

Learning Objectives

- ❖ Evolution of economics
- ❖ Meaning of an economy
- ❖ Meaning and definition of economics
- ❖ Meaning of scarcity
- ❖ Economic problem
- ❖ Central problems of an economy
- ❖ Other problems :
Fuller utilisation and growth of resources
- ❖ Opportunity cost and Marginal opportunity cost
- ❖ Production possibility curve
- ❖ Solution of central problems with the help of PPC
- ❖ Solution of other problems :
Fuller utilisation and growth of resources
- ❖ Attainable and unattainable combinations on PPC
- ❖ Branches of economics

INTRODUCTION

EVOLUTION OF ECONOMICS

The term Economics is derived from *two* Greek words namely, "Oikos" which means household and "Nemein" which means management. Thus Economics means Household Management. The term Economics was first used (as related to economic activities) by Dr. Marshall in 1890 in his famous book, "Principles of Economics". Adam Smith is known as the father of modern economics. Let us know more about the terms ; Economy, Economics and Scarcity.

1.1 MEANING OF AN ECONOMY

A system which provides people, the means to work and earn a living. All organisations like factories, shops, offices, business enterprises, transporters etc., who are involved in undertaking three economic activities, production, consumption and capital formation (investment) are collectively called an **economy** or it is a framework within which economic activities of production, consumption and capital formation are undertaken.

Economy includes all the production units in a defined area which provide people with the means to work and earn an income. Existence of an economy depends on two facts. First, human wants for goods and services are unlimited, and secondly availability of productive resources to produce these goods and services is limited.

1.2 MEANING AND DEFINITION OF ECONOMICS

It is a social science of human behaviour which aims at allocation of scarce resources in such a way that consumers can maximise their satisfaction, producers can maximise their profits and society can maximise social welfare. In simple words, *Economics is about making choice in the presence of scarcity.*

According to Robbins,

"Economics is the science which studies human behaviour as a relationship between ends and scarce means which have alternative uses."

Economics is an analysis which studies behaviour of an individual (Microeconomics) and of the society as a whole (Macroeconomics).

1.3 MEANING OF SCARCITY (SCARCITY OF RESOURCES)

In daily life, scarcity means acute shortage of a certain commodity but in economics, it means limitation of supply of a commodity in relation to its demand. It is excess of demand over available supply, i.e., demand of resources > supply of resources. The goods and services which are used to carry out production are called resources. Resources can be natural (sunlight, water), human resources (physical and mental efforts of labour) and man made resources (raw material, fixed asset). Resources are also referred to as factor inputs and non factor inputs. So long as human wants for goods and services remain ahead of the resources (both acquired and natural) the problem of scarcity would exist. Scarcity of resources is a fundamental economic problem which is faced by developing and developed economies alike. The affluent economies like U.S.A. and Western Europe face the problem of scarcity as their present wants are more than their increased resources and capability to produce.

1.4 ECONOMIC PROBLEM

1.4.1 The Meaning of Economic Problem

The scarcity of resources relative to human wants gives rise to struggle of human beings for sustenance. Economic problem basically is a problem of making choice.

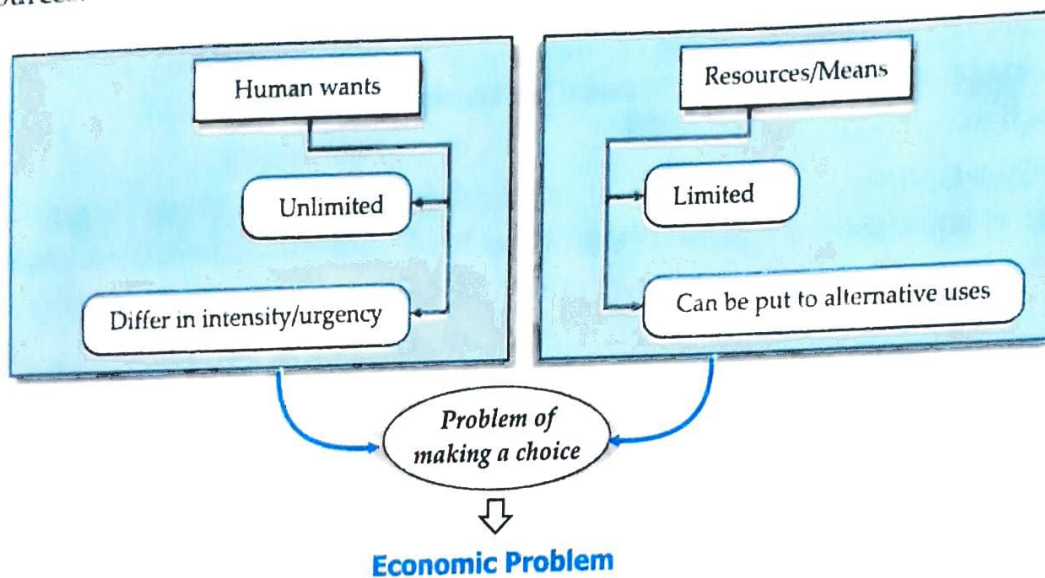
For example,

1. You have a ten rupee note (means/resources).
2. You want to buy a copy, a pen, a chocolate and a pencil (wants).

3. Your wants are unlimited in comparison to your means or your means are limited in relation to demand for them.
4. As your wants differ in urgency, also your ten rupee note can buy anything you want to, you face a problem, "a problem of making a choice" as to how should you spend 10 rupee note in such a way that you can buy maximum.

"The problem of making a choice is called economic problem."

Let us understand economic problem with the help of this chart comparing human wants with resources.



According to **Prof. Erich Roll**,

"Economic problem is essentially a problem arising from the necessity of choice ; choice of the manner in which limited resources with alternative uses are disposed off. It is a problem of husbandry of resources."

Thus it is basically a problem of scarcity of resources on one hand and also that resources can be put to alternative uses on the other hand. Therefore an individual has to make a choice as to which wants (according to priority/intensity) should be satisfied with limited resources in order to get maximum satisfaction.

1.4.2 Causes of Economic Problem or Why does Economic Problem Arise ?

Economic problem is a problem of choice. It arises due to scarcity of resources which can be put to alternative uses.

Thus the causes/reasons are :

1. **Scarcity of resources.** Availability of resources is limited in relation to need for them (their demand). Economic problem will not arise if the means to satisfy wants are also unlimited. The scarcity of resources is in relation to the quantum of human wants. A human being faces the economic problem when supply of resources is short as compared to their demand. The root cause of economic problem is scarcity of resources.

(However, a commodity in short supply cannot be called scarce if it has no demand e.g., Rotten apples, stale vegetables, old model of cars etc.)

2. Unlimited human wants. Human wants are recurring in nature. This is based on human psychological behaviour that as soon as one want is satisfied, another new want would take place. It implies everlasting existing demands and evergrowing new demands. Some of our wants are basic like the wants for food, clothing, shelter etc., while some of our wants grow with our income like wants for comforts and luxuries.

3. Resources can be put to alternative uses. Means have alternative uses. Choice is to be made between different uses. Alternative use of resources refers to the number of uses to which a resource can be put and implies that the available resource can be used only for one purpose at a time. When we opt for one want, we have to forgo the other (referring to the above example, your ten rupee note does not force you to buy only pen or only chocolate rather, it can be used in various ways in any denomination). Therefore a choice has to be made as to how should limited resources be spent in order to attain maximum satisfaction.

4. Wants differ in intensity. Human wants also differ in intensity (urgency). All wants are not of equal intensity. Some of our wants need immediate satisfaction while others can be postponed. That is why, resources can be allocated according to the priority of wants.

1.4.2.1 Features of Human Wants

- They are *unlimited*
- They *differ in intensity/urgency/priority*

(Details as given in 1.4.2)

1.4.2.2 Features of Resources/Mean

- They are *limited*
- They can be put to *alternative uses*.

(Details as given in 1.4.2)

1.4.2.3 Scarcity and Choice go Together

Scarcity and choice are inseparable. This is because, the problem of choice arises due to scarcity of resources. The human wants are unlimited and differ in intensity but resources to satisfy these wants are not only scarce but also have alternative uses, causing emergence of problem of choice. Had the resources been unlimited, there would have been no economic problem. Since all wants cannot be satisfied due to limited resources, we face the problem of choice *i.e.*, choice among multiple wants which are to be satisfied.

For example, a plot of land cannot be used for farming, as a playground, for constructing a house, as a factory, as a shopping mall etc at the *same time*. This plot of land has many uses, but a choice has to be made between all the uses as it can be used at a time for only one purpose.

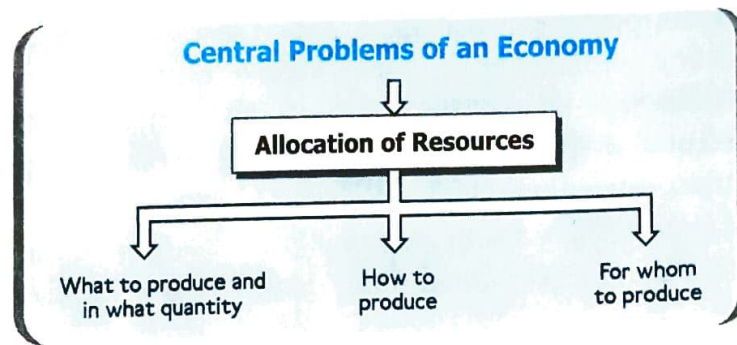
1.4.3 Economising Resources

It means making optimum utilisation of scarce resources in order to satisfy maximum of unlimited human wants. *Economising resources is the essence of economic problem*. Scarcity of resources in relation to demand for them causes economic problem. It creates the need for economising resources *i.e.*, *the efficient utilisation of what is available*. For economising resources, a society must make choices, choice of the manner in which limited resources with alternative uses are disposed off to satisfy unlimited wants which differ in intensity.

1.5 CENTRAL PROBLEMS OF AN ECONOMY

Production, exchange and consumption of goods and services are the basic economic activities of life. In the course of these activities, every society has to face *scarcity* of resources which gives rise to the problem of *choice*. In other words, every society has to decide on how to use its scarce resources. Thus broadly the central problem of an economy is *Allocation of Resources*.

Following are the *three* central problems relating to *allocation of resources*.



1.5.1 What to Produce and in What Quantity ?

This is the first basic problem of allocating resources among different alternative uses. This is also called **problem of resource allocation**. It is related to the selection of goods, as all goods cannot be produced because of limited resources. Whether to produce more of food, clothing, housing or luxury goods. Whether to have more of consumer goods or to have capital goods.

For example, while determining budgetary policy, the problem before government is as to how many resources should be allocated to agriculture sector, to industrial sector etc. Problem of choice requires the decision of what to produce and what not, which wants are urgent and which wants can wait has to be decided.

It is a *two fold* decision :

- (i) Which goods and services are to be produced ; e.g., consumer goods or capital goods, war time goods or peace time goods etc.
- (ii) Quantity of goods and services ; after a decision has been taken on types of goods, quantities of these goods should also be decided.

[Factors guiding, **What to produce are** : available technology, cost, profit, demand, maximum utility etc.]

1.5.2 How to Produce ?

This is also called the **problem of choice of technique of production**. There are *two* techniques :

- (i) **Labour intensive technique**. It uses more of labour and less of capital.
- (ii) **Capital intensive**. It uses more of capital (machines) and less of labour.
 - Choice of labour intensive would mean that the economy makes better use of its available *manpower* (generation of employment).
 - Choice of capital intensive would mean that the economy develops its *infrastructural base* required for rapid economic growth.

However choice of technique depends on the objective of the producer. It may be labour-intensive or capital-intensive. It can also be a combination of both. The efforts should be, to use the *efficient technique of production*.

For example, India prefers labour intensive technique due to abundance of labour and developed economies like that of European countries prefer capital intensive technique due to abundance of capital. Efficient technique is the one which uses the least amount of scarce resources to produce maximum. In other words, the production should be undertaken at minimum costs.

[Factors guiding, How to produce are : Objective of the producer, availability of technique, availability of resources etc.]

1.5.3 For Whom to Produce ?

This is also called the **problem of distribution of national income** among the factors of production. Goods and services are produced for the consumers and consumer's capacity to purchase goods and services depends on his income. It is very important to ensure that a person should get income equal to the contributions he makes to the national product. The problem of 'For whom to produce' is the problem of determining wage rate for the use of labour, rent for the use of land, interest rate for the use of capital and profits for the entrepreneur. More equitable is the distribution of income, more equitable will be the distribution of national product.

For example, If there is unequal distribution of income in a company, the employees of this company will not be able to buy what has been produced in the economy as per demand projected by the producers from these employees.

There are *two* aspects of the problem of 'For Whom to Produce' :

- (i) **Personal distribution.** This is concerned with distribution of production among consumers in the society.
- (ii) **Functional distribution.** This is concerned with distribution of production (or income generated through production) among factors of production, viz land, labour, capital and entrepreneur.

[Factors guiding, For whom to produce are : Distribution of income among income earners, social justice or equity.]

1.6 OTHER PROBLEMS : FULLER UTILISATION AND GROWTH OF RESOURCES

1.6.1 Fuller Utilisation of Resources

Since resources are scarce, their underutilisation or unutilisation is a waste for the economy. An economy should identify and take corrective measures for the factors which make fuller utilisation of resources impossible e.g., sometimes labour is unemployed, factories remain idle, land, labour and capital are not fully employed etc. So every economy must ensure that all available resources are utilised to the full.

1.6.2 Growth of Resources

Every economy has to explore its potential to develop itself in order to expand the size of production and national income. Every economy should ensure increase in its production capacity so that level of production is increased. An economy can achieve the objective of growth of resources through technological advancement and increase in supply of resources.