

CONTENTS

Unit 1

INTRODUCTION

Introduction to Economics	1
Microeconomics	1
Definitions of Microeconomics	1
Macroeconomics	2
Scope of Microeconomics	3
Uses of Microeconomics	5
Limitations of Microeconomics	7
Business Economics	8
Definition of Business/Managerial Economics	8
Nature/Features of Business Economics	10
Scope of Business Economics	12
Differences between Traditional and Business Economics	15
Basic Concepts	16
Production Possibility Curve (PPC)	16
Marginal Analysis	21
Incremental Analysis	24
Static and Dynamic Micro-Equilibrium	25
Micro-statics	27
Comparative Micro-statics	28
Micro-dynamics	30
Basic Principles of Economics	32
❑ Chapter Questions	40

Unit 2

MARKET EQUILIBRIUM AND EFFICIENCY

How Markets Work	42
Meaning of Demand	42
Demand Function	43
Types of Demand Function	43
Types of Demand	46
Determinants of Demand	49
Law of Demand	50
Demand Schedule and Derivation of Demand Curve	52

Movement along a Demand Curve and Shift in a Demand Curve	57
Supply	61
Meaning of Supply	61
Supply Function	62
Types of Supply	64
Law of Supply	65
Supply Schedule and Derivation of Supply Curve	67
Movement along and Shift of a Supply Curve	70
Equilibrium in Product/Output Market	73
Effect of Changes in Demand and Supply on Market Equilibrium	76
Conclusion on Equilibrium Change	80
Consumer and Producer Surplus and Market Efficiency	80
Consumer Surplus	81
Producer Surplus	85
Efficiency and Evaluation of Market Equilibrium	89
Effect of Government Policy (Tax, Subsidy and Price Control) in	
Market Equilibrium	92
Effect of Tax in Market Equilibrium	92
Effect of Subsidy in Market Equilibrium	96
Price Control and Its Effect in Equilibrium	99
Ceiling Price and Its Effect in Market Equilibrium	100
Floor Price and Its Effect in Market Equilibrium	102
❑ Numerical Exercise: Problems and Solution	104
❑ Chapter Questions	111
❑ Numerical Assignment	112

Unit 3

ELASTICITY OF DEMAND AND SUPPLY

Price Elasticity of Demand: Concept, Degree and Calculation	115
Concept of Price Elasticity of Demand	115
Degrees/ Types of Price Elasticity of Demand	116
Methods of Calculation Price Elasticity of Demand	120
Changing Elasticities along a Linear Demand Curve	127
The Case of Non-linear Demand Curve	129
Elasticity on a Special Type of Demand Curve	131
Demand Elasticity and Total Expenditure/Revenue	134
Determinants of Price Elasticity of Demand	142
Income Elasticity of Demand	143
Types of Income Elasticity of Demand	144

Calculation of Income Elasticity of Demand	147
Cross Elasticity of Demand	151
Types of Cross Elasticity of Demand	152
Measurement of Cross Elasticity of Demand	154
Arc/Average Method for Cross Elasticity	155
Advertisement Elasticity of Demand	156
Mid-point/Average Method	158
Uses of Different Types of Elasticities of Demand	159
Uses of Price Elasticity of Demand	159
Uses of Income Elasticity of Demand	162
Use of Cross Elasticity of Demand	163
Use of Advertisement Elasticity of Demand	164
Elasticity of Supply	165
Concept of Price Elasticity of Supply	165
Degrees/Types of Price Elasticity of Supply	166
Method of Measuring Price Elasticity of Supply	168
Elasticity of Supply in a Non-Linear Supply Curve	172
Determinants of Elasticity of Supply	173
Applications of Price Elasticity of Supply	175
❑ Numerical Exercise: Problems and Solution	177
❑ Chapter Questions	183

Unit 4

ANALYSIS OF CONSUMER'S BEHAVIOUR

What Consumer's Behaviour is?	187
The Concept of Utility	187
Cardinal Approach	188
Assumptions of Cardinal Utility Analysis	188
Consumer's Equilibrium under Cardinal Utility Approach	190
Law of Diminishing Marginal Utility	191
The Law of Equi-Marginal Utility	194
Criticism of Cardinal Approach to Utility Analysis	199
Derivation of Demand Curve in Cardinal Approach	201
Ordinal Approach to Utility Analysis	203
Indifference Curve Approach	204
Meaning of Indifference Curve	205
Indifference Map	207
Properties of Normal Indifference Curves	207
Marginal Rate of Substitution (MRS)	212
Budget Line	216

Shift and Rotation in the Budget Line	220
Consumer's Equilibrium under Indifference Curve Approach	223
Income Effect and the Income Consumption Curve	227
Income Consumption Curve (ICC)	227
The Case of Normal Goods	227
The Case of Complementary Goods	228
The Case of an Inferior Good	229
The Case of Neutral Goods	230
Income Effect and Derivation of Engle Curve	231
Price Effect and Price Consumption Curve (PCC)	234
Price Effect in Case of Giffen Good	235
Decomposition of Price Effect	237
Definition of Substitution Effect (SE)	237
Definition of Income Effect (IE)	238
Methods of Separation/Decomposition of Price Effect	238
Income and Substitution Effect for Inferior Goods	246
Income and Substitution Effect for Giffen Goods	247
Price Effect and Derivation of Demand Curve: Normal Good	249
Engel Curve vs. Demand Curve	251
Comparison of Cardinal and Ordinal Approaches to Utility Analysis	251
Superiority of Ordinal Utility Approach	252
Criticisms of Indifference Curve	253
Application of Indifference Curve	254
❑ Numerical Exercise: Problems and Solution	255
❑ Chapter Questions	262

Unit 5

THEORY OF PRODUCTION

Meaning of Production	265
Concept of Total, Average and Marginal Products	265
Production Function	267
Short-Run and Long-Run Production Function	268
Long-Run Production Function	269
Cobb-Douglas Production Function	271
Laws of Production Function	275
Law of Variable Proportion	275
Importance of the Law of Diminishing Returns	280

Concept of Isoquant	280
Isoquant	281
Isoquant Map	282
Marginal Rate of Technical Substitution	282
Properties of Isoquant	285
Exceptions to the General Properties	287
Isocost Line	291
Producer's Equilibrium: Optimal Employment of Inputs	294
Expansion Path or Scale Line of the Firm	296
Laws of Returns to Scale	300
Constant Returns to Scale (CRS)	302
Decreasing Returns to Scale (DRS)	304
□ Numerical Exercise: Problems and Solution	306
□ Chapter Questions	310

Unit 6

COST AND REVENUE CURVES

Part A Cost and Cost Curves

Cost Function	313
Concept of Costs	314
Explicit Cost and Implicit Cost	314
Accounting Cost and Economic Cost	315
Historical Cost and Replacement Cost	316
Separable Cost and Common Cost	317
Opportunity Cost	318
Short-Run Costs	319
Short-run Total Costs	320
Derivation of Short-run Total Costs	322
Short-run Per-Unit Costs	323
Numerical Illustration of Short-run Cost Concepts	325
Short-run Per-Unit Cost Curves	326
Relation of AVC, AC and MC	327
Relationship between AC and MC	329
Derivation of Short-run Per-Unit Cost Curves from Total Costs	329
Derivation of the Average fixed cost (AFC)	330
Derivation of the Average Variable Cost (AVC) Curve	331
Average Total Cost (ATC) or Average Cost (AC)	332
Derivation of the Short-run Marginal Cost (MC)	333
Reason for the 'U' Shape of Short Run Average Cost Curve	334

Cost Curves and Product Curves	335
Long Run Costs	336
Relationship between Short Run and Long Run AC and MC Curves	345
Reason and Empirical Evidence on the Shape of LAC Curve	348
Empirical Evidence on the Shape of LAC Curve	351
Economies and Diseconomies of Scale	352
Economies of Scale	352
Types of Economies of Scale	353
Diseconomies of Scale	356
Concept of Economies of Scope	357
Numerical Exercise: Questions and Solution	360
Part B Revenue and Revenue Curves	
Concept of Revenue	364
Revenue Function	364
Concepts of Total, Average and Marginal Revenues	364
Revenue Curves under Perfect Competition	365
Revenue Curves under Imperfect Competition	367
Relation between AR and MR in Imperfect Competition Market	370
Relation between Revenue of the Firm and Price Elasticity of Demand	372
❑ Chapter Questions	378

Unit 7

PRODUCT PRICING THEORIES AND PRACTICES

Concept of Product Pricing	381
Market Structure : Concept and Characteristics	381
Features of Perfect Competition	382
Characteristics of Monopoly Market	383
Reasons for the Rise of Monopoly	384
Features of Monopolistic Competition	386
Features of Oligopoly Market	388
Profit Maximization Goal of Firm	391
Two Approach to Firm's Equilibrium Analysis	392
Price and Output Determination in Short-Run in Perfect Competition	395
Industry's Equilibrium	395
Firm's Short-Run Equilibrium in Perfect Competition	396
Marginal Revenue–Marginal Cost (MR–MC) Approach	397

Long Run Equilibrium in Perfect Competition	402
Derivation of Short-Run Supply Curve of A Firm and Industry	405
From Firm to Market/Industry Supply Curve in the Short-Run	406
Short-Run Equilibrium of the Monopolist	408
Long-run Equilibrium of the Monopoly Firm	411
Economic Effects of Monopoly	413
Positive and Negative Aspects of a Monopoly	414
Short-Run Equilibrium of a Monopolistic Competitor	416
The Long-Run Equilibrium of a Monopolistic Competitor	418
Monopolistic Firm's Equilibrium under Product Variation and Selling Expenses	419
Difference between Perfect Competition and Monopolistic Competition	420
Price and Output Outcomes in Oligopoly	423
Pricing Under Cartel	423
Pricing Practices	426
Price Discrimination under Monopoly	426
Cost-plus Pricing	431
Incremental Cost Pricing	432
Administered Pricing	432
Export Pricing	433
Predatory Pricing	433
Skimming Pricing	434
Penetration Pricing	434
A Summary Review of Market Structures	435
❑ Numerical Exercise: Questions and Solution	436
❑ Chapter Questions	444

Unit 8

THEORY OF FACTOR PRICING

Concept of Factor Pricing	447
Rent and Its Determination	447
Concept of Economic and Contract Rents	447
Ricardian Theory of Rent	448
Modern Theory of Rent	449
Wage and Its Determination	453
Money vs. Real Wage	453
Marginal Productivity Theory of Wage	454
Explanation of the Marginal Productivity Theory of Wage	459

Determination of Market (Industry Level) Wage Rate	461
Concept of Collective Bargaining	464
Objectives of Labour Union in Bargaining	464
Minimum Wage Fixation	466
Wage Differential	468
Compensating and Non-compensating Wage Differentials	468
Causes of Wage Differentials	469
Interest Rate	470
Nominal and Real Interest Rates	471
Interest Rate Differentials (IRD)	471
The Loanable Funds Theory of Interest Rate	473
Liquidity Preference Theory of Interest Rate	476
Comparison between Loanable Funds and Liquidity Preference Theories of Interest Rates	483
Concept of Profit	484
Economic and Business Profits	484
Dynamic Theory of Profit	487
Innovation Theory of Profit	489
❑ Numerical Exercise: Questions and Solution	492
❑ Chapter Questions	493
Bibliography	495