

THE ECONOMIC PROBLEM : **SCARCITY AND CHOICES**

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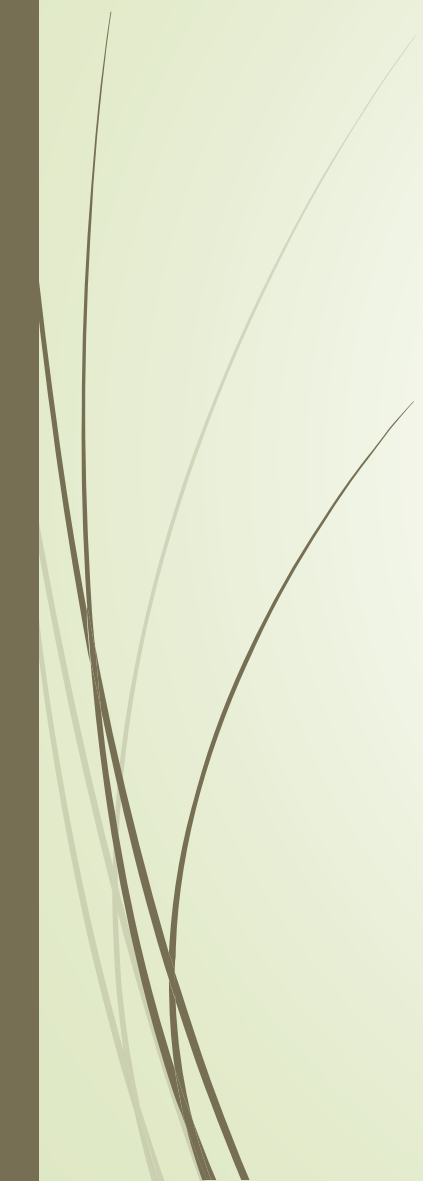
Why Economy exists?

An economy exists because of two basic facts:

- 1. Human wants for goods and services are unlimited.**
 - 2. Productive resources with which to produce goods and services are scarce.**
- Wants being unlimited and our resources being limited , we cannot satisfy all our wants.
 - That being so, an economy has to decide how to use its scarce resources to give the maximum possible satisfaction to the members of the society.
 - In doing so an economy has to solve some basic problems called Central Problems of an economy , which are mentioned and explained in the next slides.



CENTRAL PROBLEMS **OF AN** **ECONOMY**

- WHAT to Produce?
 - HOW to Produce?
 - FOR WHOM to Produce?
- 

The Economic Problem (Wants and Scarce Means)

“You must cut your coat according to your cloth.”

“You can’t make a silk purse out of a sow’s ear.”

These everyday sayings draw attention to the fact that, in comparison with all the things we want, our means of satisfying those wants are quite inadequate!

If a person’s income would be larger, he would probably think of buying extra things whose list has no end. For, even if these wants were satisfied, new wants would arise.



The Economic Problem...

- Those discussed in the previous slides are termed as ‘**the Economic Problem**’.
 - unlimited wants
 - very limited means
- And we can never completely overcome the difficulty.
But what we can do is to make the most of what we have.
In other words, we **economize**.

The Economic Problem...

Examples : Understanding Economizing

- The spending decisions of a housewife.
 - ‘**Economics**’ is derived from a Greek word meaning ‘the management of a household’. A housewife seeks to obtain the maximum satisfaction for the family from limited resources.
- How the school-girl schemes to get the most out of his pocket-money.
- The businessman faces the same problem in running his factory.
 - Should he produce this good or that, or some of both?
 - How many of each good?
 - Should he employ extra labourers or would it be better to install a machine to do the work?
 - Would it be more profitable to hire transport or to buy his own lorry? And so on.

The Economic Problem-Wants (Opportunity Cost)





Free and Scarce Goods

- Few goods are so plentiful that nobody will give anything for them. Such goods are free goods.
- Usually goods are scarce – they can be obtained only by going without something else.
- With such goods we have to economize, and so they are often referred to as ‘economic goods’.
- However, there is no hard-and-fast dividing line between economic and non-economic goods.
- Scarcity is relative to demand.

Free and scarce...

We see that economics is really concerned with the problem of choice-the decisions forced upon us by the smallness of our resources compared with our wants (Figure-). And as we choose, so we have to sacrifice.

If a newspaper boy spends his Christmas tips on a bicycle, then it is likely that he will have to go without the air rifle that he also wanted.

In deciding to work over time on a Saturday afternoon, a worker forgoes leisure time.

When the farmer sows a field with wheat, he accepts that he loses the barley it could have grown.

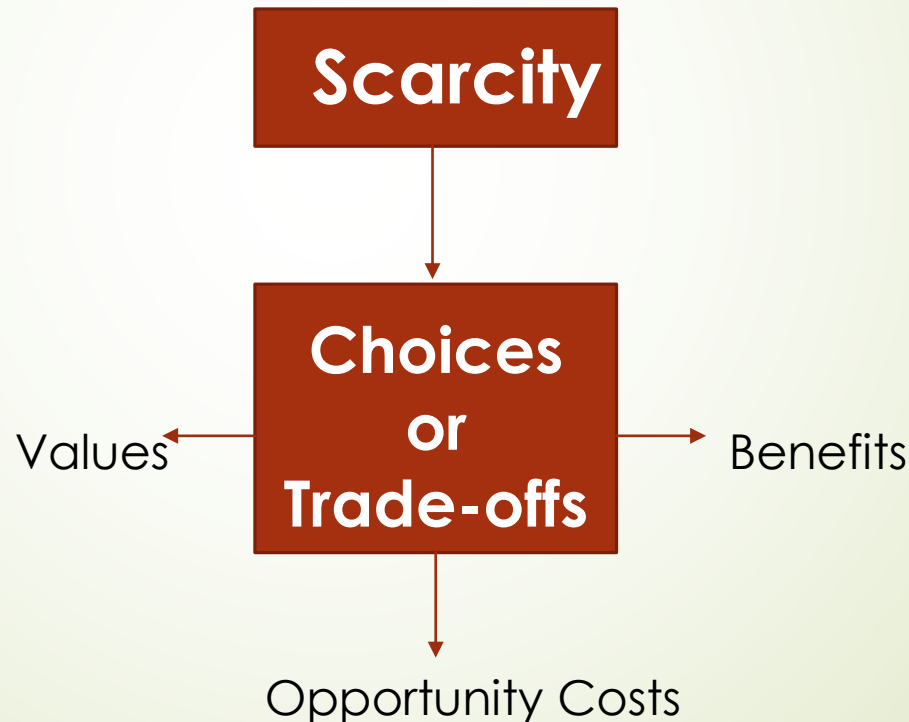


Free and scarce...

- Similar is the case with the nation. If extra materials and capital are required to accelerate the building of houses, roads and hospitals, then there will be less left for producing offices, power stations, sport center and so on. We therefore speak of Opportunity Cost – the cost of something in terms of alternatives forgone.
- In practice economizing is not so much a complete rejection of one good in favor of another, but rather deciding whether to have a little bit more of one and quite so much of another.

Scarcity and decision makers

Scarcity imposes choices on decision makers who are influenced by the benefits and opportunity costs of the alternatives, as well as their own values.

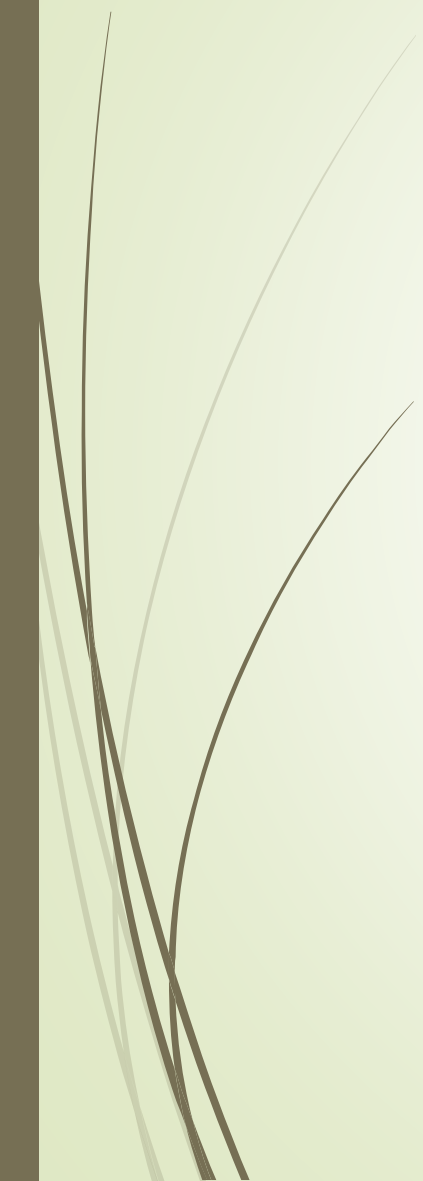


Scarcity, choices and influences on decision makers.



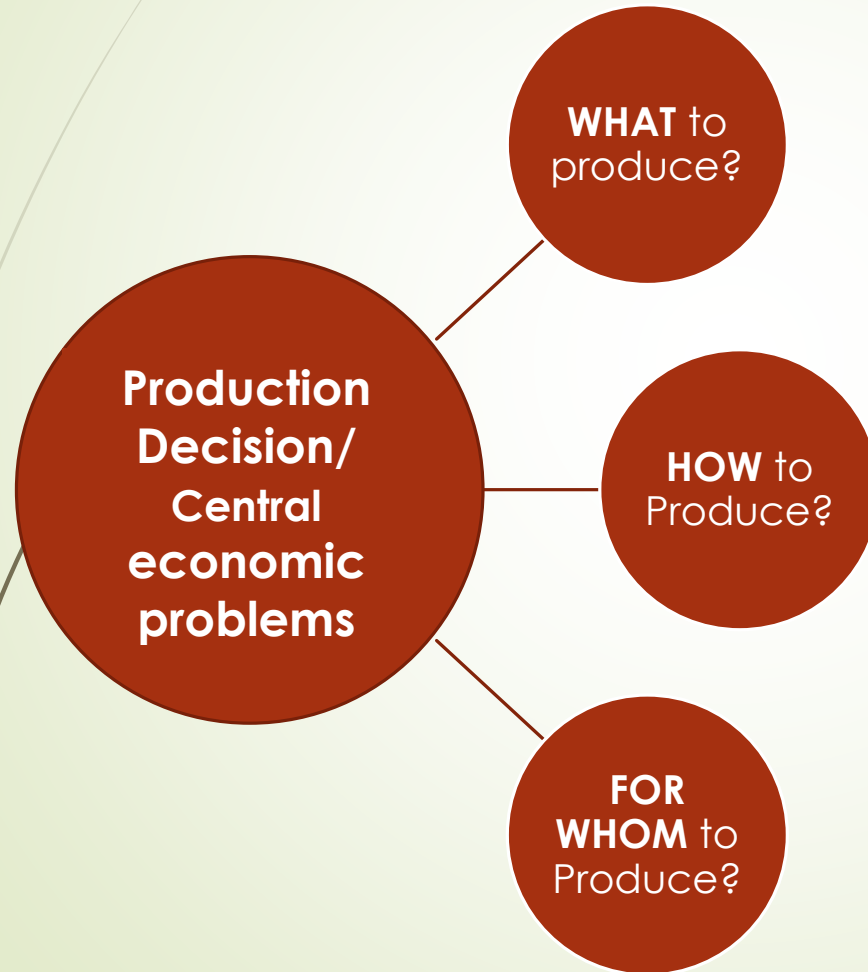
Resource Allocation

When purchasing raw materials, employing labour and undertaking investment, the business firm or the producer is involved in **resource allocation**. Society's resources are, inevitably scarce so that the individual firm has to pay for them. Decisions need to be made at three levels, namely:

1. What goods and services to produce with the available resources
 2. How to combine the available resources to produce different types of goods and services
 3. For whom the different goods and services are to be supplied.
- 

Resource Allocation

THE PRODUCTION DECISION



Given figure illustrates the interrelationship between the production decision and decisions regarding these three factors.

In truth, the **central problem** faced by every economic society is the **allocation of scarce resources** to satisfy as many wants as possible.



WHAT to Produce?

- The problem ‘**What to Produce**’ can be divided into two related questions.
 - Which goods are to be produced and which not? Resources are in fact scarce relative to human wants, an economy must choose among different alternative collections of goods and services that it should produce.
 - In what quantities those goods, which the economy has decided to produce are to be produced? “An economy has to decide how much resources should be allocated for the production of consumer goods and how much for capital goods.”



HOW to Produce?

- The problem of '**How to Produce**' means which combination of resources is to be used for the production of goods and which technology is to be made use of in production.
- There are various alternative methods of producing a good and the economy has to choose among them.
- Different methods of technique of production would use different quantities of various resources. The choice between different methods would depend on the factor supply situation and the prices of the factors of production.
- Keeping in mind the scarcity and the availability of the resources, those methods of production should be employed that economize as much as possible on the relatively scarce resources.

FOR WHOM to Produce?

- Once the problem of what and how to produce are solved, the goods are then produced.
- Because the resources and resulting output of goods is limited, the third basic economic decision, which must be taken, is '**For Whom to Produce**'.
- Who should get how much?
- The distribution of national income should be done on the basis of the Marxian principle “from each according to his ability, to each according to his needs”.
- Equality seems an option. But the problem is that equality in the distribution of national product or income may adversely affect the incentive to produce more. If this incentive is destroyed or greatly diminished as a result of promoting equality, the total national output available for sharing may be so much smaller that the living standards of all may go down.

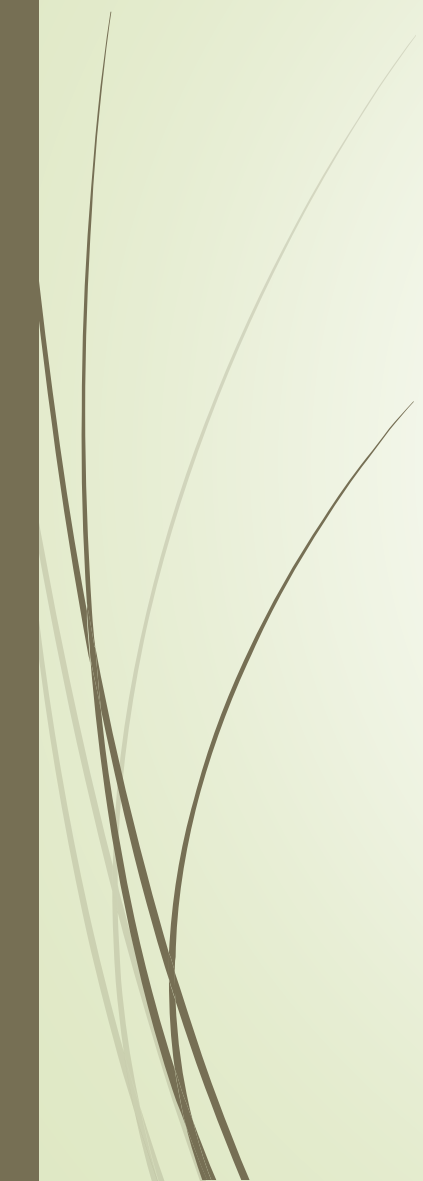


How to Allocate?

How to allocate limited resources among competing uses? For instance:

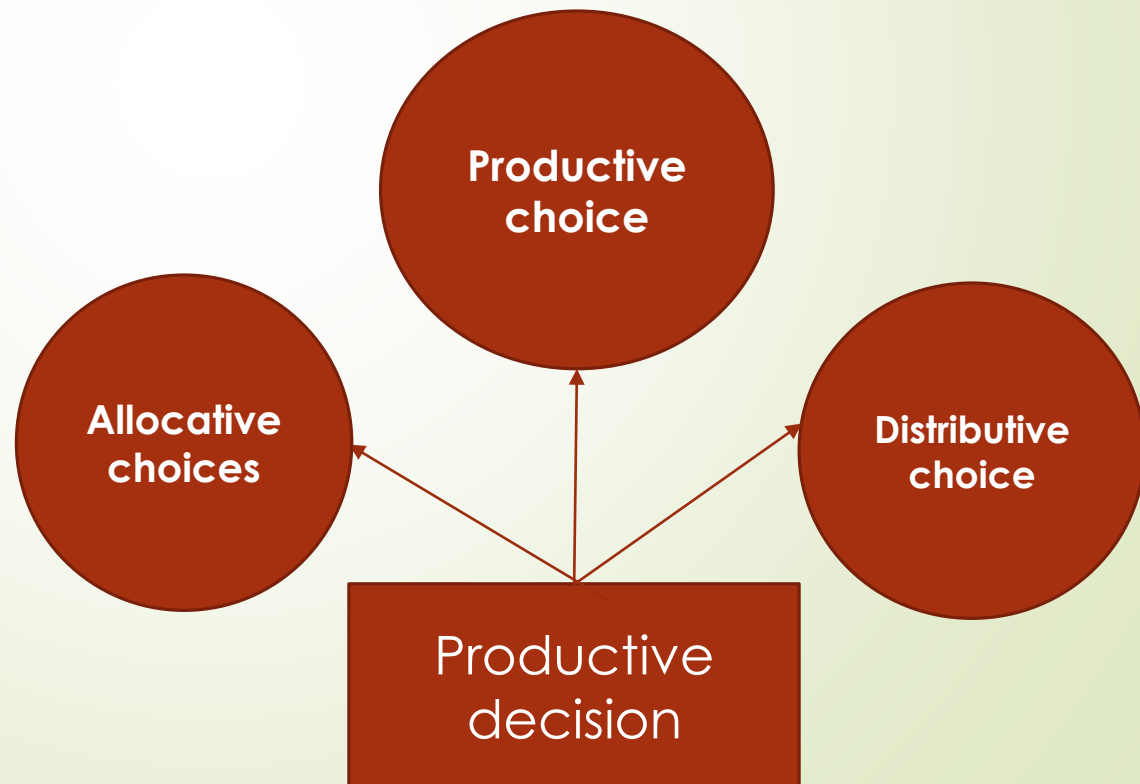
- How many workers should be employed in growing wheat?
- How many to produce motor cars?
- How many to carry passenger baggages in railway stations?
- How many work in factory and how many in road construction?

Thus, it follows that the central economic problem faced by any society is **the allocation of scarce resources among competing uses for the satisfaction of (unlimited) human needs.**



Resource Alloc...

Such decisions are sometimes described as the allocative, productive and distributive choices, respectively, which face society in general. In economics we examine how the price mechanism relates to making these choices.





THANKYOU