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Introduction to Economics

Economic Problems of an economy

Economy: Meaning

An economy is a system in which people earn their living by performing different economic activities like production, consumption and investment. In other words, an economy refers to the whole collection of production units in an area (geographical area or political boundary) of a country by which people get their living. An economy is classified into market economy and planned economy. These economies can be subdivided into closed economy and open economy.

Meaning of Economic Problems

Economic problem is the problem of choice. The problem of choice has to be faced by every economy of the world, whether developed or developing. Human beings have wants which are unlimited. When these wants get satisfied, new wants crop up. Human wants multiply at a fast rate. The economic resources to satisfy these unlimited wants are limited.

In other words, resources or factors of production (they are defined as goods and services needed to carry out production i.e., land, labour, capital and entrepreneurship) are scarce. They are available in limited quantities in relation to the demand. Resources are not only scarce but they also have alternative uses. All this necessitates a choice between which goods and services to produce first. The economy comprising of individuals, business firms, and societies must make this choice.

According to Prof. Robbins, “the economic problem is the problem of choice or the problem of economising, i.e., it is the problem of fuller and efficient utilisation of the limited resources to satisfy maximum number of wants. The scarcity of

resources creates this situation.” If an economy employs more resources to produce good X, then it will have to forego the production of good Y. Hence, economy has to choose which of the two goods X or Y will give more satisfaction. An economy can produce both wheat and rice on the same plot of land. The decision to produce wheat is an outcome of choice.

Causes of Economic Problems

The three main causes of economic problems are:

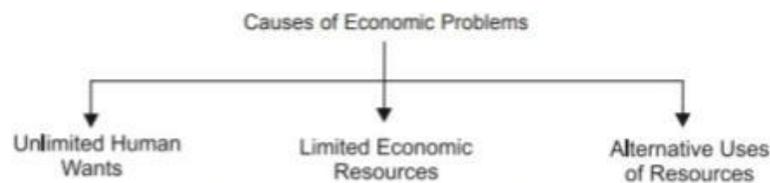


Fig. 1.4 Causes of Economic Problems

1.Human Wants are Unlimited. Human beings have wants which are unlimited. Human want to consume more of better goods and services has always been increasing. For example, the housing need has risen from a small house to a luxury house, the need for means of transportation has gone up from scooters to cars, etc. Human wants are endless. They keep on increasing with rise in people's ability to satisfy them. They are attributed to

- (i) people’s desire to raise their standard of living, comforts and efficiency;
- (ii) human tendency to accumulate things beyond their present need,
- (iii) multiplicative nature of some wants e.g. buying a car creates want for many other things - petrol, driver, car parking place, safety locks, spare parts, insurance, etc.
- (iv) basic needs for food, water and clothing, (v) influence of advertisements in modern times create new kinds of wants and demonstration effect. Due to these reasons human wants continue to increase endlessly.

While some wants have to be satisfied as and when they arise such as food, clothes, shelter, water, etc., some can be postponed e.g. purchase of a luxury car. The priority of wants varies from person to person and from time to time for the same person. Therefore, the question arises as to ‘which want to satisfy first’ and ‘which the last’. Thus, consumers have to make the choice as to ‘what to consume’ and ‘how much to consume’.

2. Resources are Limited. Scarcity of resources is the root cause of all economic problems. All resources that are available to the people at any point of time for satisfying their wants are scarce and limited. Conceptually, anything which is available and can be used to satisfy human wants and desire is a resource. In economics, however, resources that are available to individuals, households, firms and society at any point of time are traditionally natural resources (land). Human resources (labour), capital resources (like machine, building, etc.) and entrepreneurship are scarce. Resource scarcity is a relative term. It implies that resources are scarce in relation to the demand for resources. The scarcity of resources is the mother of all economic problems. It forces people to make choices.

3. Resources have Alternative Uses. Resources are not only scarce in supply but they have alternative uses. Same resources cannot be used for more than one purpose at a time. For example, ` 100 can be put in various alternative purposes such as buying petrol, notebook, ice-cream, burger, cold drink, etc. Similarly an area of land can be used for farming or as a playground or for constructing school, college or hospital building or for constructing residential building, etc. But return on the area of a land or utility of putting ` 100 in various uses varies according to the use of the concerned resources. Thus, people have to make choice between alternating uses of the resources. If the area of land is put to a particular use, the landlord has to forgo the return expected from its other alternative uses. This is termed as opportunity cost. Economics as a social science analyses how people (individuals and the whole society or economy) make their choices between economic goals they want to achieve, between goods and services they want to produce and between alternative uses of their resources which will maximize their gains.