

Lesson 1

Topic -> Economics, Economy AND CENTRAL PROBLEMS OF AN Economy

Economics -> Economics is a subject matter that focuses on the rational management of scarce resources in a manner such that our economic welfare is maximised.

HOTS (Higher order Thinking skills)

Q1) State the fundamental problem that has led to the emergence of Economics as a subject matter of study?

Ans It is the problem of scarcity of resources in relation to our needs/desires.

Q2) State the two principal characteristics of resources?

Ans Two principle characteristics of resource are that:-

- 1) Resource are scarce in relation to our needs and,
- 2) Resources have alternative use

Economy -> Economy is a system spread over a particular area that reveals the nature and level of economic activities in that area. It shows how people of the concerned area earn their living.

Power Points

1) Economics is a subject matter that focuses on rational management of scarce resources in a manner such that the individuals maximize their economic gain at the micro level and the society maximizes its welfare at the macro level.

2) Economic Problem is the problem of choice or the problem of allocation of resources. It arises because 1) resources are scarce, and 2) resources have alternative uses.

3) Economic Activities are those activities which are related to the use of scarce resources.

Examples: Production, Consumption, Investment, and exchange

4) Microeconomics is that branch of Economics which studies economic problems (or economic issues) relating to individual economic units like a consumer, or a producer. Problem of resource allocation is the principal microeconomic issue.

5) Macroeconomics is that branch of Economics which studies economic problems (or economic issues) relating to economy as a whole. level of output and employment is the principal macroeconomic issue.

6) Market Economy is a free economy in which central problems (what, how and for whom to produce) are solved by the market forces of supply and demand.

7) Centrally Planned Economy is the one in which the central problems (what, how and for whom to produce) are

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addressed by some central authority of the government.

8) Mixed Economy is the one which shares the characteristic features of a free Economy as well as a planned economy. The central problems (what how and for whom to produce) are not entirely left to the free play of market forces. goal of profit maximization is allowed to be pursued, but not at the cost of social justice.

9) difference between Microeconomics and Macroeconomics

Ans Microeconomics

Macroeconomics

- | | |
|--|---|
| 1) Microeconomics studies economic relationships or economic problems at the level of an individual firm, an individual household or an individual consumer. | Macroeconomics studies economic relationships or economic problems at the level of the economy as a whole. |
| 2) Microeconomics is basically concerned with determination of output and price for an individual firm or industry. | Macroeconomics is basically concerned with determination of aggregate output and general price level in the economy as a whole. |
| 3) Study of microeconomics assumes that macro variables remain constant, e.g., It is assumed that aggregate output is given while we are studying determination of output and price of an individual firm or industry. | Study of macroeconomics assumes that micro variables remain constant. It is assumed that distribution of income remains constant when we are studying the level of output in the economy. |

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Shifting / Rotation of Production Possibility Curve1) Change in Resources

a) Resources are Increased -> If resources are increased, we can produce more of both the goods. Accordingly, PPC shifts to the right, as in fig. 3 (from ab to a_1b_1)

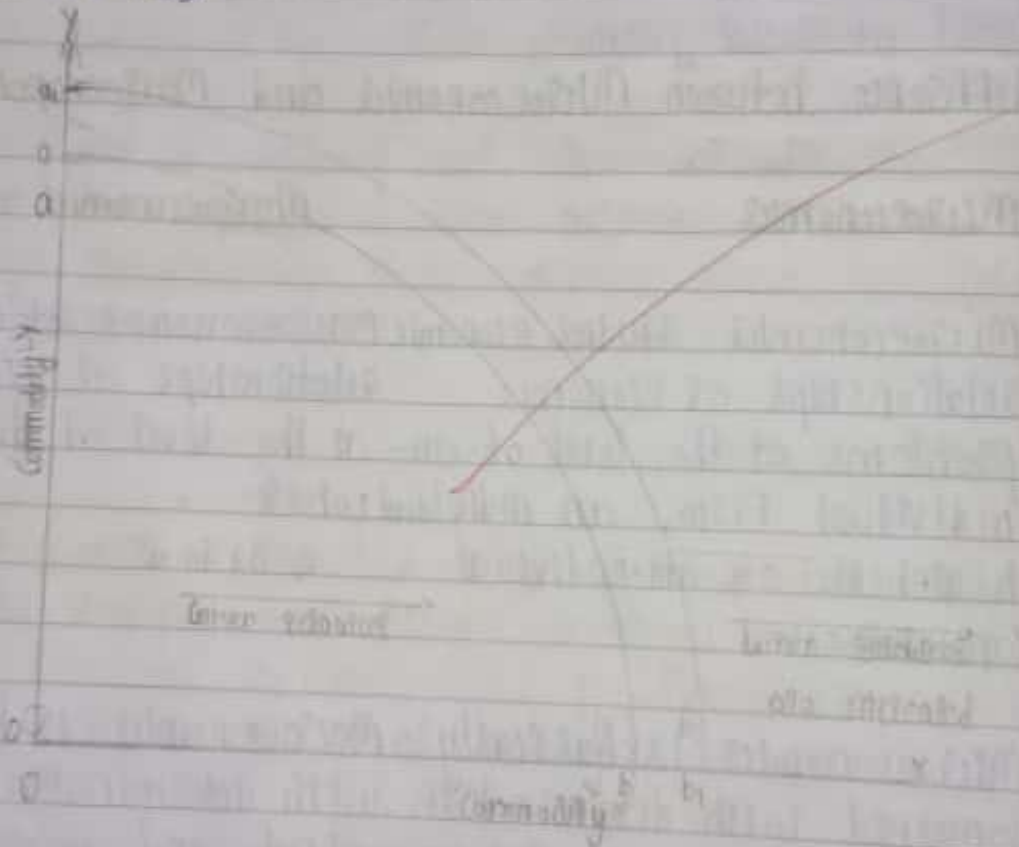


figure 3

over time, an entrepreneur may acquire more resources, (say) in the form of capital stock. This enhances his production capacity. Accordingly PPC expands or shifts to the right, from ab to a_1b_1 .

b) Resources are Reduced -> If resources are reduced, we can produce less of both the goods. Accordingly, PPC shifts to the left, as in fig. 4 (from ab to a_1b_1)

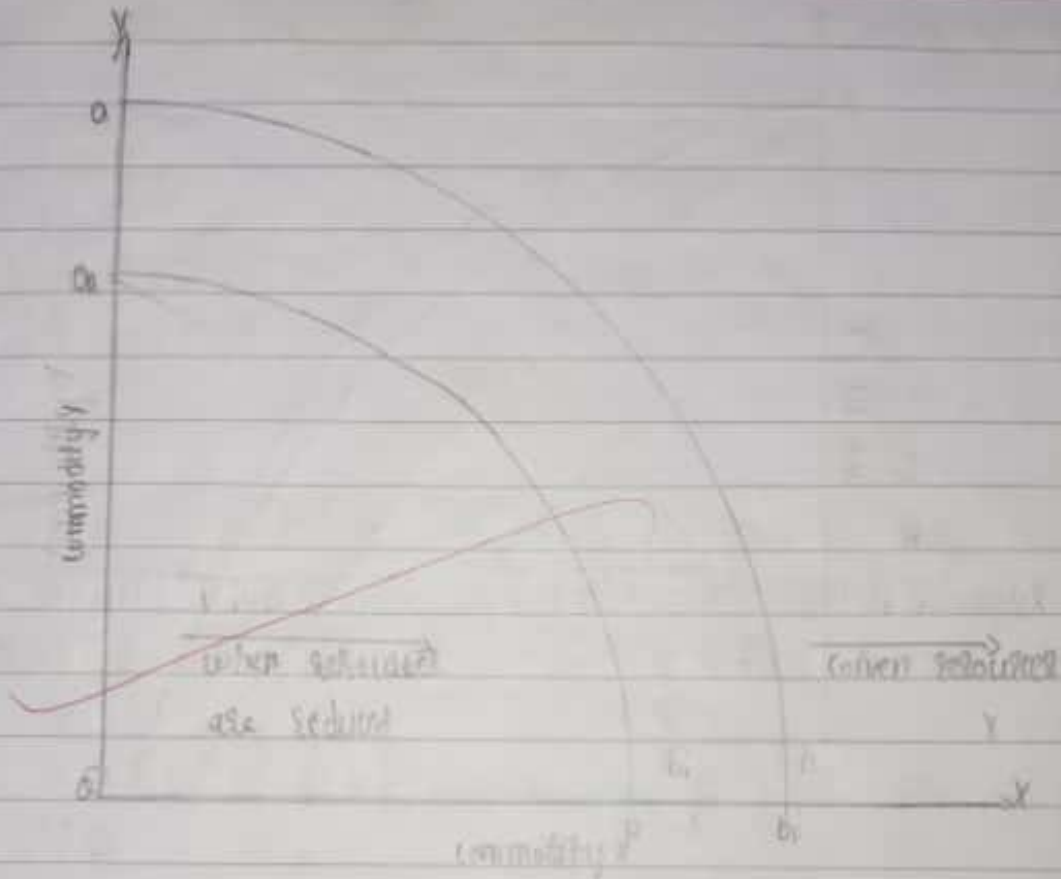


Figure 14

Capital stock of an entrepreneur may shrink over time. This reduces his production capacity. Accordingly, PPC contracts or shifts to the left from ab to a_1b_1 .

3) Change in Technology

a) Efficient Technology for the production of commodity X: Efficient technology for the production of commodity X would mean more production of X with the same resources. Accordingly, PPC would rotate (NOT shift) as shown in fig-5 (from ab to ab_1).

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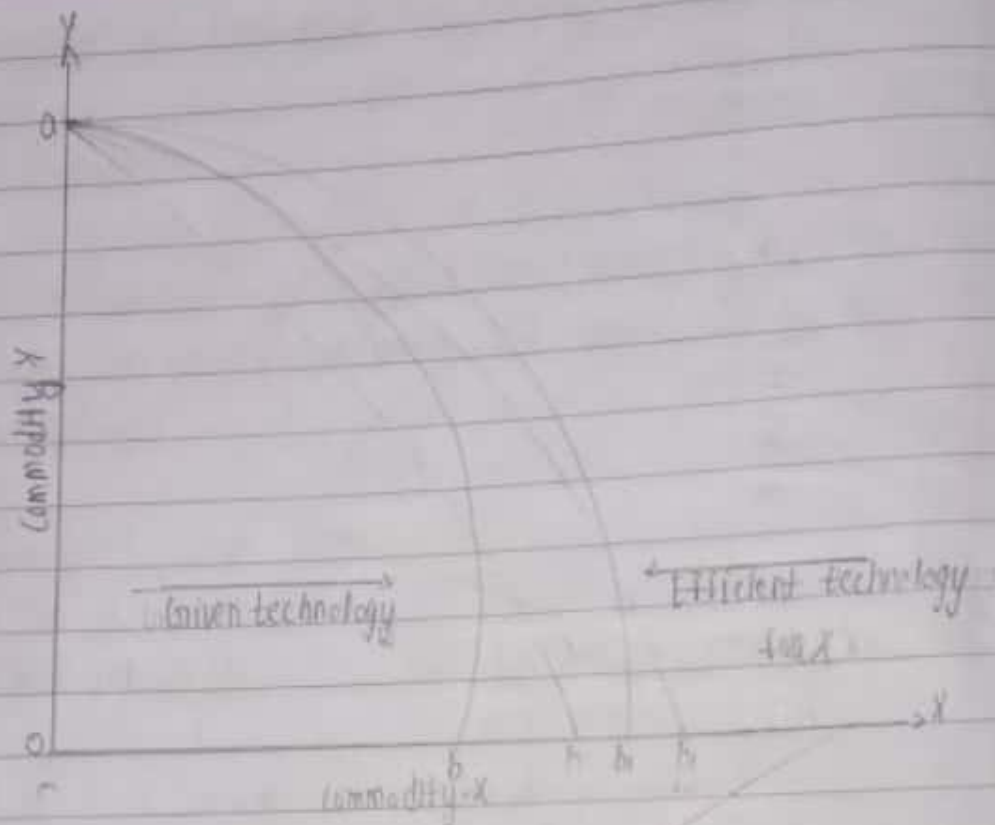


Figure 5

Efficient technology for commodity X raises productivity, more of X can be produced with the same resources. Thus PPC rotates to the right, from ab to ab_1 . Constant technology for commodity Y implies that maximum production of Y remains constant and equal to oa .

b) Efficient technology for the production of commodity Y: Efficient technology for the production of commodity Y would mean more production of Y with the same resources. Accordingly, PPC would rotate (not shift) as shown in fig-6 (from ab to a_1b_1)

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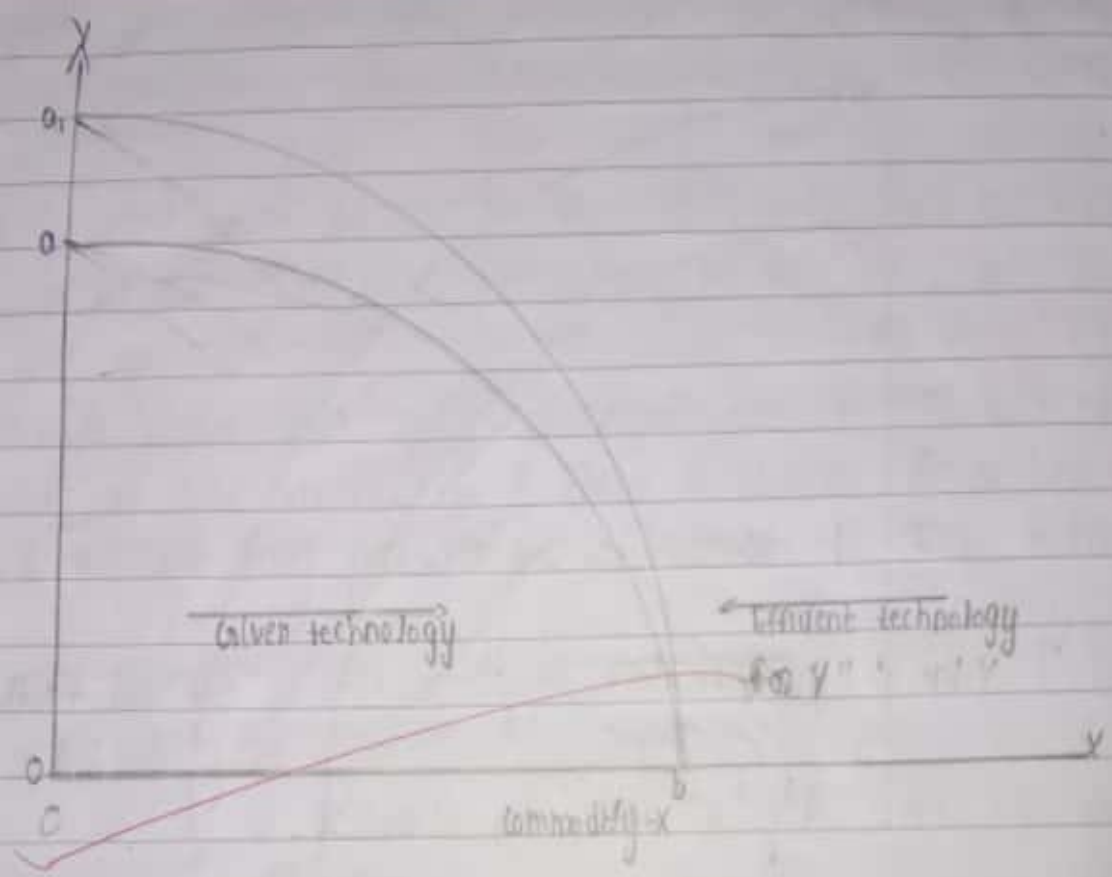


Figure 6

Efficient technology for commodity-Y raises productivity of Y. Accordingly more of Y can be produced with the same resources. Thus, PPC rotates from ab to a_1b . Constant technology for commodity-X implies that maximum production of X remains constant and equal to ob .

- b) Efficient Technology for the production of both X and Y: Efficient technology for the production of both X and Y would mean greater production of both X and Y with the same resources. Accordingly, PPC would shift to the right as shown in fig 7 (from ab to a_1b_1)

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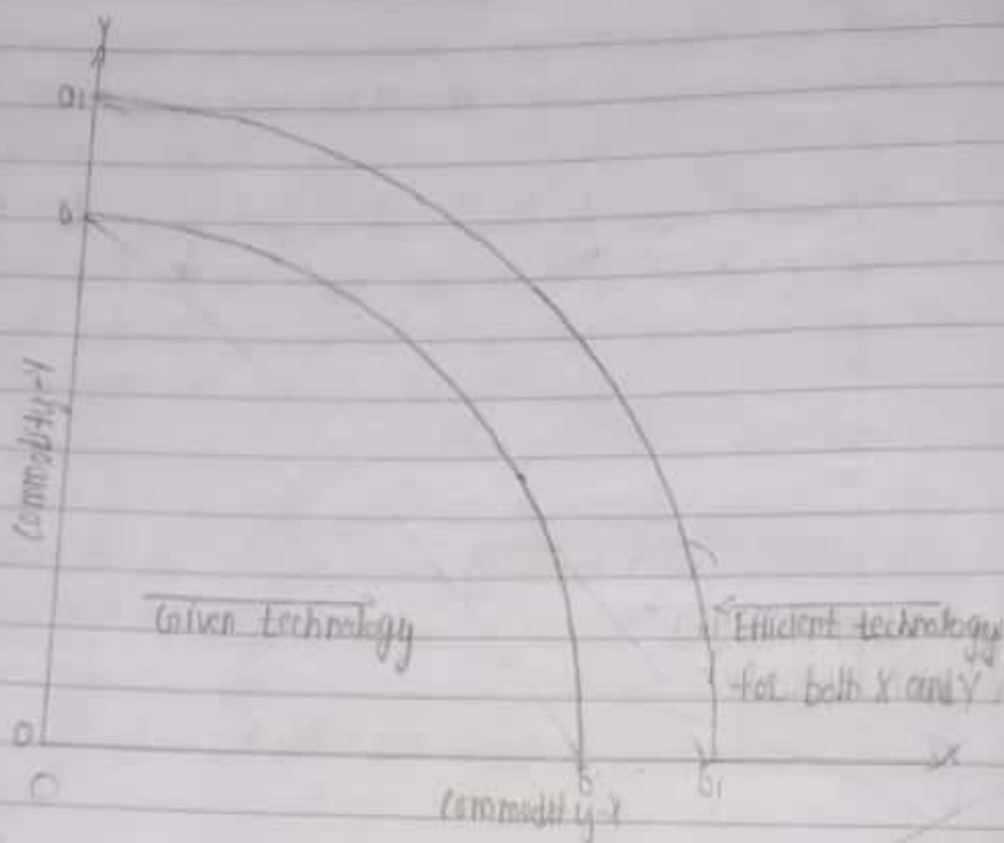


Figure 7

Efficient technology for commodity-X as well as for commodity-Y raises productivity of both X and Y. Accordingly, more of X as well as of Y can be produced with the same resources. Thus, PPC shifts to the right from ab to a_1b_1 .

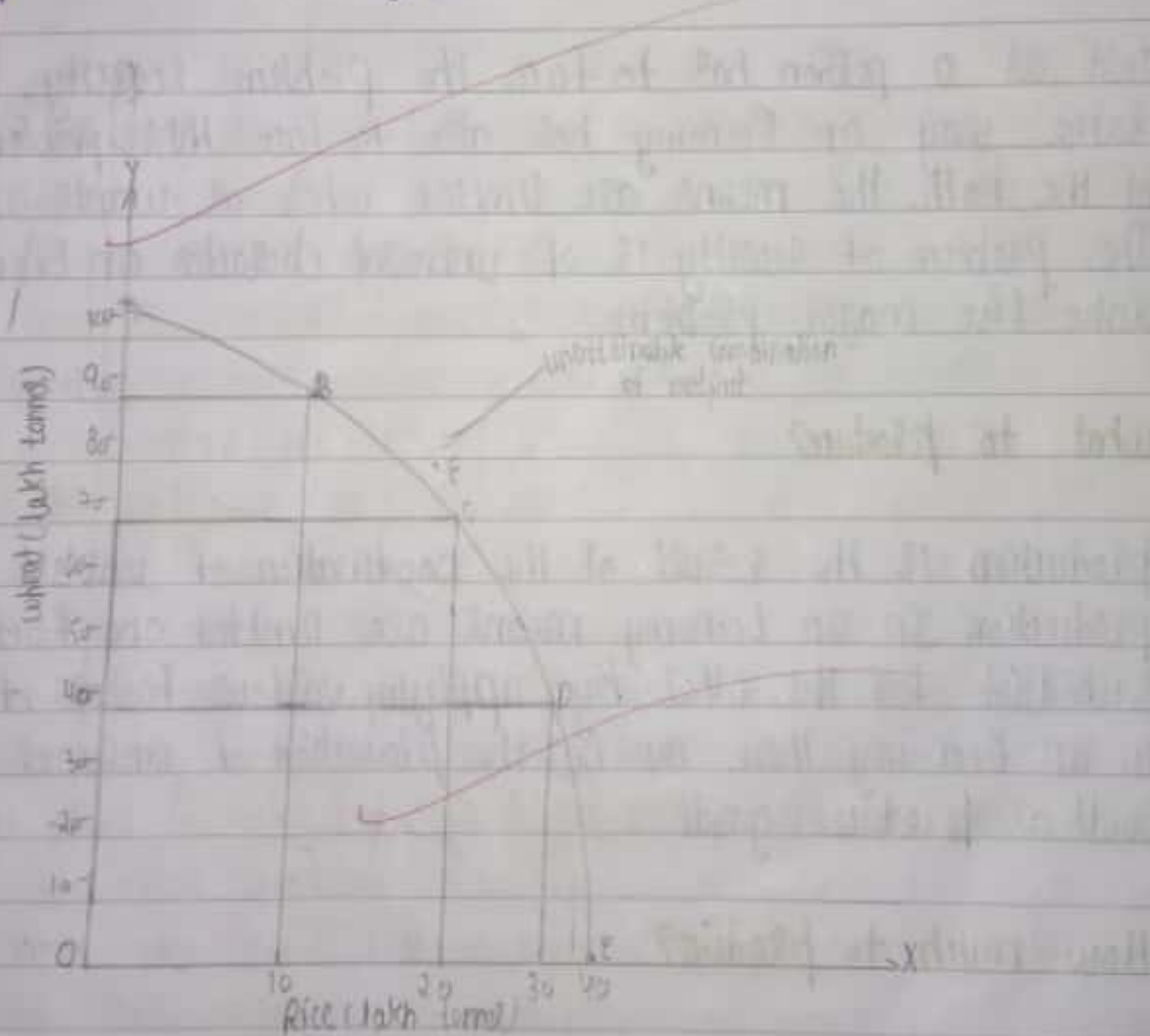
Q1) Explain PPC with the help of schedule and diagram.

Ans production possibility curve shows different combinations of two goods which can be produced with the given resources on the assumptions that 1) resources are fully and efficiently utilised and 2) technique of production remains constant.

The table showing different possibilities of production of wheat and rice is called production possibility schedule.

Goods	Production Possibilities				
	A	B	C	D	E
wheat	100	90	70	40	0
Rice	0	10	20	30	40

Combination A shows that 100kg of wheat can be produced without any production of Rice. Combination E shows that 40 kg of rice can be produced without any production of wheat.



a) what are the assumption of PPC

Ans Assumption of PPC

Two basic assumptions of PPC are as these

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- 1) the given resources are fully and efficiently utilized, and
- 2) there is no change in technology.

observe carefully, these assumptions include four points: 1) PPC is drawn on the basis of a given set of resources, 2) given resources are fully utilized 3) given resources are efficiently utilized, and 4) the state of technology does not change.

Q) what are the central problem of Economy?

Ans Just as a person has to face the problem scarcity, in the same way an Economy has also to face this problem. In both of the both, the means are limited where as wants are unlimited. The problem of scarcity is of universal character an Economy has to solve five major problems

1) what to produce?

production is the result of the coordination of various factors. production in an Economy, means are limited. one factor can be substitute for the other. by applying various factors of production in an Economy there can be the production of consumer goods as well as producer goods.

2) How much to produce?

Ans After deciding which goods are to be produced, another problem arises as to how much of those goods are to be produced. If we choose to have more of one commodity, we have to sacrifice the other commodity.

3) How to produce?

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Ans Production involves two main methods of production

labour intensive methods and capital intensive method. Labour intensive technique of production means the use of more labour and less capital. Capital intensive technique, on the other hand refers to the use of more capital than labour. As India, is a labour abundant country more work is done with the help of labour.

4) for whom to produce?

Ans Another problem is for whom the Economy has to produce. Should the goods we produced for consumption or for production? Should there be production for the rich or the poor? Should we produce the luxury items or articles of mass consumption? Should the production be for Economy consumption, domestic consumption or for export?

5) full utilization of resources

If the scarce productive resources like labour and raw material are not fully utilized. It signifies their wastage or unemployment. The society must make efforts to utilize the scarce productive resources to the fullest extent so that wants for goods and services can be freely satisfied.

very short answer

Q1) why does the problem of choice arise

Ans The problem of choice arises because of scarcity.

Q2) Define Micro-economics?

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Ans Microeconomics is that branch of economics which studies individuals or particular units such as household, firms,

Q3) Define two reason for the problem of choice.

- 1) unlimited wants
- 2) limited wants

Q4) Give one reason for the rightward shift of PPC.

Ans A rightward shift of a PPC indicates the situation of growth of resources under which an economy can produce more of both the goods.

Q5) Give two examples of micro-economic study.

Ans study of a firm 2) study of partial equilibrium

Q6) What gives rise to an economic problem?

Ans Scarcity of resources gives rise to an economic problem.

Q7) Define PPC (Production Possibility Curve)

Ans Production Possibility Curve represents graphically alternative production possibilities facing an economy.

Q8) Define the characteristics of the resources.

Ans) Two characteristics of the resources:

- 1) Resources are scarce in relation to our needs, and

2) Resources have alternative resources.

Q9) What is macroeconomics?

Ans Macro-economics is that economy which studies aggregates related to the whole economy such as national income, general price level, etc.

Q10) What are economic activities?

Ans Those activities which are concerned with the acquiring and use of wealth are called economic activity.

Q11) What are economic activities?

Ans Economic activities are related to production, distribution, exchange and consumption of goods and services.

Q12) What is meant by scarcity?

Ans Scarcity means the shortage of commodities or productive resources in relation to their demand.

Q13) What is the shape of PPC?

Ans Concave to the origin

Q14) Concept of opportunity cost

Ans opportunity cost is the cost of availing one opportunity in terms of the loss of the other opportunity
or

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opportunity cost is the value of a factor in its next best alternative use.

Diagrammatic Illustration

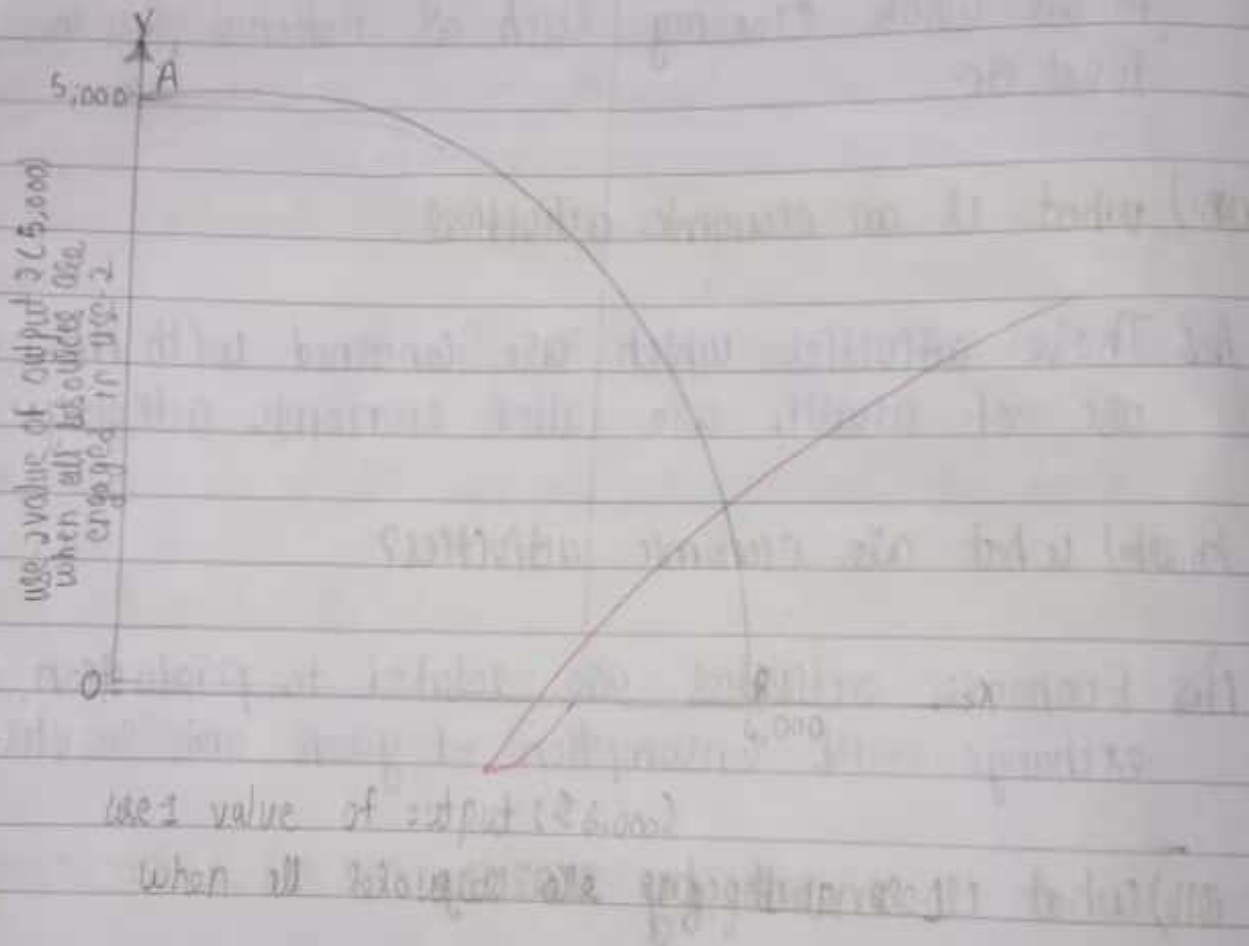


Fig. 10 shows production possibility curve AB. X-axis use-1 and Y-axis show use-2 of a given set of resources. The diagram is drawn on the assumptions that technology remains constant and that the resources are fully and efficiently utilized. Value of output in use-1 assumed as 6,000, and in use-2 as 5,000 resources are employed. In use-1 the opportunity cost = 5,000 in its next best alternative use.

Economics: - A science of wealth ADAM SMITH WEALTH
DEFINITION

ADAM Smith in his book "wealth of Nations" in 1776 Define economics as, "An Enquiry into the Nature and causes of wealth of Nations." Many other earlier Economists also give similar definitions. According to Adam Smith Economics as a science of wealth is a body of knowledge which treats wealth as everything. Attention is exclusively pay to the wealth.

Later Many Economists condemned this definition of Adam Smith accused economics of selfishness and worship of the God of wealth. They therefore called it a dismal science.

Marshall's Definition

Science of Material welfare

According to Marshall, "Economics is a study of man's action in the ordinary business of life. It enquires how to get his income and how to use it. Thus it is on one side a study of wealth and on the other, and more important side a part of the study of man."

From this definition it is quite clear that although Economics still studies wealth, wealth is not considered of primary importance. In other words, it has been given a secondary place, the first place being given to man.

Robbins Definitions

Science of Scarcity or Science of choice

Robbins offered a definition which he thought was free from

The Defects of both Adam Smith and Marshall. he Defined Economics thus, "Economics studies human behaviour as relation-ship between ends and scarce means which have alternative uses."

According to Robbins, Economics tells us how a man makes use of his scarce means, having alternative uses for the satisfaction of his unlimited ends. Since This involves choice-making, economics has also been called as a science of choice.

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very short answer

Q13) what is meant by economic Theory

Ans Economic theory is a body of economic principles and laws built up on the basis of logical reasoning

Q14) Define a commodity.

Ans A commodity is a thing which is market able, scarce, valuable and useful

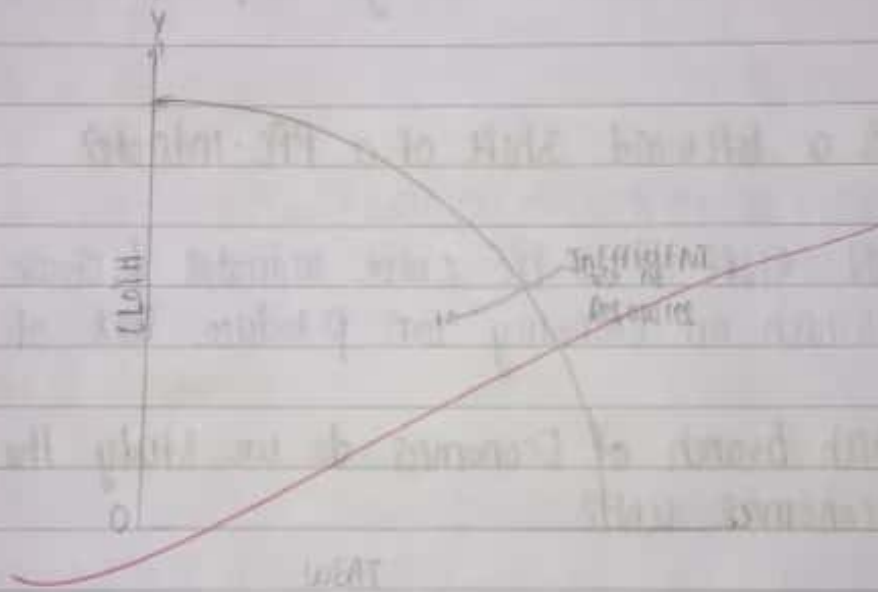
Q15) what are the main tools of economic analysis?

Ans The tools of economic analysis are logic of reasoning, graphs, diagrams, and functional relationships.

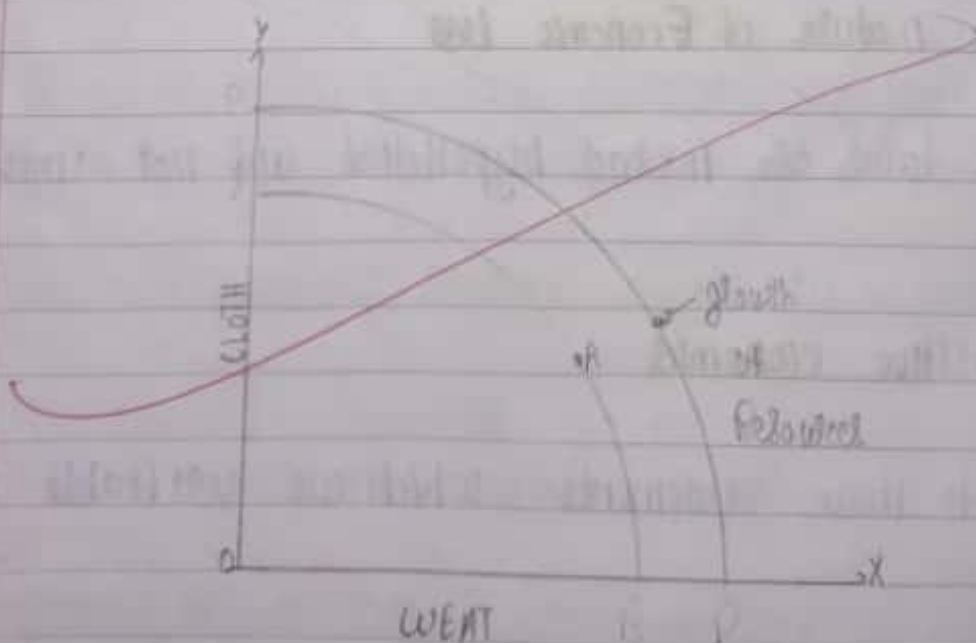
Q1) Define 'Marginal Rate of Transformation'

Ans Marginal rate of Transformation is the rate at which the quantity of output of one good is sacrificed to produce one more unit of the other good.

Q2) Draw a PPC showing inefficient use of resources in an Economy



Q3) Draw a PPC showing growth of Resources



Q4) Why is PPC sloping downward

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Ans Production possibility curve is downward sloping because more production of one good is associated with the less of the another good.

Q20) What does a rightward shift of PPC indicate?

Ans A rightward shift of a PPC indicates the situation of growth of resources under which an economy can produce more of both the goods.

Q21) What does a leftward shift of a PPC indicate?

Ans A leftward shift of a PPC curve indicates decrease in the resources under which an economy can produce less of both the goods.

Q22) Under which branch of Economics do we study the behaviour of a single economic unit?

Ans Micro-economics

Q23) What is the nature of Economic laws?

Ans The economic laws are inexact, hypothetical and not universally applicable.

Q24) What is positive economics?

Ans It refers to those statements which are verifiable in economics.

Q25) What is normative economics?

Ans It refers to those statements in economics which involve value judgement or which are not verifiable.

Q26) Define market

Ans A market is any set of arrangements which allows individuals pursuing their respective economic activities to interact freely with each other.

Q27) Who is a Producer?

Ans Producer is one who produces or sell goods and services for the generation of income.

Q28) Who is a Consumer?

Ans A consumer is one who consume goods and services for the satisfaction of his wants.

Q29) What is meant by optimization?

Ans Maximisation of output per unit of inputs is known as optimization.

Q30) Who are primary economic agents in a modern society?

Ans Producers and consumers are the primary economic agents or decision makers in a modern society.

Q31) What type of science economics is?

Ans Economics is a social science.

Q37) Draw a PPC and show the following situations on the diagram

- 1) full employment of Resources
- 2) under-utilisation of Resources
- 3) growth of Resources.

Ans The given ahead diagram shows PPC

Marginal opportunity cost

Marginal opportunity cost is also described as a rate at which output of Good X to be sacrificed for every additional unit of Good Y. In this sense, it refers to the slope of PPC

Diagrammatic illustration

Fig 1.1 illustrates the concept of marginal opportunity cost. It is assumed that initially resources are employed such as that output in use-1 = ok and output in use-2 = ol

Now, some resources are shifted from use-1 to use-2. Consequently less of output in use-1 = ok_1 , and gain of output in use-2 = l_2l_1

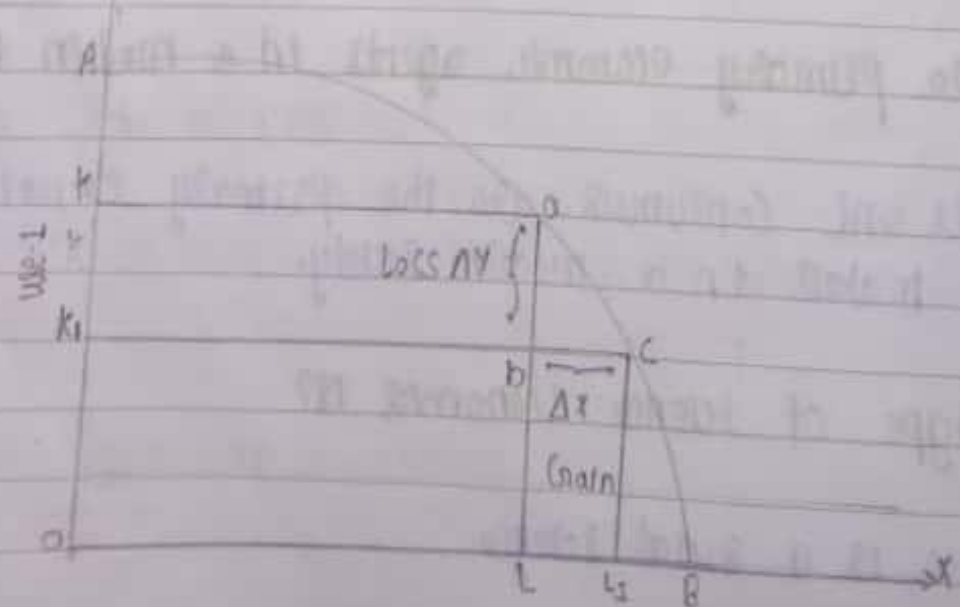


Figure 11

Marginal opportunity cost $= \frac{\Delta Y}{\Delta X} = \frac{kk_1}{ll_1}$

-> Rate at which output of Good-Y is to be sacrificed for every additional unit of Good-X

Marginal opportunity cost (MOC)

$\frac{\Delta \text{Loss of output}}{\Delta \text{gain of output}}$

$\frac{kk_1}{ll_1} = \frac{ab}{bc}$

= rate at which output of Good-Y is to be sacrificed for every additional unit of Good-X
(also called Marginal Rate of Transformation)

Market Economies: Centrally Planned Economies, and Mixed Economies: Some Notable Characteristics

Market Economy	Centrally Planned Economy	Mixed Economy
1) There is a market mechanism that connects buyers and sellers	There is almost a complete lack of market mechanism of the free play of the forces of demand and supply	Market mechanism operates to connect buyers and sellers. But, not without 'checks and balances' by the government.
2) Prices of goods and services are	Prices of goods and services are largely	Prices of goods and services are largely settled through

settled through the market forces of demand and supply

settled by the 'central Authority' appointed by the government of the country

The market forces of demand and supply. But, policies like of 'floor price', 'Price ceiling', 'Support Price' are often pursued to promote equality and social justice

3) The consumers are sovereign. They buy according to their taste and preferences, and maximise their satisfaction. The producers maximise their profits by producing goods and services as demanded by the consumers.

Consumer sovereignty is ruled out. Instead, the central authority decides what goods and services the consumers would need for their livelihood

Consumer is sovereign. But Resources are not allowed to be used in the production of such goods which are socially harmful

4) The government does not interfere with the decisions of the households and the producers or, we can say that the government does not interfere with the free play of the market forces of demand and supply. It focuses largely on the maintenance of law order and defence of the country

The government takes upon itself the responsibility of growth and development of the country

The government plays a key role in the process of growth and development, but focuses largely on fighting draw-backs of the market Economy

5) Accumulation of capital is allowed as a matter of right. Capital emerges as the principal means of production	There is a state ownership of collective means of production	There is a private as well as public ownership of the means of production
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Q) very short/

Q) Draw a PPC and show the following situations on the diagram

- 1) full employment of Resources
- 2) under-utilisation of Resources
- 3) growth of Resources

Ans The give ahead diagram shows PPC.

