

### The nature of the economic problem



The basic economic problem arises as humans have unlimited wants and resources\* available to fulfill such wants are limited or finite. This is known as the problem of **scarcity**.

Due to scarcity, people are forced to make **choices**. Thus, individuals or governments have to rank their choices and decide the allocation of resources for production of goods that have top priority, as it is impossible to satisfy all wants.



\*Resources available in the world are of two types:

Renewable

Non-renewable

Renewable resources are commodities such as solar energy, oxygen, fish stocks or forestry that is inexhaustible or replaceable over time.

Non-renewable resources are those which are available in fixed quantities and are limited in supply. Examples include metal ores, oil and coal.



When a choice is made, it results in an **opportunity cost**. It is the next best alternative that is forgone. For instance, an individual may have to choose between studying for economics test or watch Netflix. If he decides to study for the test, Netflix and chill becomes an opportunity cost.

The economic problem of scarcity is faced by the agents such as consumers, workers, producers and the government. Hence, each of them have to make a choice, which results in an opportunity cost.

### Consumers

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- An individual might be faced with a situation where he can either buy airpods or apple watch with his current savings

### Workers

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- A worker might face an opportunity cost in terms of his career choice. For instance, I can choose to be a teacher or an accountant with my current credentials

### Producers

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- A producer have to decide what to make. In a given agricultural field, a farmer might have to decide to grow wheat or tomatoes.

## **Factors of Production**

Resources are commonly known as factors of production. It includes all the inputs used in the production of a good or service. There are four factors of production: land, labor, capital and enterprise

Land:

It is quite a broad category as a factor of production in that it refers to all natural resources. These resources are gifts that are given by nature. It can range from land used for agriculture or commercial real estate, as well as the natural resources derived from land. These resources can be renewable, such as forests, or non-renewable such as oil or natural gas

**The income earned from land or other such natural resources is called rent.**

Labor:

Labor includes any human input. This includes both the mental and physical effort, involved in producing goods and services. On the mental side of this factor of production are laborers like artists producing art, or programmers creating software. On the more physical side of labor might be food service workers, construction workers, or factory workers.

**The income earned by labor resources is called wages.**

Capital:

These are man-made goods used in the production of other goods. Their use in commercial production is what separates them from more widely used consumer goods. It include hammers, forklifts, computers, and delivery vans.

**The income earned by owners of capital resources is called interest.**

Enterprise:

It is the willing and ability to bear uncertain risks and to make decisions in a business. Entrepreneurs are the people who organize the other factors of production and which crucially bear the risk of losing their money in case of business failure.

**The income an entrepreneur receives is referred to as profit.**

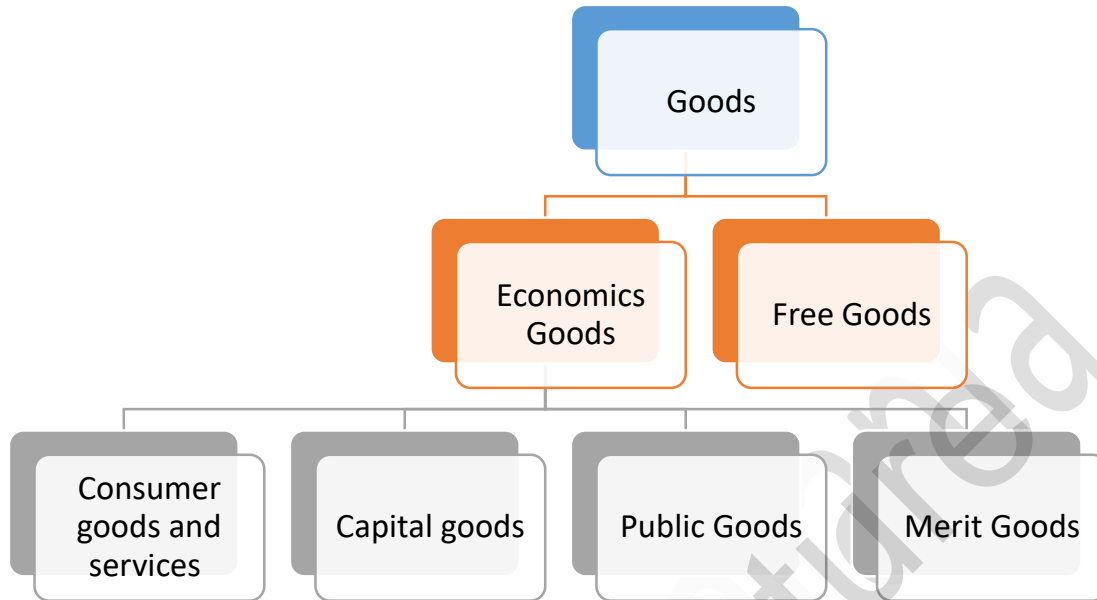
**FOP and Mobility**

	Geographically Mobile	Occupationally Mobile
Land	<p>A land is perfectly immobile in the traditional sense as it is not possible to move a piece of land from its location</p> <p>However, in its wider sense, it can be moved to a certain extent</p>	<p>The occupational mobility of land is high. It can be used for a number of purposes.</p> <p>For instance, a school premise can be used as a hospital too</p>
Labor	<p>Labor's geographically mobility depends on factors such as:</p> <ol style="list-style-type: none"> <li>1. Visa Restrictions</li> <li>2. Family Ties</li> <li>3. Lack of information</li> </ol>	<p>In case of an unskilled worker, the occupational mobility of labor remains high</p> <p>For skilled workers, it is difficult to switch occupations as appropriate skills and qualifications may be required.</p>
Capital	<p>The geo mobility of heavy machineries remains low or immobile. In case of a coal mine and a dock, it is in fixed position</p> <p>The geo mobility of screw drivers and other smaller capital goods remain high</p>	<p>The occupational mobility depends on the type of capital good.</p> <p>A delivery van for books can be used by a pharmaceutical company to distribute medicines. However, a coal mine occupational mobility cannot be changed as it has been made for specific purpose</p>
Enterprise	<p>An entrepreneur is geographically mobile as someone who has been successful in starting up and running a business in one country is likely to be successful in another country also.</p>	<p>An entrepreneur is occupationally mobile because if he has the ability to bear risks and organize fop for one business, he should be able to do this for another business as well.</p>

**FOP (Quantity and Quality)**

	Quantity	Quality
Land	<p>The amount of physical land does not change much with time. It can however be impacted by natural disasters</p> <p>Natural resources, especially non-renewable resources are reduced by use.</p>	<p>The quality of land can be improved by the use of fertilizers, less pollutants and proper drainage system.</p>
Labor	<p>The quantity of labor can be increased by</p> <ol style="list-style-type: none"> <li>1. increase in the size of population</li> <li>2. increase in retirement age</li> <li>3. reduction in the school leaving age</li> <li>4. people switching from part-time work to full-time</li> </ol>	<p>The quality of labor can be improved as a result of better education, better training, more experience and better healthcare.</p>
Capital	<p>The quantity of capital can be increased by buying more physical capital goods from abroad. The country can also invest money in producing more capital goods</p>	<p>The quality of capital goods can be improved by producing technologically advanced capital goods. If the capital good is technologically advanced, it will result in more productivity.</p>
Enterprise	<p>The quantity of enterprise will increase if there are more entrepreneurs, reduction in both, corporate taxes and government regulations.</p>	<p>The quality of enterprise can be improved if entrepreneurs received better education, training, healthcare and gain more experience.</p>

### Few Definitions in Economics



**Free Goods:** A product that does not require any resources to make it and so does not have an opportunity cost

**Economic Goods** are those goods that require resources to produce it and therefore has an opportunity cost. It can be further classified into consumer goods & services, capital goods, public goods and merit goods.

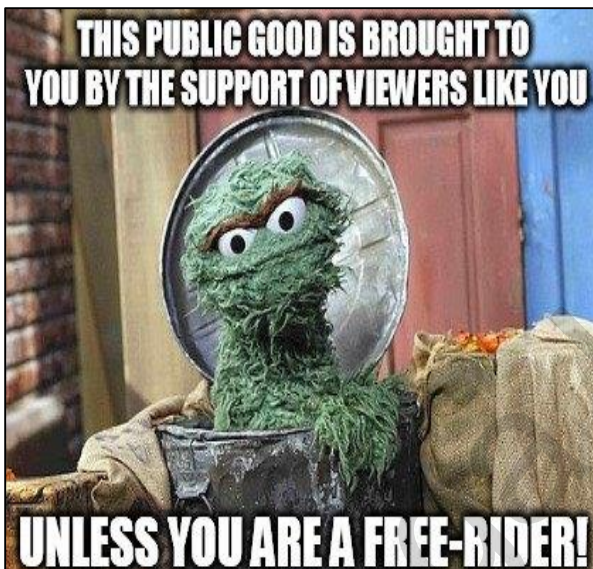


Consumer goods satisfy human wants. They can be durable i.e. long lasting such as cars, televisions, furniture and computer. Non-durable consumer goods perish or gets used up quickly, for instance food, drinks, petrol & washing powder

Consumer Services include when someone performs services for people to satisfy their wants or needs. For e.g. banker, doctor, insurance, cleaner, teacher or policemen



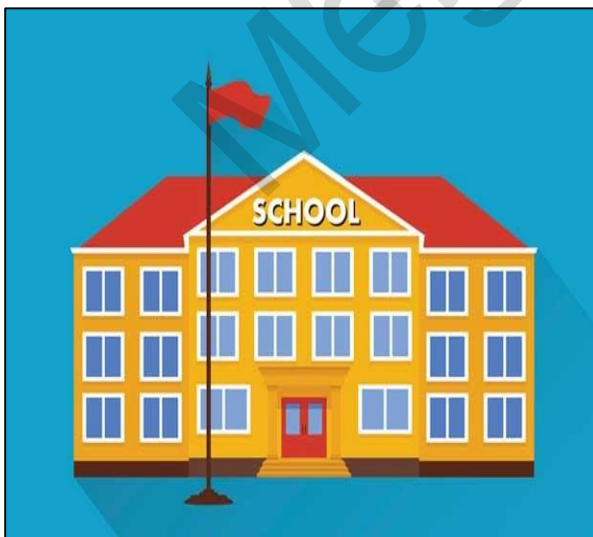
Capital goods are man-made resources which help to produce other goods and services. The buying of capital goods is known as an investment. For e.g. screw drivers, drills, ploughs and lorries



Public goods are provided by the government to the general public because people need them, but will not pay for them.

A government provides these goods & services as no private firm would wish to produce them because nobody would pay for their use.

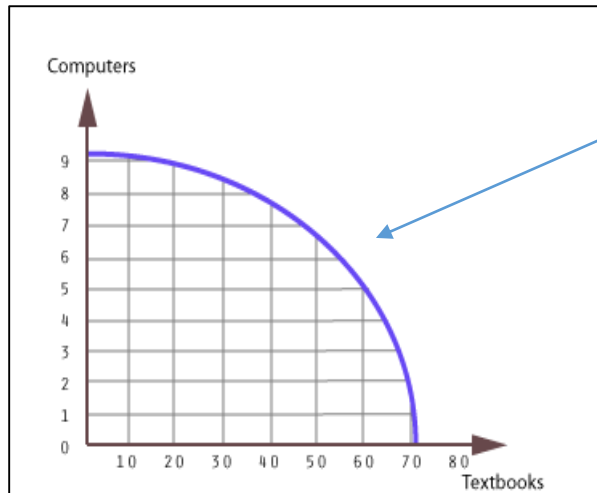
For e.g. defense, law & order, street light and light houses.



Merit goods are provided by the government because she thinks that the public deserves the goods such as education and health care. These goods provide benefits not only to the recipient, but produces welfare for the society.

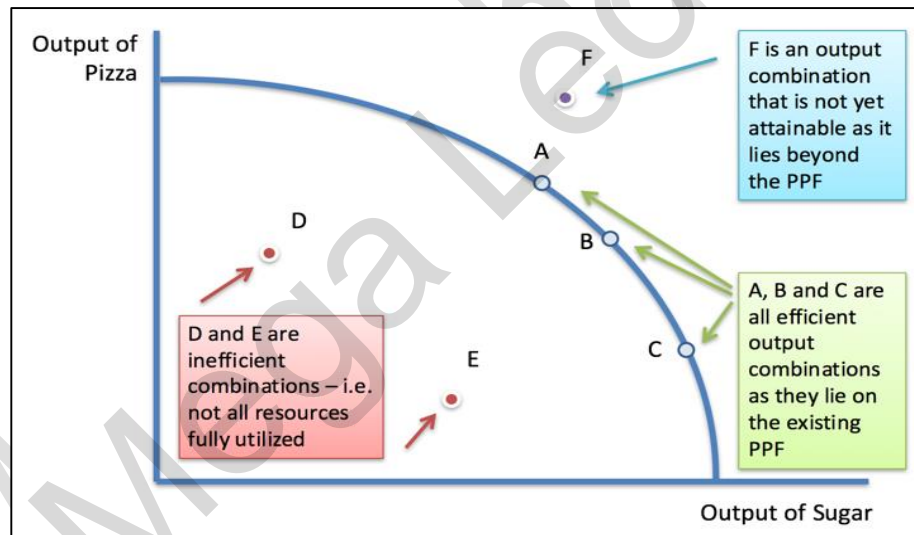
## Production Possibility Curve

### Definition of PPC



Production Possibility Curve also known as production possibility frontier shows the maximum combination of two goods, given that resources in the economy are fully and efficiently employed and assuming a constant state of technology

### Points under, on and beyond a PPC



The PPC helps us to examine various economic models. In the above figure:

Point A, B & C represents full employment of the resources. Each point lying on the PPC is efficient and indicates no wastage of resources

Point F is beyond the curve and represents that with the current resources available, the output combination at F is unattainable. This indicates the concept of scarcity.

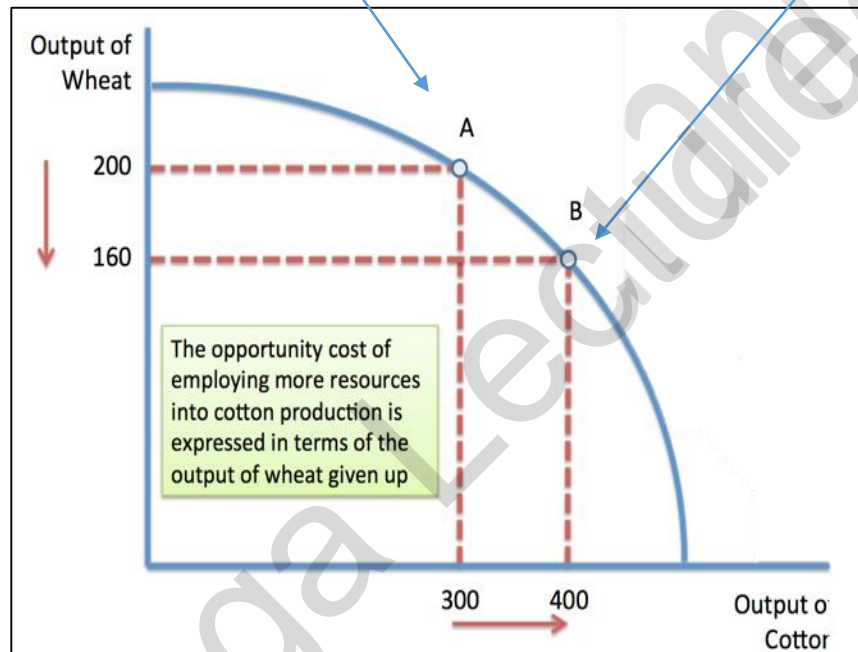
Point D & E represents unemployment of resources or underutilization of resources as the production level is below full capacity, which represents inefficiency.



### Movement along a PPC

The concept of opportunity cost & choice can also be shown via the Production Possibility Curve. Since the PPC is downward sloping, it shows that in order to produce more of one good, resources have to be diverted away from the production of the other good.

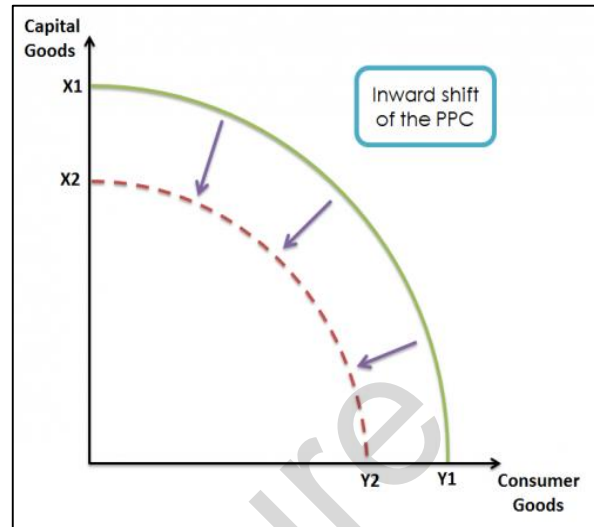
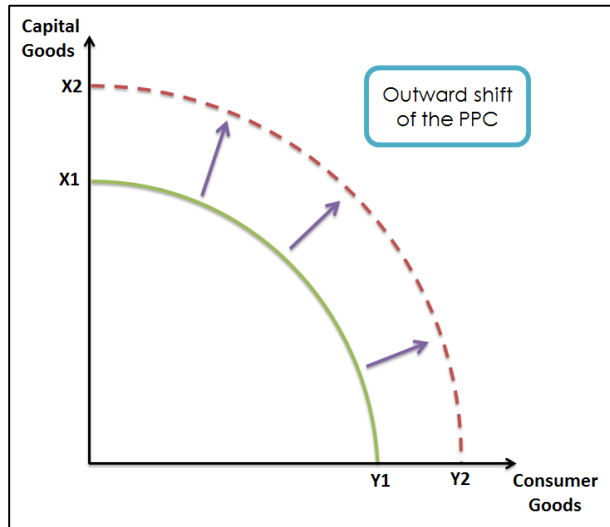
The concept of choice can be illustrated by the diagram as the economy has to decide either to produce at Point A (200 Wheat & 300 Cotton) or Point B (160 Wheat & 400 cotton).



If the economy decides to move from Point A to B, it is giving up 40 output of wheat to produce 100 additional output of cotton. In this example, opportunity cost or the next best alternative foregone, then is the **40 output of wheat**

The economy has moved to Point B, it has made a choice and can no longer produce at Point A

### Shifts in the PPC



An outward shift of the PPC represents economic growth. For an outward shift to occur, there has to be an increase in the quantity or quality of resources. For instance:

1. Advances in technology
2. Improved education
3. Increase in the labor force
4. Discovery of new resources
5. Training of labor

An inward shift of the PPC represents a fall in the economy's production potential. For an inward shift to occur, there has to be a decrease in the quantity or quality of resources. For instance:

1. Natural disasters
2. Fall in the labor force
3. Exhaustion of non-renewable resources
4. Lack of investment in capital and labor

### Few More Definitions in Economics

**Micro Economics:** The study of the behavior and decisions of household and firms, and the performance of individual market

**Macro Economics:** The study of the whole economy, for e.g. unemployment, inflation, economic growth and balance of payments.