



*Introductory  
Microeconomics*

**Textbook in Economics for Class XII**



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**OFFICES OF THE PUBLICATION  
DIVISION, NCERT**

NCERT Campus  
Sri Aurobindo Marg  
New Delhi 110 016 Phone : 011-26562708

108, 100 Feet Road  
Hosdakere Halli Extension  
Banashankari III Stage  
Bengaluru 560 085 Phone : 080-26725740

Navjivan Trust Building  
P.O. Navjivan  
Ahmedabad 380 014 Phone : 079-27541446

CWC Campus  
Opp. Dhankal Bus Stop  
Panihati  
Kolkata 700 114 Phone : 033-25530454

CWC Complex  
Maligaon  
Guwahati 781 021 Phone : 0361-2674869

**Publication Team**

Head, Publication Division : M. Siraj Anwar

Chief Editor : Shveta Uppal

Chief Business Manager : Gautam Ganguly

Chief Production Officer : Arun Chitkara

Assistant Editor : R. N. Bhardwaj

Production Assistant : Sunil Kumar

**Cover, Layout and Illustrations**

Nidhi Wadhwa

# Foreword

THE National Curriculum Framework (NCF), 2005, recommends that children's life at school must be linked to their life outside the school. This principle marks a departure from the legacy of bookish learning which continues to shape our system and causes a gap between the school, home and community. The syllabi and textbooks developed on the basis of NCF signify an attempt to implement this basic idea. They also attempt to discourage rote learning and the maintenance of sharp boundaries between different subject areas. We hope these measures will take us significantly further in the direction of a child-centred system of education outlined in the National Policy of Education (1986).

The success of this effort depends on the steps that school principals and teachers will take to encourage children to reflect on their own learning and to pursue imaginative activities and questions. We must recognise that, given space, time and freedom, children generate new knowledge by engaging with the information passed on to them by adults. Treating the prescribed textbook as the sole basis of examination is one of the key reasons why other resources and sites of learning are ignored. Inculcating creativity and initiative is possible if we perceive and treat children as participants in learning, not as receivers of a fixed body of knowledge.

These aims imply considerable change in school routines and mode of functioning. Flexibility in the daily time-table is as necessary as rigour in implementing the annual calendar so that the required number of teaching days are actually devoted to teaching. The methods used for teaching and evaluation will also determine how effective this textbook proves for making children's life at school a happy experience, rather than a source of stress or boredom. Syllabus designers have tried to address the problem of curricular burden by restructuring and reorienting knowledge at different stages with greater consideration for child psychology and the time available for teaching. The textbook attempts to enhance this endeavour by giving higher priority and space to opportunities for contemplation and wondering, discussion in small groups, and activities requiring hands-on experience.

The National Council of Educational Research and Training (NCERT) appreciates the hard work done by the textbook development committee responsible for this book. We wish to thank the Chairperson of the advisory group in Social Sciences, at the higher secondary level, Professor Hari Vasudevan and the *Chief Advisor* for this book, Professor Tapas Majumdar, for guiding the work of this

committee. Several teachers contributed to the development of this textbook; we are grateful to their principals for making this possible. We are indebted to the institutions and organisations which have generously permitted us to draw upon their resources, materials and personnel. We are especially grateful to the members of the National Monitoring Committee, appointed by the Department of Secondary and Higher Education, Ministry of Human Resource Development, under the Chairpersonship of Professor Mrinal Miri and Professor G.P. Deshpande for their valuable time and contribution. As an organisation committed to systemic reform and continuous improvement in the quality of its products, NCERT welcomes comments and suggestions which will enable us to undertake further revision and refinements.

New Delhi  
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# Textbook Development Committee

## **CHAIRPERSON, ADVISORY COMMITTEE FOR SOCIAL SCIENCE TEXTBOOKS AT THE HIGHER SECONDARY LEVEL**

Hari Vasudevan, *Professor*, Department of History, University of Calcutta, Kolkata

## **CHIEF ADVISOR**

Tapas Majumdar, *Professor Emeritus of Economics*,  
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## **ADVISOR**

Satish Jain, *Professor*, Centre for Economics Studies and Planning,  
School of Social Sciences, Jawaharlal Nehru University, New Delhi

## **MEMBERS**

Harish Dhawan, *Lecturer*, Ramlal Anand College (Evening) New Delhi

Papiya Ghosh, *Research Associate*, Delhi School of Economics, New Delhi

Rajendra Prasad Kundu, *Lecturer*, Economics Department,  
Jadavpur University, Kolkata

Sugato Das Gupta, *Associate Professor*, CESP, Jawaharlal Nehru  
University, New Delhi

Tapasik Bannerjee, *Research Fellow*, Centre for Economics Studies  
and Planning, Jawaharlal Nehru University, New Delhi

## **MEMBER-COORDINATOR**

Jaya Singh, *Lecturer*, Economics, Department of Education in Social  
Sciences and Humanities, NCERT, New Delhi

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## Introduction



### 1.1 A SIMPLE ECONOMY

Think of any society. People in the society need many goods and services<sup>1</sup> in their everyday life including food, clothing, shelter, transport facilities like roads and railways, postal services and various other services like that of teachers and doctors. In fact, the list of goods and services that any individual<sup>2</sup> needs is so large that no individual in society, to begin with, has all the things she needs. Every individual has some amount of only a few of the goods and services that she would like to use. A family farm may own a plot of land, some grains, farming implements, maybe a pair of bullocks and also the labour services of the family members. A weaver may have some yarn, some cotton and other instruments required for weaving cloth. The teacher in the local school has the skills required to impart education to the students. Some others in society may not have any resource<sup>3</sup> excepting their own labour services. Each of these decision making units can produce some goods or services by using the resources that it has and use part of the produce to obtain the many other goods and services which it needs. For example, the family farm can produce corn, use part of the produce for consumption purposes and procure clothing, housing and various services in exchange for the rest of the produce. Similarly, the weaver can get the goods and services that she wants in exchange for the cloth she produces in her yarn. The teacher can earn some money by teaching students in the school and use the money for obtaining the goods and services that she wants. The labourer also can try to fulfill her needs by using whatever money she can earn by working for someone else. Each individual can thus use her resources to fulfill her needs. It goes without saying that no individual has unlimited resources compared to her needs. The amount of corn that the family farm can produce is limited by the amount of resources it has, and hence, the amount of different goods



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<sup>1</sup>By goods we mean physical, tangible objects used to satisfy people's wants and needs. The term 'goods' should be contrasted with the term 'services', which captures the intangible satisfaction of wants and needs. As compared to food items and clothes, which are examples of goods, we can think of the tasks that doctors and teachers perform for us as examples of services.

<sup>2</sup>By individual, we mean an individual decision making unit. A decision making unit can be a single person or a group like a household, a firm or any other organisation.

<sup>3</sup>By resource, we mean those goods and services which are used to produce other goods and services, e.g. land, labour, tools and machinery, etc.

and services that it can procure in exchange of corn is also limited. As a result, the family is forced to make a choice between the different goods and services that are available. It can have more of a good or service only by giving up some amounts of other goods or services. For example, if the family wants to have a bigger house, it may have to give up the idea of having a few more acres of arable land. If it wants more and better education for the children, it may have to give up some of the luxuries of life. The same is the case with all other individuals in society. Everyone faces scarcity of resources, and therefore, has to use the limited resources in the best possible way to fulfill her needs.

In general, every individual in society is engaged in the production of some goods or services and she wants a combination of many goods and services not all of which are produced by her. Needless to say that there has to be some compatibility between what people in society collectively want to have and what they produce<sup>4</sup>. For example, the total amount of corn produced by family farm along with other farming units in a society must match the total amount of corn that people in the society collectively want to consume. If people in the society do not want as much corn as the farming units are capable of producing collectively, a part of the resources of these units could have been used in the production of some other good or services which is in high demand. On the other hand, if people in the society want more corn compared to what the farming units are producing collectively, the resources used in the production of some other goods and services may be reallocated to the production of corn. Similar is the case with all other goods or services. Just as the resources of an individual are scarce, the resources of the society are also scarce in comparison to what the people in the society might collectively want to have. The scarce resources of the society have to be allocated properly in the production of different goods and services in keeping with the likes and dislikes of the people of the society.

Any allocation<sup>5</sup> of resources of the society would result in the production of a particular combination of different goods and services. The goods and services thus produced will have to be distributed among the individuals of the society. The allocation of the limited resources and the distribution of the final mix of goods and services are two of the basic economic problems faced by the society.

In reality, any economy is much more complex compared to the society discussed above. In the light of what we have learnt about the society, let us now discuss the fundamental concerns of the discipline of economics some of which we shall study throughout this book.

## 1.2 CENTRAL PROBLEMS OF AN ECONOMY

Production, exchange and consumption of goods and services are among the basic economic activities of life. In the course of these basic economic activities, every society has to face **scarcity** of resources and it is the scarcity of resources that gives rise to the problem of **choice**. The scarce resources of an economy have competing usages. In other words, every society has to decide on how to use its scarce resources. The problems of an economy are very often summarised as follows:

<sup>4</sup>Here we assume that all the goods and services produced in a society are consumed by the people in the society and that there is no scope of getting anything from outside the society. In reality, this is not true. However, the general point that is being made here about the compatibility of production and consumption of goods and services holds for any country or even for the entire world.

<sup>5</sup>By an allocation of the resources, we mean how much of which resource is devoted to the production of each of the goods and services.