://www.economicsconcepts.com/law_diminishing_marginal_utility.htm). It states, other things beings equal, the additional benefit which a person derives from a given increase of his stock of a thing diminishes with every increase in the stock that he already has, but this may not happen.

The utility of an additional unit may increase due to a sudden change in fashions, tastes, etc. The only difference between the laws of economics and the laws of physical sciences is that the hypothetical element in the former is more permanent as compared to the later. In the words of **Samuelson** writes “Despite the approximate character of economics laws, it is blessed with many valid principles".

**(3)** **Economic laws qualitative or quantitative.** Laws of economics are qualitative in nature. They are not exactly stated in quantitative terms. They tell the direction of change which is expected rather than the amount of change. For example, according to the [law of demand](http://www.economicsconcepts.com/law_of_demand.htm), the quantity demanded varies inversely with price. We do not say that 10% rise in price will lead to 30% fall m the quantity demanded.

**(4)** **Applies on the average in normalconditions.** Economic laws do not deal with any particular individual, firm, commodity etc. It takes an average economic unit and lays down its economic behavior.

**(5)** **Laws of economics are more exact than the laws of other social sciences.** We do admit that the laws of economics are not 100% exact. They are, however, more exact than the laws of any other social science.

## Comparison with Laws of other Sciences:

**(1)** **Economic Laws and Physical Laws.** The laws of economics different from the laws of physical sciences. The economist deals with the activities or behaviors of men in society. The activities of men are various and uncertain and no definite conclusion can be drawn from them. We can only say what is likely by happen and riot what must happen. On the other hand, natural sciences deal with matter and atoms which are constant units. They always confirm to certain behavior. So the law derived from them are more definite, certain and universal.

**(2)** **Moral Laws and Economic Laws.** Moral laws are laws of human conduct. They emanate from public opinions. They guide us as to how we should live in society. The examples of moral laws are. “Thou shall not tell a lie” or “Treat your fellowmen with courtesy”, If you disobey these laws, you can be hated or at the most ex-communicated by the society.

There is no punishment by a government. An economic law, on the Other hand, tells us as to how a man should behave when he is engaged in an economic activity. If any body violates an economic law, be can suffer financial loss. For example, output should be produced at minimum cost. If any body breaks this law, it is then he who suffers. There is no public censure or punishment by a government.

**(3)** **Statutory Laws and Economic Laws.** ***Statutory laws*** are the laws issued by a state. It is the duty of the citizens of a country to obey these Laws. They disobey, and then they are punished. For example, government issues a law that “Theft is a crime". Whosoever breaks this law will be put behind the bar. Economic laws are quite different from that of statutory laws. An economic law is a statement of a scientific truth about human behavior in the matter of the allocation of scarce resources into unlimited ends. You are at liberty to violate an economic law but that is not the case with statutory laws.

# 5.

# Methods of Economic Analysis:

An economic theory derives laws or generalizations through two methods:

(1)Deductive Method and (2) Inductive Method.

These two ways of deriving economic generalizations are now explained in brief:

## (1) Deductive Method of Economic Analysis:

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

**For instance,** if we accept the general proposition that man is entirely motivated by self-interest. In applying the deductive method of ***economic analysis***, we proceed from general to particular.

The classical and neo-classical school of economists notably, Ricardo, Senior, Cairnes, J.S. Mill, Malthus, Marshall, Pigou, applied the deductive method in their economic investigations.

## Steps of Deductive Method:

The main steps involved in deductive logic are as under:

**(i) Perception of the problem to be inquired into:** In the process of deriving economic generalizations, the analyst must have a clear and precise idea of the problem to be inquired into.

**(ii) Defining of terms:** The next step in this direction is to define clearly the technical termsused analysis. Further, assumptions made for a theory should also be precise.

**(iii) Deducing hypothesis from the assumptions:** The third step in deriving generalizations is deducing hypothesis from the assumptions taken.

**(iv) Testing of hypothesis:** Before establishing laws or generalizations, hypothesis should be verified through direct observations of events in the rear world and through statistical methods. (Their inverse relationship between price and quantity demanded of a good is a well established generalization).

## Merits of Deductive Method:

The main merits of deductive method are as under:

(i) This method is near to reality. It is less time consuming and less expensive.

(ii) The use of mathematical techniques in deducing theories of economics brings exactness and clarity in economic analysis.

(iii) There being limited scope of experimentation, the method helps in deriving economic theories.

(iv) The method is simple because it is analytical.

## Demerits of Deductive Method:

It is true that deductive method is simple and precise, underlying assumptions are valid.

(i) The deductive method is simple and precise only if the underlying assumptions are valid. More often the assumptions turn out to be based on half truths or have no relation to reality. The conclusions drawn from such assumptions will, therefore, be misleading.

(ii) Professor Learner describes the deductive method as ‘armchair’ analysis. According to him, the premises from which inferences are drawn may not  
hold good at all times, and places. As such deductive reasoning is not applicable universally.

(iii) The deductive method is highly abstract. It require; a great deal of care to avoid bad logic or faulty economic reasoning.

As the deductive method employed by the classical and neo-classical economists led to many facile conclusions due to reliance on imperfect and incorrect assumptions, therefore, under the German Historical School of economists, a sharp reaction began against this method. They advocated a more realistic method for economic analysis known as inductive method.

## (2) Inductive Method of Economic Analysis:

***Inductive method*** which also called ***empirical method*** was adopted by the “Historical School of Economists". It involves the process of reasoning from particular facts to general principle.

This method derives economic generalizations on the basis of (i) Experimentations (ii) Observations and (iii) Statistical methods.

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.

## Steps of Inductive Method:

The main steps involved in the application of inductive method are:

(i) Observation.

(ii) Formation of hypothesis.

(iii) Generalization.

(iv) Verification.

## Merits of Inductive Method:

(i) It is based on facts as such the method is realistic.

(ii) In order to test the economic principles, method makes statistical techniques. The inductive method is, therefore, more reliable.

(iii) Inductive method is dynamic. The changing economic phenomenon are analyzed and on the basis of collected data, conclusions and solutions are drawn from them.

(iv) Induction method also helps in future investigations.

## Demerits of Inductive Method:

The main weaknesses of this method are as under:

(i) If conclusions drawn from insufficient data, the generalizations obtained may be faulty.

(ii) 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.

(iii) The inductive method is time-consuming and expensive.

### 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 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.

# Economic Analysis and Economic Policy:

[Economics](http://www.economicsconcepts.com/economics_as_a_science_of_growth_and_efficiency.htm), like other social sciences, has two aspects. One aspect is analytical and the other is practical. Both these aspects are of great importance because ***economic analysis*** is the basis for ***economic policy***. These are, in fact, integral parts of each other.

## What is Economic Analysis or Economic Theory?

### Definition and Explanation:

[***Economic analysis***](http://www.economicsconcepts.com/methods_of_economic_analysis.htm) or ***economic theory*** is a body of economic principles built up as a result of logical reasoning. We can call it a “base of tools” with which the economists analyze economic problems. Economic theory derives principles from facts which are systematically arranged and interpreted. In the words of**Maconnell:**

“The task of economic theory is to systematically arrange, interpret and generalizes upon facts”.

Economic theory thus is a statement or a set of related statements about cause and effect, action and reaction.

## Steps for Making an Economic Theory:

The main steps involved in constructing theory of economics are as under:

**(i) Selecting the problem.** The first step involved in the formulation of a theory is the selection of problem which is related to the real world.

**(ii) Formulation of hypothesis.** The second step is to formulate hypothesis of the economic problem to be analyzed.

**(iii) Predictions.** The third step required in the construction of a theory is to draw implications from the assumptions by way of logical reasoning.

**(iv) Testing of predictions.**Finally, the predictions are tested by the process of observation and statistical analysis of the data.

The economic theory is extremely valuable in explaining economic phenomenon, predicting economic events, judging performance of the economy and in formulating economic policies.

## What is an Economic Policy:

### Definition and Explanation:

Economic policy is an attempt to devise government actions and to design institutions that might improve economic performance.

The creation of specific policies for achieving economic goals of the society is not simple and easy matter. The main steps in policy formulation are as under:

## Steps for Making an Economic Policy:

**(i) Clear statement of goals.** There should be clear statement of economic goals to be achieved.

**(ii) Effects of alternative policies.** The second step is to examine and consider the possible effects of alternative policies designed to achieve the economic goal. For example, while considering the merits and demerits of fiscal policy in the achievement of desired level employment, the altering monetary policy must remain under examination.

**(iii) Evaluation.** The third step is to evaluate the effectiveness of the policies. The process of evaluation should be continuous. If any drawback is found in it at any stage, it should he improved.

## Goals of Economic Policies:

There are number of economic goals which economic policies are designed to achieve. These goals are:

(i) Economic growth (ii) more jobs for persons willing and able to work (iii) maximum benefits at minimum cost from the limited productive resources (iv) stability in price level (v) high degree of freedom in economic activities (vi) fair distribution of income (vii) provision of economic security to disabled, handicapped, unemployed etc., (viii) reasonable favorable balance in balance of payments.

The economic goals to be achieved differ with the level of employment in the country. For example, the developed countries can aim at achieving full employment, proper distribution of income and price stability etc. The developing countries, on the other hand, are mostly faced with the problems of unemployment, unequal distribution of wealth, price instability etc. Each country, therefore, must devise a system of priorities for its ***objectives***.

If may, here also be noted that an economic theory formed as a basis for policy measure at one time is not applicable for all times to come. An economic theory which is true today may be obsolete tomorrow.

# 7.

# Importance of the Study of Economics:

The ***importance and utility of the subject of Economics*** can be judged from this fact that it is now considered to be one of the most important and useful subject as compared to any other branch of knowledge. The reasons for gaining its importance are that it makes human welfare its direct and primary concern.

It helps in raising the quality of [economic](http://www.economicsconcepts.com/economics_as_a_science_of_growth_and_efficiency.htm)life. As it greatly helps in the solution of economic and. social problems so it exercises an over-whelming influence on the minds of the people. In the words of**Durbin:**

“Economics is the intellectual religion of the day”.

About the importance of Economics **Malthus**remarks:

“Political economy is perhaps the only science of which it may be said that the ignorance of it is not merely a deviation of good but produces great positive evil”.

**Edmund Burks** is not wrong in saying that:

“The age of chivalry has gone, that of sophistry, economists, and calculators has succeeded”.

## Advantages of the Study of Economics:

The advantages of the study of economics are as under:

(1) Intellectual Value: The knowledge of Economics is very useful as it broadens our outlook, sharpens our intellect, and inculcates in us the habit of balanced thinking. The study of Economics makes us realize that we as human beings are dependent upon one another for our daily needs. This feeling creates in us the intelligent appreciation of our position and the spirit of co-operation with others.

# (2) Practical Advantages: The practical advantages of Economics are much more important than its theoretical advantages. These advantages can be looked at from the individual and community point of view.

# (3) Personal Stake in Economics: From personal point of view, the study of Economics is useful as it enables each of us to understand better and appreciate more intelligently the nature and significance of our money earning and money spending activities. With the knowledge of Economics, the consumer can better adjust his expenditure to his income. The study of Economics is also useful to a producer. It suggests him the ways of bringing about the most economical combinations of the various factors of production at his disposal. It also helps in solving the various intricacies of exchange. From the study of Economics, one can easily judge as to why the prices have risen or fallen. The knowledge of Economics also explains us as to how the reward of various factors of production is determined. Thus, we find that every’ individual can rightly hope to become a better and more efficient consumer, producer and businessman, if he has the working knowledge of economics.

# (4) Economics for the Leader: The study of economics is not only helpful from the individual point of view but it is also very useful for the welfare of the community. It enables a statesman to understand and better grasp the economic and social problems facing the country. Every government has to tackle different kinds of economic problems such as unemployment, inflation, over production, under-production, imposition of tariffs and control, problem of monopolies, etc. the statesman can successfully solve these problems, if he has thorough knowledge of the subject of Economics. The knowledge of Economics for a finance minister is also indispensable. He has to raise revenue by imposing taxes on the incomes of the people for meeting the necessary expenditure of the government. Economics here comes to his rescue and guides him as to how the taxes could be levied and collected.

# (5) Poverty and Development: The greatest advantage of Economics is that it helps in removing traces of poverty from the country. Take the case of Pakistan; we in Pakistan are confronted with different kinds of problems. For example, low-per capita income, low productivity of agriculture, slow development of industries, fast increase in population, under-developed means of communication and transport, etc. The study of Economics helps in devising ways and means and suggesting practical measures in solving these problems.

# (6) Economics for the citizen: Such being, the importance of study of Economics, it is rightly remarked by Wooten that “you cannot be in real sense a citizen unless you are also in some degree an economist”. He is perfectly right in giving the statement. The world is so fast changing that we are completely now living in a world dominated by economic forces and economic ideas. If the people of any country do not have the working knowledge of an economic system; then the government of that  country can easily hoodwink citizens have knowledge of Economics, then the government will be very vigilant and spend the money in a wise manner.

The importance of the study of Economies can also be judged from this fact that the daily newspapers cannot be understood without some knowledge of Economics. The newspapers often describe complicated economic problems such as inflation, balance of payment, balance of trade, imperfect markets, dumping, co-operative farming, sub-division and fragmentation of holdings, mechanization of agriculture, If you do not have working knowledge of Economics, you cannot understand these diverse problems.

From brief discussion, we conclude, that the knowledge of Economics is very useful. As such it is necessary that every citizen, worker, administrator, consumer, etc., should have at least working knowledge of it. In the words of **Sir Henry Clay:**

“Some study of Economics is at one a practical necessity and a normal obligation”.