



Q1. Discuss the central problems of an economy.

Ans: Every economy faces three central problems due to scarce availability of resources. This scarcity challenges the best possible usage of these available resources to fulfill the unlimited demands. The three central problems of an economy are as follows:

The very first problem encountered by any economy is to decide what goods are to be produced and in what quantities or amount. There is a lot to be decided; whether to produce consumer goods or luxury goods; agricultural goods or investment goods; whether to cater education and healthcare sector or to strengthen country's military. An appropriate example was set by the Latin American nation Costa Rica; they dismantled their military in 1949 and invested the money, which earlier was spent on the maintenance of their army, on education and healthcare. Once it is decided, what to produce, the next decision is to estimate the amount or quantity of the production. So the economy constantly struggles to choose what to produce and in what quantities.

The second problem that arrives is how to harvest the given or available resources? That is, what technique is to be used for producing various goods and services? It depends majorly on the nation's endowment of resources in deciding the optimum technique. It has to be decided whether efficient production is possible through labour-intensive or capital-intensive techniques. This decision rests on the present economic conditions and also that the selected technique shall not only reduce the cost of production but also add to the social and economic welfare. For example, if a country is facing wide unemployment possibly due to huge population, then it is wise to opt for labour-intensive technique so that there is reduction in unemployment.

Finally, the purposeful distribution of final goods and services produced (national income) has to be done; that is, who gets what and how much? The economy needs to decide the best suitable mechanism for distribution of the final products among different segments of the society. The objective behind selecting such mechanism is to reduce inequality of income, to reduce poverty and to add to the social welfare and standard of living of people.

Q2. What do you mean by the production possibilities of an economy?

Ans: Production possibilities of an economy imply those numerous alternative combinations of goods and services, which a particular economy can produce, with the given technology and employing the available resources fully and efficiently. In other words, it refers to various feasible bundles of goods and services that can be produced together by efficiently utilizing the given technology and available resources.

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