

Chapter 2

Economic Problems

Nature of Economics Problems:-----

“ Economic Problem is the problem relating to the necessity of choosing What , How and for Whom to produce and how to achieve economic growth.”---Leftwhich

Causes of Economic Problems--Two main causes

1. Unlimited Wants
2. Limited Means – Land , Labour ,Capital Enterprise.

Central Economic Problems :---

1. What to produce and how much to produce
2. How to produce ?
3. For whom to produce ?
4. How to achieve full utilization of resources?
5. How to achieve efficiency in production and distribution ?
6. How to achieve economic growth ?

Production Possibility Curve:-----

- “ The production possibility curve is that curve which shows the possible combinations of two goods that can be produced by an economy , given available resources and technology”
- - Lipsey

Properties

1. PPC Slopes Downwards
2. PPP is Concave to the point of origin

PPC illustrates three concepts:--

1. Scarcity:- It is implied by the unattainable combinations beyond the PPC.
2. Choice:- It is implied by the need to choose among the attainable points on the curve .
3. Opportunity Cost:- It tells us the opportunity cost of movie in terms of computers or vice versa.

2. The link between “choices” and “resources”: PRODUCTION POSSIBILITIES CURVE

Simplifying Assumptions:

1. Economy is operating efficiently
2. Available supply of resources is fixed in quantity and quality at this point of time
3. No new development in technology during analysis
4. Economy produces only 2 types of products

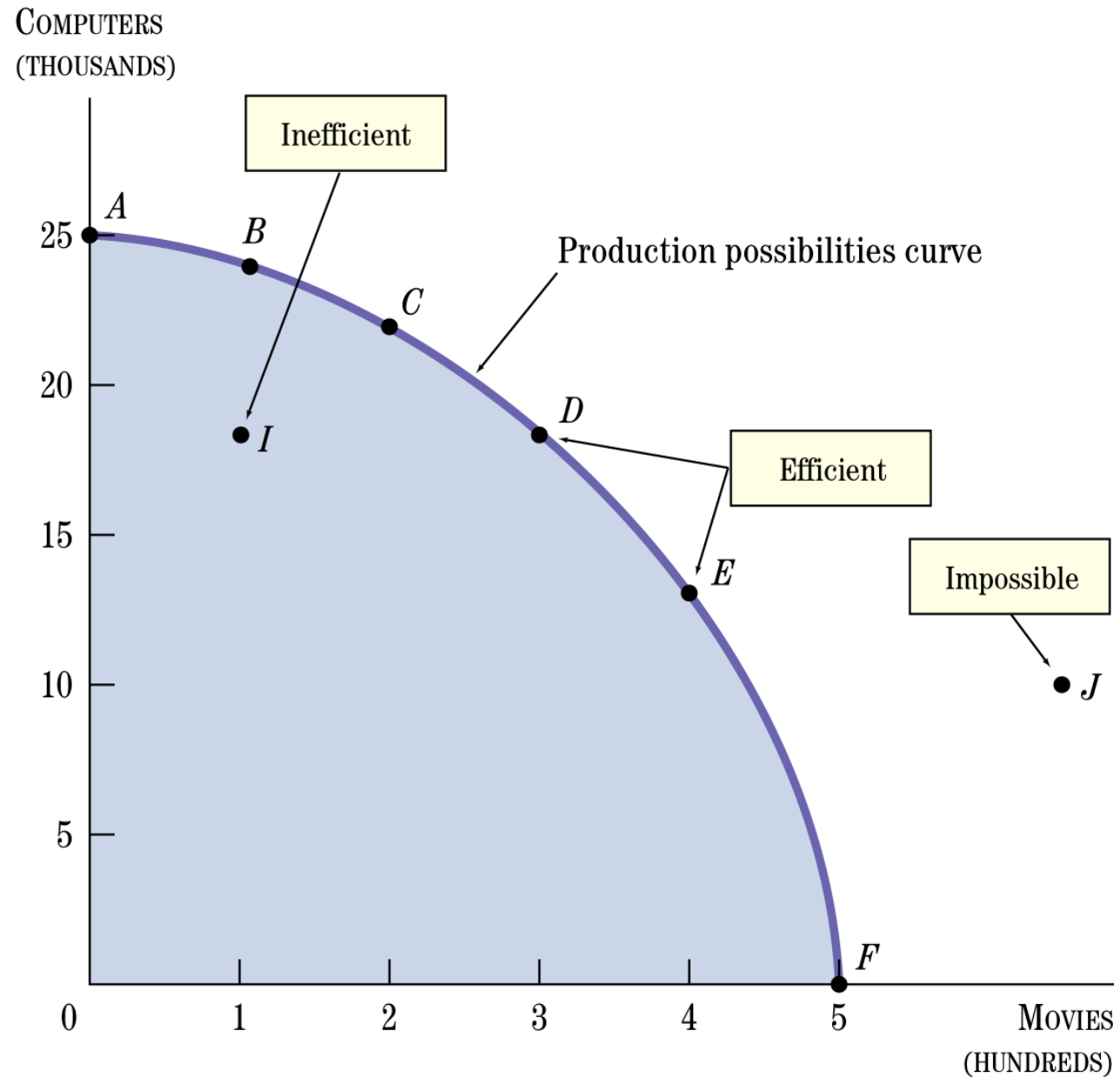
TABLE 1.1 – PRODUCTION POSSIBILITIES

<u>CHOICE</u>	<u>MOVIES</u>	<u>COMPUTERS</u>
A	0	25,000
B	100	24,000
C	200	22,000
D	300	18,000
E	400	13,000
F	500	0

Production Possibilities Curve (Continued)

- Choices will be necessary because resources and technology are fixed
- A production possibilities *table* indicates some of the possible choices
- PPC is a graphical presentation of choices

Figure 1.2
The Production
Possibilities Curve



Production Possibilities Curve (Continued)

- Points on the curve represent maximum possible combinations
- Points inside the curve represent underemployment or unemployment
- Points outside the curve are unattainable at present
- Optimal or best product will some point *on* the curve. The exact point depends on society ; this is a normative decision.

Law of increasing opportunity costs

- The slope of PPC becomes steeper, showing increasing opportunity cost. That is, the amount of other goods and services that must be foregone to obtain *more* of any given product increases
- Economic rationale: economic resources are not completely adaptable to alternative uses

3. Unemployment, economic growth and the future

- Unemployment and productive inefficiency occur when the economy is producing less than full production or inside the PPC
- Economic growth occurs when PPC shifts outward. This happens when:
 1. Resource supplies expand in quality or quantity
 2. Technological advances are occurring
- Our present choices affect our future possibilities

Figure 1.3
Shifts in the Production
Possibilities Curve

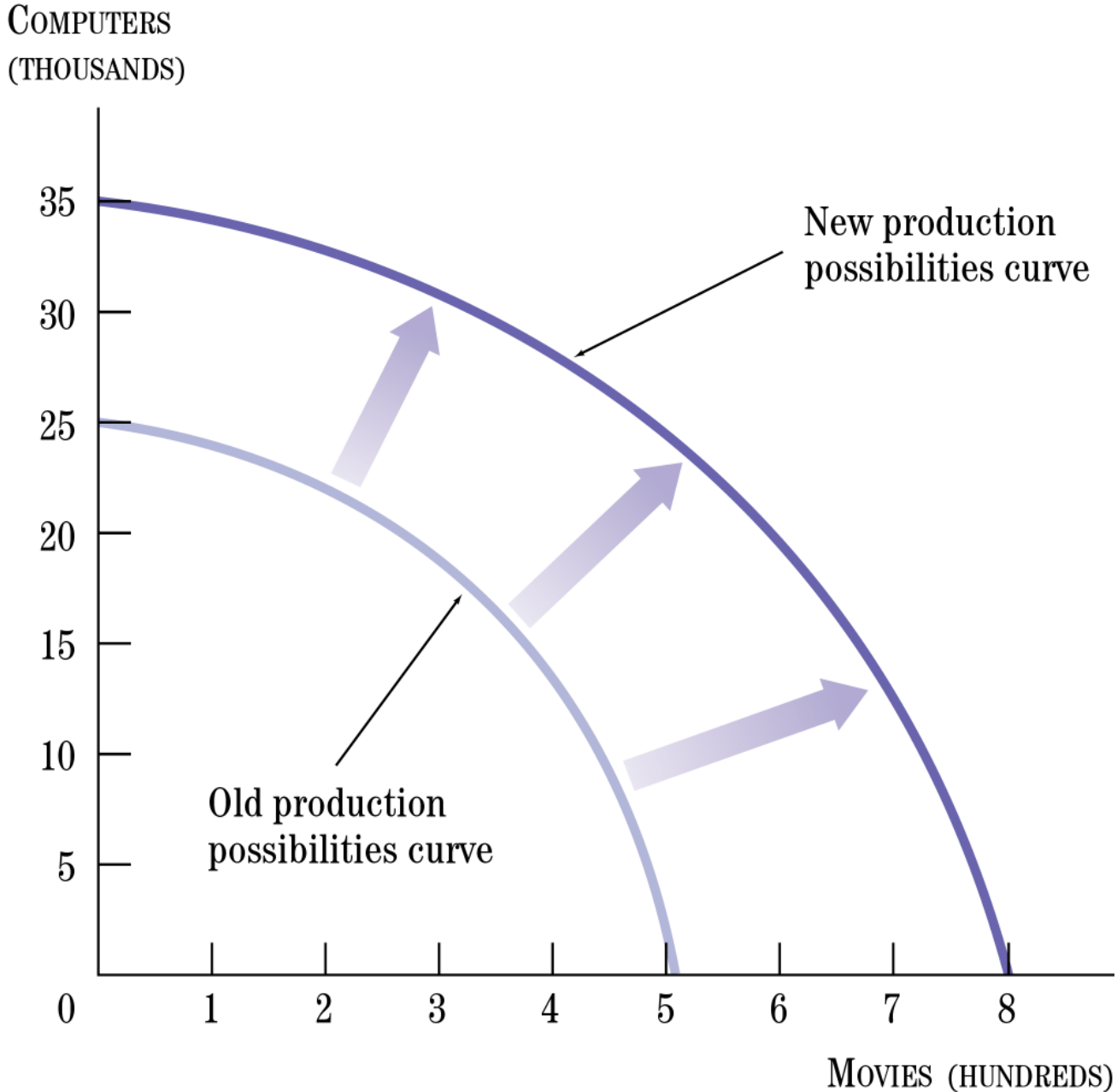
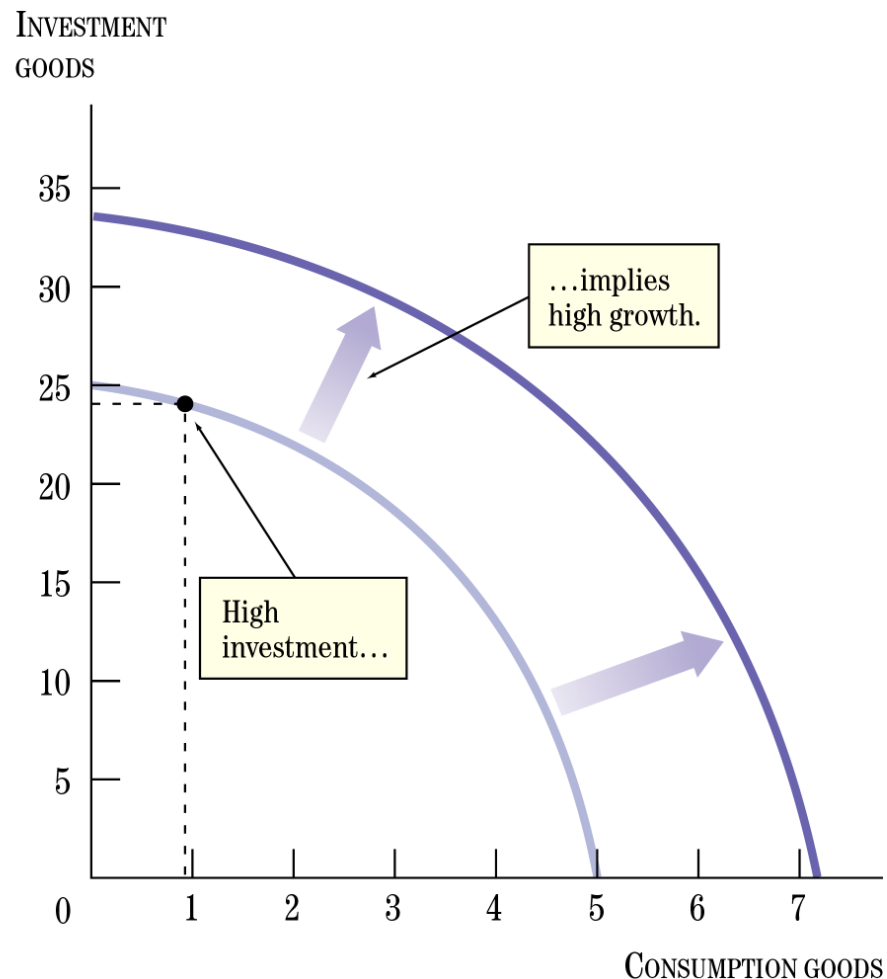
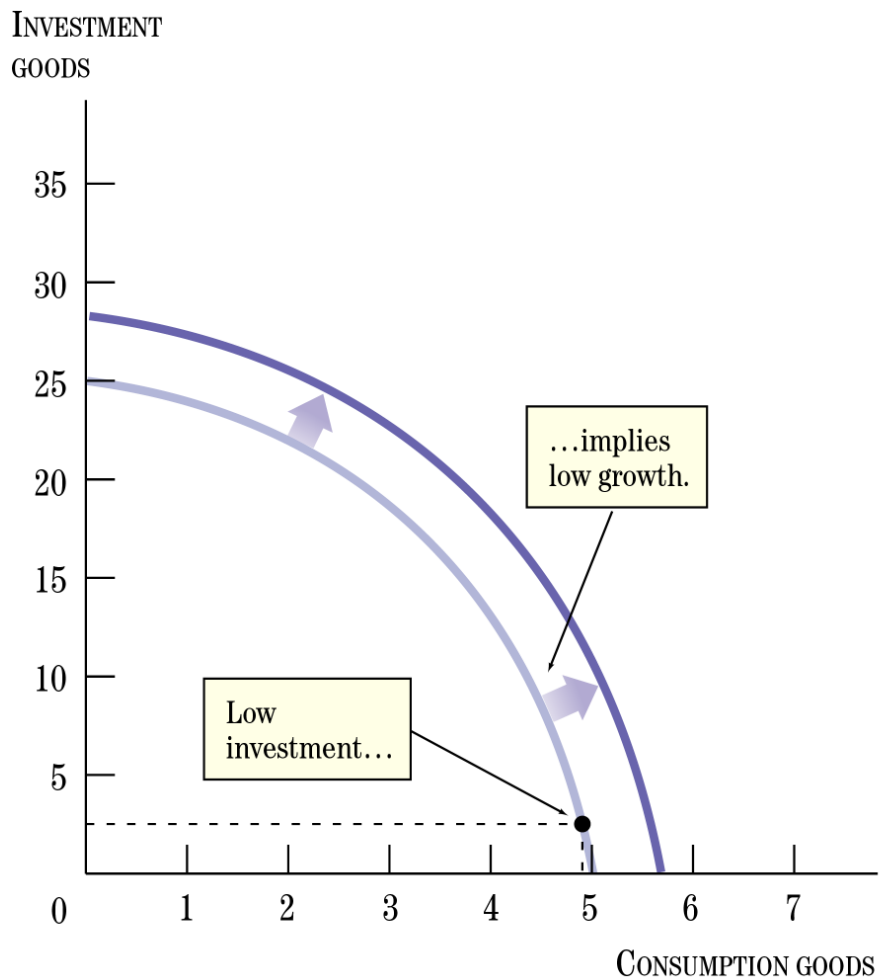


Figure 1.4
Shifts in the Production Possibilities Curve Depend on Choices



4. Economic systems

- Who owns the factors of production or economic resources?
- Who coordinates economic activity?
How?
- Three main types of economic systems
 1. Market economies (Capitalism)
 2. Command economy (Communism)
 3. Mixed systems

Characteristics of economic systems

Market economy

- There is private ownership of resources
- Markets and prices coordinate and direct economic activity

Command economy

- There is public (state or government) ownership of resources
- Economic activity is coordinated by central planning

Figure 1.5
From One Central Idea, Many Powerful Ideas Follow

