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CORE CONCEPT OF

BUSINESS ECONOMICS & ENVIRONMENT

1. What is Concept of Partial Equilibrium?
2. Point out the General Equilibrium.
3. Briefly explain the Theory of Consumption.
4. Illustrate the Relative Income Theory of Consumption?

Partial Equilibrium

Prof. Stigler defines as "Partial Equilibrium is one which is based on only a restricted range of data, a standard example is price of a single product, the prices of all other products being held fixed during the analysis." This analysis consists of two types of economic problems. First those relevant to only exacting characteristic of the economic activities of a definite person, firm or industry. For example, it may bind to itself to the market for a single item where its value, the methods of production and the sum of aspects used in its manufacture are taken into account while all other aspects affecting it are supposed to be constant. Second, it studies only the first order consequences of the economic actions it analyses. It pays no attention to the effects on the cost of other products fetched about by the product being analysed and in turn secondary influences of the former on the product.

General Equilibrium

General equilibrium analysis is a widespread study of a number of economic variables, their interconnections and inter-reliance for sympathetic operations of the economic structure as a whole. It fetches mutually the grounds and consequent series of changes in prices and volume of products and services in association to the entire financial system. A financial system can be in general equilibrium only if all customers, all firms, all industries and all factor-services are in equilibrium concurrently and they are interrelated through product and factor cost. It subsists when all cost are in equilibrium each customer expends his given earnings in a mode that yields him the utmost satisfaction all firms in each industry are in equilibrium at all prices and productivity and the supply and demand for productive resources are at equal at equilibrium prices.

BREAKING DOWN 'Economic Equilibrium '-

The equilibrium price is where the supply of goods matches demand. When a major index experiences a period of consolidation or sideways momentum, it can be said that the forces of supply and demand are relatively equal and that the market is in a state of equilibrium.

Theory of Consumption-

There are many different theories on income and consumption behavior, and we will focus on some of the more mainstream concepts in consumption theory. The three most important theories of consumption are as follows: 1. Relative Income Theory of Consumption 2. Life Cycle Theory of Consumption 3. Permanent Income Theory of Consumption.

Relative Income Theory of Consumption: An American economist J.S. Duesenberry put forward the theory of consumer behaviour which lays stress on relative income of an individual rather than his absolute income as a determinant of his consumption. Another important departure made by Duesenberry from Keynes's consumption theory is that, according to him, the consumption of a person does not depend on his current income but on certain previously reached income level.

According to Duesenberry's relative income hypothesis, consumption of an individual is not the function of his absolute income but of his relative position in the income distribution in a society, that is, his consumption depends on his income relative to the incomes of other individuals in the society. For example, if the incomes of all individuals in a society increase by the same percentage, then his relative income would remain the same, though his absolute income would have increased.

According to Duesenberry, because his relative income has remained the same the individual will spend the same proportion of his income on consumption as he was doing before the absolute increase in his income. That is, his average propensity to consume (APC) will remain the same despite the increase in his absolute income.