

Micro - economic Theory

M L Jhingan

MICROECONOMIC THEORY

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MICROECONOMIC THEORY

By the same author

ADVANCED ECONOMIC THEORY (4TH EDITION)

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To
P. R. Jhingan
my revered father and teacher

PREFACE

This is an introductory textbook on microeconomics designed primarily for B.A., B.Com Pass and Hons. courses in Indian universities. It deals with the neo-classical price theory in a simple, coherent, and critical manner.

The book is divided into six parts. Part one discusses the tools and methods of economic analysis, the nature and central problems of an economy, and the price system. Part two analyses the theory of consumer behaviour both in terms of the utility analysis and the indifference curve approach, along with the concept of elasticity of demand. Part three explains the production theory in detail. Part four studies product pricing by introducing the student to the revenue, cost and supply curves, and then discusses the pricing process under perfect competition, monopoly, monopolistic competition, duopoly, oligopoly, monopsony, and bilateral monopoly. There is a separate chapter on linear programming. Part five discusses the theories of factor pricing and the determination of rent, wages, interest, and profit. Part six analyses some basic concepts of taxation.

I crave the indulgence of my fellow teachers to make suggestions for the improvement of this book which shall be most welcome.

M.L. JHINGAN

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PART ONE

BASIC CONCEPTS

NATURE AND SCOPE OF ECONOMICS

1. INTRODUCTION

Economics, prior to the appearance of Adam Smith's *Wealth of Nations*, was a handmaid to theology and politics. True to its older name, 'Political Economy', it was regarded as a branch of statecraft. Kautilya, the great Indian statesman, named his book on statecraft as *Arthashastra*, the Hindi equivalent of 'Economics'. To the Greeks, *Oeconomicus* was the science of household management. Even Montesquieu, the French political thinker, in his celebrated work *Esprit de lois* (1748), ascribed economic principles to the particular form of government established in a country. The Mercantilists whom Schumpeter called "the consultant administrators and pamphleteers" were concerned with specific phenomena like money, taxation, foreign trade, industry, commerce, etc. It was in the latter half of the eighteenth century that the transformations effected by the Industrial Revolution tended to make Economics as a distinct body of knowledge independent of theological and political systems. However, the appellation 'Political Economy' lingered on till the close of the 19th century.

L.M. Fraser¹ has classified definitions of Economics into Type A and Type B. Type A definitions are related to *wealth* and *material welfare* and Type B to the *scarcity of means*.

2. TYPE A DEFINITIONS

(1) *The Classical View*. The classical economists beginning with Adam Smith defined economics as the science of wealth. Adam Smith defined it as treating of the "nature and causes of wealth of nations", whereby it "proposes to enrich both the people and the sovereign." Among his followers, J.B. Say in France defined econo-

¹L.M. Fraser, *Economic Thought and Language*, Ch. 2.

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mics as “the study of the laws which govern wealth,” to Nassau Senior at Oxford, “the subject treated by political economists . . . is not happiness, but wealth”; whereas to F.A. Walker in America, “Economics is that body of knowledge which relates to wealth.” J.E. Cairnes who was engaged in a long controversy with Mill and Senior over the scope and method of economics said in 1850 that “Political Economy is a science . . . it deals with the phenomena of wealth.” While B. Price declared in 1878 that “all are agreed that it is concerned with wealth.”

This conception of economics as a science of wealth laid exclusive stress on *material* wealth. Following Smith and Say, the Earl of Lauderdale (1804) and McCulloch (1827) regarded economics as related to *material wealth*, wealth being ‘the objects of man’s desires.’ In an age when religious sentiments ran high, this conception of economics was interpreted as concerning only the acquisition of riches or money. This led economics to be stigmatized as the science of Mammonism, a dismal science, the science of getting rich. Bailey called it “a mean, degrading, sordid inquiry.” To Carlyle it was a “pig-science”. Ruskin lamented in the preface to his *Unto the Last* that economists were in “an entirely damned state of soul.” Even economists like Jevons and Edgeworth were despaired of this wealth-oriented conception of economics. Edgeworth regarded it as “dealing with the lower elements of human nature.”

The main drawback in wealth definition of economics had been its undue emphasis on wealth-producing activities. Wealth was considered to be the end in itself. Moreover, as pointed out by Macfie the “fatal word ‘material’ is probably more responsible for the ignorant slanders on the ‘dismal science’ than any other description.” By stressing on the word ‘material wealth’, the classical economists narrowed the scope of economics by excluding all economic activities which are related to the production of non-material goods and services.

(2) *The Neo-classical View.* It was, however, the neo-classical school led by Alfred Marshall which gave economics a respectable place among social sciences. Marshall laid emphasis on man and his welfare. Wealth was regarded as the source of human welfare, not an end in itself but a means to an end. According to Marshall, “Political Economy or Economics is 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. Thus it is of the one side a study of wealth; and on the other, and more

important side, a part of the study of man.”²

Certain logical inferences can be drawn from Marshall's definition. *Firstly*, economics is concerned with man's ordinary business of life. It is related to his wealth-getting and wealth-using activities. Or, as Marshall put it: It “deals with his [man's] efforts to satisfy his wants, in so far as the efforts and wants are capable of being measured in terms of wealth or its general representative, *i.e.* money.”³ *Secondly*, economics is a social science. It “is a study of men as they live and move and think in the ordinary business of life.”⁴ Thus, economics is concerned with the economic aspects of social life. It excludes the activities of socially undesirable and abnormal persons like thieves, misers, etc. *Thirdly*, it is related to those economic activities which promote material welfare. Non-economic activities and activities having ignoble ends are excluded from the study of economics. *Lastly*, by using the broad term ‘Economics’ in place of the narrower term ‘Political Economy’, Marshall lifted economics to the realm of a science and divested it of all political influences.

Marshall's conception of economics as a study of material welfare was followed by others. Notable among his followers were E. Cannan, W. Beveridge and A.C. Pigou. “The aim of Political Economy”, according to Cannan, “is the explanation of the general causes on which the material welfare of human beings depends.”⁵ Beveridge defined it as “the study of the general methods by which men co-operate to meet their material needs.”⁶ To Pigou, “Economic welfare is the subject-matter of economic science,” economic welfare being “that part of social welfare that can be brought directly or indirectly into relation with the measuring rod of money.”⁷

(3) *Its Criticism*. Marshall, however, emphasized that economics is concerned with wealth simply by accident and its “true philosophic *raison d'être* must be sought elsewhere.” Robbins, therefore, in his *Essay on the Nature and Significance of Economic Science* finds fault with Cannan's enunciation of the welfare conception of economics.

Firstly, Robbins criticizes the distinction between material and non-material things as established by the neo-classical economists. The latter include only those activities within the scope of economics

²A Marshall, *Principles of Economics* (8th ed.), p. 1.

³*Ibid.*, p. 41, Word in parenthesis mine.

⁴*Ibid.*, p. 12.

⁵E. Cannan, *Elementary Political Economy*, p. 1.

⁶W. Beveridge, “Economics as a Liberal Education,” *Economica*, Vol. I.

⁷A C. Pigou, *The Economics of Welfare*, p. 11.