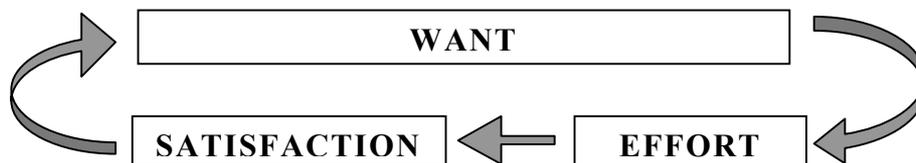


# 01. ECONOMICS – DEFINITION AND NATURE & SCOPE OF ECONOMICS – DIVISIONS OF ECONOMICS

Economics is the science that deals with production, exchange and consumption of various commodities in economic systems. It shows how scarce resources can be used to increase wealth and human welfare. The central focus of economics is on scarcity of resources and choices among their alternative uses. The resources or inputs available to produce goods are limited or scarce. This scarcity induces people to make choices among alternatives, and the knowledge of economics is used to compare the alternatives for choosing the best among them. For example, a farmer can grow paddy, sugarcane, banana, cotton etc. in his garden land. But he has to choose a crop depending upon the availability of irrigation water.

Two major factors are responsible for the emergence of economic problems. They are: i) the existence of unlimited human wants and ii) the scarcity of available resources. The numerous human wants are to be satisfied through the scarce resources available in nature. Economics deals with how the numerous human wants are to be satisfied with limited resources. Thus, the science of economics centres on **want - effort - satisfaction**.



Economics not only covers the decision making behaviour of individuals but also the macro variables of economies like national income, public finance, international trade and so on.

## A. DEFINITIONS OF ECONOMICS

Several economists have defined economics taking different aspects into account. The word ‘Economics’ was derived from two Greek words, *oikos* (a house) and *nemein* (to manage) which would mean ‘managing an household’ using the limited funds available, in the most satisfactory manner possible.

### i) Wealth Definition

Adam Smith (1723 - 1790), in his book "An Inquiry into Nature and Causes of Wealth of Nations" (1776) defined economics as the science of wealth. He explained how a nation's wealth is created. He considered that the individual in the society wants to promote only his own gain and in this, he is led by an "invisible hand" to promote the interests of the society though he has no real intention to promote the society's interests.

**Criticism:** Smith defined economics only in terms of wealth and not in terms of human welfare. Ruskin and Carlyle condemned economics as a 'dismal science', as it taught selfishness which was against ethics. However, now, wealth is considered only to be a means to an end, the end being human welfare. Hence, the wealth definition was rejected and the emphasis was shifted from 'wealth' to 'welfare'.

## **ii) Welfare Definition**

Alfred Marshall (1842 - 1924) wrote a book "Principles of Economics" (1890) in which he defined "Political Economy" or Economics as a study of mankind in the ordinary business of life; it examines that part of individual and social action which is most closely connected with the attainment and with the use of the material requisites of well being". The important features of Marshall's definition are as follows:

a) According to Marshall, economics is a study of mankind in the ordinary business of life, i.e., economic aspect of human life.

b) Economics studies both individual and social actions aimed at promoting economic welfare of people.

c) Marshall makes a distinction between two types of things, viz. material things and immaterial things. Material things are those that can be seen, felt and touched, (E.g.) book, rice etc. Immaterial things are those that cannot be seen, felt and touched. (E.g.) skill in the operation of a thrasher, a tractor etc., cultivation of hybrid cotton variety and so on. In his definition, Marshall considered only the material things that are capable of promoting welfare of people.

**Criticism:** a) Marshall considered only material things. But immaterial things, such as the services of a doctor, a teacher and so on, also promote welfare of the people.

b) Marshall makes a distinction between (i) those things that are capable of promoting welfare of people and (ii) those things that are not capable of promoting welfare of people. But anything, (E.g.) liquor, that is not capable of promoting welfare but commands a price, comes under the purview of economics.

c) Marshall's definition is based on the concept of welfare. But there is no clear-cut definition of welfare. The meaning of welfare varies from person to person, country to country and one period to another. However, generally, welfare means happiness or comfortable living conditions of an individual or group of people. The welfare of an individual or nation is dependent not only on the stock of wealth possessed but also on political, social and cultural activities of the nation.

### **iii) Welfare Definition**

Lionel Robbins published a book "An Essay on the Nature and Significance of Economic Science" in 1932. According to him, "economics is a science which studies human behaviour as a relationship between ends and scarce means which have alternative uses". The major features of Robbins' definition are as follows:

a) Ends refer to human wants. Human beings have unlimited number of wants.

b) Resources or means, on the other hand, are limited or scarce in supply. There is scarcity of a commodity, if its demand is greater than its supply. In other words, the scarcity of a commodity is to be considered only in relation to its demand.

c) The scarce means are capable of having alternative uses. Hence, anyone will choose the resource that will satisfy his particular want. Thus, economics, according to Robbins, is a science of choice.

**Criticism:** a) Robbins does not make any distinction between goods conducive to human welfare and goods that are not conducive to human welfare. In the production of rice and alcoholic drink, scarce resources are used. But the production of rice promotes human welfare while production of alcoholic drinks is not conducive to human welfare. However, Robbins concludes that economics is neutral between ends.

b) In economics, we not only study the micro economic aspects like how resources are allocated and how price is determined, but we also study the macro economic aspect like how national income is generated. But, Robbins has reduced economics merely to theory of resource allocation.

c) Robbins definition does not cover the theory of economic growth and development.

#### **iv) Growth Definition**

Prof. Paul Samuelson defined economics as “the study of how men and society choose, with or without the use of money, to employ scarce productive resources which could have alternative uses, to produce various commodities over time, and distribute them for consumption, now and in the future among various people and groups of society”.

The major implications of this definition are as follows:

a) Samuelson has made his definition dynamic by including the element of time in it. Therefore, it covers the theory of economic growth.

b) Samuelson stressed the problem of scarcity of means in relation to unlimited ends. Not only the means are scarce, but they could also be put to alternative uses.

c) The definition covers various aspects like production, distribution and consumption.

Of all the definitions discussed above, the ‘growth’ definition stated by Samuelson appears to be the most satisfactory. However, in modern economics, the subject matter of economics is divided into main parts, viz., i) Micro Economics and ii) Macro Economics.

Economics is, therefore, rightly considered as the study of allocation of scarce resources (in relation to unlimited ends) and of determinants of income, output, employment and economic growth.

## **B. SCOPE OF ECONOMICS**

Scope means province or field of study. In discussing the scope of economics, we have to indicate whether it is a science or an art and a positive science or a normative science. It also covers the subject matter of economics.

### **i) Economics - A Science and an Art**

**a) Economics is a science:** Science is a systematized body of knowledge that traces the relationship between cause and effect. Another attribute of science is that its phenomena should be amenable to measurement. Applying these characteristics, we find that economics is a branch of knowledge where the various facts relevant to it have been systematically collected, classified and analyzed. Economics investigates the possibility of deducing generalizations as regards the economic motives of human beings. The motives of individuals and business firms can be very easily measured in terms of money. Thus, economics is a science.

**Economics - A Social Science:** In order to understand the social aspect of economics, we should bear in mind that labourers are working on materials drawn from all over the world and producing commodities to be sold all over the world in order to exchange goods from all parts of the world to satisfy their wants. There is, thus, a close inter-dependence of millions of people living in distant lands unknown to one another. In this way, the process of satisfying wants is not only an individual process, but also a social process. In economics, one has, thus, to study social behaviour i.e., behaviour of men in-groups.

**b) Economics is also an art.** An art is a system of rules for the attainment of a given end. A science teaches us to know; an art teaches us to do. Applying this definition, we find that economics offers us practical guidance in the solution of economic problems. Science and art are complementary to each other and economics is both a science and an art.

### **ii) Positive and Normative Economics**

Economics is both positive and normative science.

**a) Positive science:** It only describes what it is and normative science prescribes what it ought to be. Positive science does not indicate what is good or what is bad to the society. It will simply provide results of economic analysis of a problem.

**b) Normative science:** It makes distinction between good and bad. It prescribes what should be done to promote human welfare. A positive statement is based on facts. A normative statement involves ethical values. For example, "12 per cent of the labour force in India was unemployed last year" is a positive statement, which could be verified by scientific measurement. "Twelve per cent

unemployment is too high” is normative statement comparing the fact of 12 per cent unemployment with a standard of what is unreasonable. It also suggests how it can be rectified. Therefore, economics is a positive as well as normative science.

### **iii) Methodology of Economics**

Economics as a science adopts two methods for the discovery of its laws and principles, viz., (a) deductive method and (b) inductive method.

**a) Deductive method:** Here, we descend from the general to particular, i.e., we start from certain principles that are self-evident or based on strict observations. Then, we carry them down as a process of pure reasoning to the consequences that they implicitly contain. For instance, traders earn profit in their businesses is a general statement which is accepted even without verifying it with the traders. The deductive method is useful in analyzing complex economic phenomenon where cause and effect are inextricably mixed up. However, the deductive method is useful only if certain assumptions are valid. (Traders earn profit, if the demand for the commodity is more).

**b) Inductive method:** This method mounts up from particular to general, i.e., we begin with the observation of particular facts and then proceed with the help of reasoning founded on experience so as to formulate laws and theorems on the basis of observed facts. E.g. Data on consumption of poor, middle and rich income groups of people are collected, classified, analyzed and important conclusions are drawn out from the results.

In **deductive** method, we start from certain principles that are either indisputable or based on strict observations and draw inferences about individual cases. In **inductive** method, a particular case is examined to establish a general or universal fact. Both deductive and inductive methods are useful in economic analysis.

### **iv) Subject Matter of Economics**

Economics can be studied through a) traditional approach and (b) modern approach.

**a) Traditional Approach:** Economics is studied under five major divisions namely consumption, production, exchange, distribution and public finance.

**1. Consumption:** The satisfaction of human wants through the use of goods and services is called consumption.

**2. Production:** Goods that satisfy human wants are viewed as “bundles of utility”. Hence production would mean creation of utility or producing (or creating) things for satisfying human wants. For production, the resources like land, labour, capital and organization are needed.

**3. Exchange:** Goods are produced not only for self-consumption, but also for sales. They are sold to buyers in markets. The process of buying and selling constitutes exchange.

**4. Distribution:** The production of any agricultural commodity requires four factors, viz., land, labour, capital and organization. These four factors of production are to be rewarded for their services rendered in the process of production. The land owner gets rent, the labourer earns wage, the capitalist is given with interest and the entrepreneur is rewarded with profit. The process of determining rent, wage, interest and profit is called distribution.

**5. Public finance:** It studies how the government gets money and how it spends it. Thus, in public finance, we study about public revenue and public expenditure.

### **b) Modern Approach**

The study of economics is divided into: i) Microeconomics and ii) Macroeconomics.

**1. Microeconomics** analyses the economic behaviour of any particular decision making unit such as a household or a firm. Microeconomics studies the flow of economic resources or factors of production from the households or resource owners to business firms and flow of goods and services from business firms to households. It studies the behaviour of individual decision making unit with regard to fixation of price and output and its reactions to the changes in demand and supply conditions. Hence, microeconomics is also called price theory.

**2. Macroeconomics** studies the behaviour of the economic system as a whole or all the decision-making units put together. Macroeconomics deals with the behaviour of aggregates like total employment, gross national product (GNP), national income, general price level, etc. So, macroeconomics is also known as income theory.

Microeconomics cannot give an idea of the functioning of the economy as a whole. Similarly, macroeconomics ignores the individual's preference and

welfare. What is true of a part or individual may not be true of the whole and what is true of the whole may not apply to the parts or individual decision-making units. By studying about a single small-farmer, generalization cannot be made about all small farmers, say in Tamil Nadu state. Similarly, the general nature of all small farmers in the state need not be true in case of a particular small farmer. Hence, the study of both micro and macroeconomics is essential to understand the whole system of economic activities.