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CORE CONCEPT OF BUSINESS ECONOMICS

According to Smith:

“The great object of the Political Economy of every country is to increase the riches and power of that country.” Like the mercantilists, he did not believe that the wealth of a nation lies in the accumulation of precious metals like gold and silver.

To him, wealth may be defined as those goods and services which command value-in-exchange. Economics is concerned with the generation of the wealth of nations. Economics is not to be concerned only with the production of wealth but also the distribution of wealth. The manner in which production and distribution of wealth will take place in a market economy is the Smithian ‘invisible hand’ mechanism or the ‘price system’. Anyway, economics is regarded by Smith as the ‘science of wealth.’

Other contemporary writers also define economics as that part of knowledge which relates to wealth. John Stuart Mill (1806-73) argued that economics is a science of production and distribution of wealth. Another classical economist Nassau William Senior (1790-1864) argued “The subject-matter of the Political Economics is not Happiness but Wealth.” Thus, economics is the science of wealth. However, the last decade of the nineteenth century saw a scathing attack on the Smithian definition and in its place another school of thought emerged under the leadership of an English economist, Alfred Marshall (1842-1924).

Criticisms:

Following are the main criticisms of the classical definition:

- i. This definition is too narrow as it does not consider the major problems faced by a society or an individual. Smith’s definition is based primarily on the assumption of an ‘economic man’ who is concerned with wealth-hunting. That is why critics condemned economics as ‘the bread-and-butter science’.
- ii. Literary figures and social reformers branded economics as a ‘dismal science’, ‘the Gospel of Mammon’ since Smithian definition led us to emphasise on the material aspect of human life, i.e., generation of wealth. On the other hand, it ignored the non-material aspect of human life. Above all,



as a science of wealth, it taught selfishness and love for money. John Ruskin (1819-1900) called economics a 'bastard science.' Smithian definition is bereft of changing reality.

iii. The central focus of economics should be on scarcity and choice. Since scarcity is the fundamental economic problem of any society, choice is unavoidable. Adam Smith ignored this simple but essential aspect of any economic system.

Marshall's Welfare Definition:

Alfred Marshall in his book 'Principles of Economics' published in 1890 placed emphasis on human activities or human welfare rather than on wealth. Marshall defines economics as "a study of men as they live and move and think in the ordinary business of life." He argued that economics, on one side, is a study of wealth and, on the other, is a study of man.

Emphasis on human welfare is evident in Marshall's own words: "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, "Economics is on the one side a study of wealth; and on the other and more important side, a part of the study of man." According to Marshall, wealth is not an end in itself as was thought by classical authors; it is a means to an end—the end of human welfare.

This Marshallian definition has the following important features:

- i. Economics is a social science since it studies the actions of human beings.
- ii. Economics studies the 'ordinary business of life' since it takes into account the money-earning and money-spending activities of man.
- iii. Economics studies only the 'material' part of human welfare which is measurable in terms of the measuring rod of money. It neglects other activities of human welfare not quantifiable in terms of money. In this connection A. C. Pigou's (1877- 1959)—another great neo-classical economist—definition is worth remembering. Economics is "that part of social welfare that can be brought directly or indirectly into relation with the measuring rod of money."
- iv. Economics is not concerned with "the nature and causes of the Wealth of Nations." Welfare of mankind, rather than the acquisition of wealth, is the object of primary importance.



Criticisms: Though Marshall's definition of economics was hailed as a revolutionary one, it was criticised on several grounds.