

## INTRODUCTION TO ECONOMICS

### WHAT IS ECONOMICS?

Economics is not a natural science, i.e. it is not concerned with studying the physical world like chemistry, biology. Social sciences are connected with the study of people in society. It is not possible to conduct laboratory experiments, nor is it possible to fully unravel the process of human decision-making.

“Economics is the study of how we the people engage ourselves in production, distribution and consumption of goods and services in a society.”

The term economics came from the Greek for oikos (house) and nomos (custom or law), hence "rules of the household.

Another definition is: “The science which studies human behavior as a relationship between ends and scarce means which have alternative uses.”

### BRANCHES OF ECONOMICS

#### Normative economics:

Normative economics is the branch of economics that incorporates value judgments about what the economy should be like or what particular policy actions should be recommended to achieve a desirable goal. Normative economics looks at the desirability of certain aspects of the economy. It underlies expressions of support for particular economic policies. Normative economics is known as statements of opinion which cannot be proved or disproved, and suggests what should be done to solve economic problems, i-e unemployment should be reduced. Normative economics discusses "what ought to be".

#### Examples:

1-A normative economic theory not only describes how money-supply growth affects inflation, but it also provides instructions that what policy should be followed.

2- A normative economic theory not only describes how interest rate affects inflation but it also provides guidance that what policy should be followed.

#### Positive economics:

Positive economics, by contrast, is the analysis of facts and behavior in an economy or “the way things are.” Positive statements can be proved or disproved, and which concern how an economy works, i-e unemployment is increasing in our economy. Positive economics is sometimes defined as the economics of "what is"

#### Examples:

1- A positive economic theory might describe how money-supply growth affects inflation, but it does not provide any instruction on what policy should be followed.

2- A positive economic theory might describe how interest rate affects inflation but it does not provide any guidance on whether what policy should be followed.

**We** the people: includes firms, households and the government.

**Goods** are the things which are produced to be sold.

**Services** involve doing something for the customers but not producing goods.

### FACTORS OF PRODUCTION

Factors of production are inputs into the production process. They are the resources needed to produce goods and services. The factors of production are:

- **Land** includes the land used for agriculture or industrial purposes as well as natural resources taken from above or below the soil.
- **Capital** consists of durable producer goods (machines, plants etc.) that are in turn used for production of other goods.
- **Labor** consists of the manpower used in the process of production.
- **Entrepreneurship** includes the managerial abilities that a person brings to the organization. Entrepreneurs can be owners or managers of firms.\_

**Scarcity** does not mean that a good is rare; scarcity exists because economic resources are unable to supply all the goods demanded. It is a pervasive condition of human existence that exists because society has unlimited wants and needs, but limited resources used for their satisfaction. In other words, while we all want a bunch of stuff, we can't have everything that we want.

**Rationing** is a process by which we limit the supply or amount of some economic factor which is scarcely available. It is the distribution or allocation of a limited commodity, usually accomplished based on a standard or criterion. The two primary methods of rationing are markets and governments. Rationing is needed due to the scarcity problem. Because wants and needs are unlimited, but resources are limited, available commodities must be rationed out to competing uses.

## **ECONOMIC SYSTEMS**

There are different types of economic systems prevailing in the world.

### **Dictatorship:**

Dictatorship is a system in which economic decisions are taken by the dictator which may be an individual or a group of selected people.

### **Command or planned economy:**

A command or planned economy is a mode of economic organization in which the key economic functions – for whom, what, how to produce are principally determined by government directive. In a planned economy, a planning committee usually government or some group determines the economy's output of goods and services. They decide about the optimal mix of resources in the economy. They also decide how the factor of production needs to be employed to get optimal mix.

### **Free market/capitalist economy:**

A free market/capitalist economy is a system in which the questions about what to produce, how to produce and for whom to produce are decided primarily by the demand and supply interactions in the market. In this economy what to produce is thereby determined by the market price of each good and service in relation to the cost of producing each good and service.

In a free economy the only goods and services produced are those whose price in the market is at least equal to the producer's cost of producing output. When a price greater than the cost of producing that good or service prevails, producers are induced to increase the production. If the product's price falls below the cost of production, producers reduce supply.

### **Islamic economic system:**

This system is based on Islamic values and Islamic rules i-e zakat, ushr, etc. Islam forbids both the taking and giving of interest. Modern economists, too, have slowly begun to realize the futility of interest. The Islamic economic principles if strictly followed would eliminate the possibility of accumulation of wealth in the hands of a few and would ensure the greater circulation of money as well as a wider distribution of wealth. Broadly speaking these principles are (1) Zakat or compulsory alms giving (2) The Islamic law of inheritance which splits the property of an individual into a number of shares given to his relations (3) The forbiddance of interest which checks accumulation of wealth and this strikes at the root of capitalism.

### **Pakistan case: A mixed economy**

In Pakistan, there is mixed economic system. Resources are governed by both government and individuals. Some resources are in the hand of government and some are in the hand of public. Optimal mix of resources is decided by the price mechanism i-e by the market forces of demand and supply. Pakistan economy thus consists of the characteristics of both planned economy and free market economy. People are free to make their decisions. They can make their properties. Government controls the Defence.

**CIRCULAR FLOW OF GOODS & INCOME**

There are two sectors in the circular flow of goods & services. One is household sector and the other is the business sector which includes firms. Households demands goods & services, Firms supply goods & services. An exchange takes place in an economy. In monetary economy, firms exchange goods & services for money. Firms' demands factors of production and households supply factors of production. Firms pay the payment in terms of wages, rent, etc. This is circular flow of goods. On the other hand, household gives money to firms to purchase the goods & services from firms, and firms' gives money to households in return for factors of production.

**DISTINCTION BETWEEN MICRO & MACRO ECONOMICS****Micro Economics:**

The branch of economics that studies the parts of the economy, especially such topics as markets, prices, industries, demand, and supply. It can be thought of as the study of the economic trees, as compared to macroeconomics, which is study of the entire economic forest. Microeconomics is a branch of economics that studies how individuals, households, and firms make decisions to allocate limited resources typically in markets where goods or services are being bought and sold. It also examines how these decisions and behaviors affect the supply and demand for goods and services, which determines prices, and how prices, in turn, determine the supply and demand of goods and services.

**Macro Economics:**

The branch of economics that studies the entire economy, especially such topics as aggregate production, unemployment, inflation, and business cycles. It can be thought of as the study of the economic forest, as compared to microeconomics, which is study of the economic trees. Macroeconomics, involves the "sum total of economic activity, dealing with the issues of growth, inflation, and unemployment and with national economic policies relating to these issues" and the effects of government actions (e.g., changing taxation levels) on them.