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ECONOMICS - MICRO

What is Economics

- Resources
  A resource is a source from which a benefit is produced.
  A stock or supply of money, materials, staff and other assets that can be drawn

- Economic Development
  Economic Development is a process by which we improve economic and social well being of people

- Sustainable Development
  Sustainable Development is development that meets the needs of present, without compromising the ability of future generations to meet their own needs.

Factors of Production

The factors of production are resources that are the building blocks of the economy; they are what people use to produce goods and services

- Land
- Labor
- Capital
- Entrepreneurship

Microeconomics Vs. Macroeconomics

- MICROECONOMICS
  Relationship with individual component

- MACROECONOMICS
  The sum total of all Micro Units

Economic Terms

- Demand
- Supply
- Price
- Income
- Preference. Choice
- Government Intervention
- Subsidy & Grants

Demand

- The quantity of a commodity that a consumer is willing to buy and is able to afford, at a given prices of goods and income of the consumer is called demand for that commodity

  Demand curve is a graphic presentation of various quantities of a commodity that a consumer is willing to buy at different prices of the same commodity. It is presumed that prices of other commodities and his income remain constant.

- The downward sloping demand curve shows that at lower prices, the individual is willing to buy more of that commodity. At a higher price he will be less willing to buy that commodity. Therefore, there is a negative relationship between price of a commodity and quantity demanded which is referred to as the LAW OF DEMAND.

Supply

- In economics, supply means the quantities that a seller is willing and able to sell at different prices.
- If the prices goes up he will offer more to sell at different prices to make more profit
- Supply describes the total amount of a specific good or service that is available to consumer.
- Supply and Demand have important relationship as quantity demanded will change supply pattern by the producer or supplier

Price

- Price is the amount of money that has to be paid to acquire a given product.
- Price is also a measure of value
- Price usually refers to what is asked for goods
- Whenever resources are particularly scarce, demand exceeds supply and prices are driven up.

Income

- Income is money that an individual or business receives in exchange for providing a good or service.

- Income can also be through investing capital

Preference; Choice

- Something that is preferred over other
- Consumer preferences allow a consumer to rank different goods according to levels of utility or the total satisfaction of consuming a good or service.
- Preference of a good or service determine the real demand for certain good or service.

Market Equilibrium

- Market equilibrium is a market state where the supply in the market is equal to the demand in the market.
- The equilibrium price is the price of a good or service when demand equals to supply in a market.
- If the market price is above the equilibrium price, quantity supplied is greater than quantity demanded, creating a surplus.
- There is no drop or rise in Price during equilibrium.
- When quantity supplied exceeds quantity demanded, price tends to fall until equilibrium is restored
- When quantity supplied is less than quantity demanded price tends to rise until equilibrium is restored.

Market Failure

- In economics, market failure is a situation in which the allocation of goods and services by a free market is not efficient, often leading to a net social welfare loss.
- Market failure is inefficient distribution of goods and services in the free market.
- Market failure happens when price mechanism fails to allocate scarce resources efficiently.
- Reasons of market failure: Environmental concerns, under-provision of merit goods, lack of public goods, over-provision of demerit goods

Goods

- Merit Goods: health education
- Demerit Goods: Alcohol, drugs, Cigarettes
- Positive Externalities -exercising
- Negative externalities - smoking
- Public Good Roads, street light, Health Services, Education,
- Private Good- clothes, car, house

Normal Goods

- The quantity of a good that the consumer demands can increase or decrease with the rise in income depending on the nature of the good.
- For most goods, the quantity that a consumer chooses, increases as the consumer's income increases and decreases as the consumer's income decreases.
- Such goods are called normal goods.
- Thus, a consumer's demand for a normal good move in the same direction as the income of the consumer.

Inferior Goods

- INFERIOR GOODS: There are some goods the demands for which move in the opposite direction of the income of the consumer. Such goods are called inferior goods.
- As the income of the consumer increases, the demand for an inferior good fall, and as the income decreases, the demand for an inferior good rises. Ex. Low quality food items like coarse cereals
- Griffen Goods: Griffen goods are highly inferior goods, showing a very high negative income effect.
- As a result, when price of such commodities falls, their demand also falls, even when they happen to be relatively cheaper than other goods.
- This is popularly known as 'Griffen Paradox.'

Inferior Goods

- A good can be a normal good for the consumer at some levels of income and an inferior good for her at other levels of income.
- At very low levels of income a consumer's demand for low quality cereals can increase with income.
- But beyond a level, any increase in income of the consumer is likely to reduce her consumption of such food items as she switches to better quality cereals.

Substitute Goods. Complementary Goods

- The quantity of a good that the consumer chooses can increase or decrease with the rise in the price of a related good depending on whether the two goods are substitutes or complementary to each other.
- Goods which are consumed together are called complementary goods. Ex. Tea and sugar, shoes and socks, pen and ink, etc.
- Since tea and sugar are used together, an increase in the price of sugar is likely to decrease the demand for tea and decrease in the price of sugar is likely to increase the demand for tea. Similar is the case with other complements.

Substitute and Complements

- IN GENERAL, THE DEMAND FOR A GOOD MOVES IN THE OPPOSITE DIRECTION OF THE PRICE OF ITS COMPLEMENTARY GOODS.
- In contrast to complements, goods like tea and coffee are not consumed together. In fact, they are substitutes for each other.
- Since tea is a substitute for coffee, if the price of coffee increases, the consumers can shift to tea, and hence, the consumption of tea is likely to go up.
- On the other hand, if the prices of coffee decreases, the consumption of tea is likely to go down. The demand for a good usually moves in the direction of the price of its substitutes.

Elasticity of Demand

- The demand for a good move in the opposite direction of its price. But the impact of the price change is always not the same.
- Sometimes, even for a small change in price leads to change in demand considerably.
- There are some goods for which the demand is not affected much even when the price changes.
- Price elasticity of demand for a good is defined as the percentage change in demand for the good divided by the percentage change in the price.
- Demand for essential goods is often found to be same even when price increases.
- Demand for luxury goods is seen to be elastic (means changes in demand levels) when there is changes in market price.
- For some commodities there is change in quantity demanded is equals to change in price.
- This is called unitary elastic at that price.
- The demand for a good is likely to be elastic if close substitutes are easily available. Ex. Mobile phone, computers

Articles of Distinction

- There are certain goods which are ‘articles of social distinction’.
- These articles are demanded only because their prices are very high.
- If their prices fall they will no longer be considered as articles of distinction and their demand will shrink.
- Thus, these goods defy the law of demand.
- Ex. Precious diamonds, vintage cars, High end Watches

The prices of eggs rises and yet it is observed that the demand for eggs is rising. Does it mean that the demand curve for eggs is upward sloping

- No. Increase in demand for eggs may not be related to increase in price of eggs, instead it may be related to income or seasonal change.
- When any of the other determinant of demand changes, there is shift in demand curve.
- Thus it is not change in demand due to change in the price.

Factors Affecting Price Elasticity of Demand

- Nature of Commodity: Ordinarily, necessaries like salt, kerosene oil, textbooks, seasonal vegetables, etc. have inelastic demand. Luxuries like ACs costly furniture, fashionable garments etc. have elastic demand.
  Jointly demanded goods, like bread and butter, pen and ink, paints and brushes, camera and films, ordinarily show a moderate elasticity of demand.

- For example, rise in price of butter will not substantially reduce its demand if the demand for bread has not decreased.

- Availability of substitutes: tea and coffee,

- Postponement of use: Demand will be elastic for goods, the consumption of which can be postponed Demand for residential houses may be less if the interest rates are high.

Factors Affecting Price Elasticity of Demand

- Habit of Consumers: Goods to which consumers become habitual or addicted will have inelastic demand.
- Cigarettes and liquor are examples.
- Demand for cigarettes and liquor does not reduce even when these goods are highly taxed.
- Time Period: Demand is inelastic in short period, and elastic in long period.
- It is because, long period is long enough for a consumer to change his consumption habits.

The government keeps raising taxes on cigarettes leading to a rise in price of this commodity. But there is insignificant fall in demand. Why?

- There is low elasticity of demand for cigarettes. As

  1. there is no close substitutes
  2. it is a habit forming commodity

- Thank You