

CHAPTER – ECONOMICS AND ECONOMY

❖ **BASIC TERMINOLOGY:-**

- **ECONOMICS:-** Economics is a subject matter that deals with the rational management of limited resources (in relation to unlimited wants) in manner such that, at the micro level an individual consumer is able to maximise his satisfaction, and an individual producer is able to maximise his profit, and at the macro level, a country is able to achieve highest possible GDP growth and highest possible social welfare.

❖ **WHY DO STUDY ECONOMICS?**

- **SCARCITY OF RESOURCES:-** The limitation of resources (less) in relation to its demand. ($R < D$)

❖ **WHAT IS MICRO ECONOMICS?**

1. The word micro is derived from the language greek word “Mikros” which means “small”.
2. It deals with the determination of price output of an individual in the market.
3. Micro economics variable are demand, supply, price etc.

❖ **WHAT IS MACRO ECONOMICS?**

1. The macro derived from the word “Macros” which means “large or aggregate.
2. It deals with output, employment, income determination of economy as a whole.
3. Macro economics are aggregate demand, aggregate supply, savings, investments etc.

- ❖ **ALLOCATION OF RESOURCES:-** It refers to distribution of resources for producing goods and services. It is related to the central problem of the economy.

❖ **DIFFERENCE BETWEEN POSITIVE AND NORMATIVE ECONOMY**

Or

CHARACTERISTICS OF POSITIVE AND NORMATIVE ECONOMY

Basis	Positive economy	Normative economy
Meaning	It deals with what is or how the economic problems are actually solved related to the past present and future.	It deals with what ought to be or how the economy problem should be solved.
Verification	It can be verified with actual data.	It cannot be verified with actual data.
Purpose	It is based upon facts and thus are not suggestive.	It is based upon individual opinion and therefore it is suggestive in nature.
Value judgement	It does not give value judgement i.e. it is natural between ends.	It gives value judgement.
Examples	<ul style="list-style-type: none"> • Price of Indian economy are constantly rising. • 22% of the population in India is below poverty line • There are inequalities of income in our country. 	<ul style="list-style-type: none"> • India should take steps to control rising prices. • Income inequalities should be reduced.

- ❖ **ECONOMIC PROBLEM:-** It is a problem of choice rising due to the reason that resources are scarce and they have alternative uses.

❖ **DIFFERENCE BETWEEN MICRO AND MACRO ECONOMICS?**

Basis	Micro economics	Macro economics
Meaning	It is that part of economic theory which studies the behaviour of individual units of an economy.	It studies the behaviour of aggregates of the economy as a whole.
Variables	Demand and supply	Aggregate demand and aggregate supply.

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Objective	It aims to determine price of commodity.	It aims to determine income and employment of the economy.
Assumption	It assumes that macro variables to be constant.	It assumes that micro variables to be constant.
Other name	Also known as price theory.	Also known as income and employment theory.
Examples	Individual income, individual output	National income, national output

❖ **TYPES OF ECONOMY:-**

❖ **ECONOMY:-** It is a system by which people of an area earn their living.

❖ **THREE TYPES OF ECONOMY:-**

1. Market economy
2. Centrally planned
3. Mixed economy

❖ **DIFFERENCE BETWEEN CENTRALLY PLANNED, MARKET ECONOMY AND MIXED ECONOMY?**

Basis	Market economy	Centrally planned	Mixed economy
Meaning	It refers to an economy in which the means of production are owned, controlled, operated by private sector.	It refers to an economy in which the means of production are owned, controlled, operated by government.	It refers to an economy which is governed by free play of market forces (demand supply) but are regulated by government.
Ownership	All the means of production land, labour, capital and enterprise are private property.	All means of production are owned by government.	All means of production are controlled by the people and government.
Decision making	The consumer buy goods according to his choice i.e. the consumer is sovereign.	The central authority decides what goods are to be produced for the people i.e. consumer is not sovereign.	Public distribution system ensures the supply of essential goods to the consumers i.e. consumer is sovereign.
Role of government	Most are owned, controlled by the people i.e. market determines demand and supply. The prices of goods and services.	Resources are controlled owned by the government. The government decides at what price the goods are to be sold in the market.	Resources are controlled both by the government and by the people. Prices are determined by the market. But, the government regulates (control) the price of essential goods.
Domination	Private sector dominates the economy activity.	Public sector dominates the economy activity	Both public and private sectors dominates the economic activity.

❖ **VITAL COMPONENTS OF MICRO ECONOMICS:-**

- a. **THEORY OF CONSUMER (DEMAND) BEHAVIOUR:-** It studies how a consumer allocates his income to different uses so that he maximise his satisfaction.
- b. **THEORY OF PRODUCER (SUPPLY) BEHAVIOUR:-** It studies how a producer decides what to produce or how much quantity to maximise the profit.
- c. **THEORY OF PRICE:-** It studies how prices of goods are determined in the market.

❖ **VITAL COMPONENTS OF MACRO ECONOMICS:-**

- a. **THEORY RELATED TO EQUILIBRIUM LEVEL OF OUTPUT AND EMPLOYMENT:-** It studies how equilibrium is reached when $(AS = AD)$.
- b. **PHYSICAL AND MONITARY POLICIES:-** It relates to budgetary, monetary measures.

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- c. **MONEY SUPPLY AND CREDIT CREATION** :- It studies the components of money supply and how commercial banks at money supply through credit creation.
- d. **GOVERNMENT BUDGET**:- It focus on measurement and impact of budgetary deficits in the economy.

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CENTRAL PROBLEMS OF AN ECONOMY

Q1. Explain central problems of an economy or economy problem?

Ans. It is problem which every economy has to face in the path of its development.

❖ **BASIC REASONS ARE:- OR THREE CENTRAL PROBLEMS ARE:-**

1. Unlimited wants
2. Limited resources
3. Alternative use

1. **UNLIMITED WANTS:-** Human wants are unlimited regardless of the nature of available resources. If one of his wants gets satisfied, then another want crops up.

EXAMPLE:- A teenager wants a mobile phone for convenience and if his parents provide him so. Then, his wants do not restrict after that. One of his new wants comes upon, such as regular recharge, new laptop, new bike etc.

2. **LIMITED RESOURCES:-** In order to fulfil unlimited wants of human the resources are limited i.e. the resources are scarce in relation to our wants. So, we should get the best of what we have.

3. **ALTERNATIVE USE:-** Scarce resources are used alternatively. Hence, it becomes important to decide the allocation or distribution of resources effectively and efficiently. **EXAMPLE:-** The salary of an individual is to be used in different sectors such as home tuition, home expenses, medicines, instalment of houses etc.

Hence, it should be clearly decided how much resources should be devoted for each purpose in order to get maximum possible benefit.

Q2. Explain the central problems of an economy?

Ans. The above reasons create different economic problems which are as follows:

1. What to produce
2. How to produce
3. For whom to produce

1. **WHAT TO PRODUCE:-** The foremost problem i.e. faced by an economy is what to produce i.e. what type of goods is to be produced more than the other. Due to scarce resources the economy can't produce unlimited goods and hence, the quantity and priority of goods must be decided. Generally, the economy has two types of goods i.e. consumer goods, producer goods.

WHAT TO PRODUCE HAS TWO ASPECTS:-

- a. **WHAT POSSIBLE COMMODITIES TO PRODUCE:-** An economy has to decide which consumer goods (rice, wheat, clothes etc.) which of capital goods machinery, equipment etc. are to be produced.

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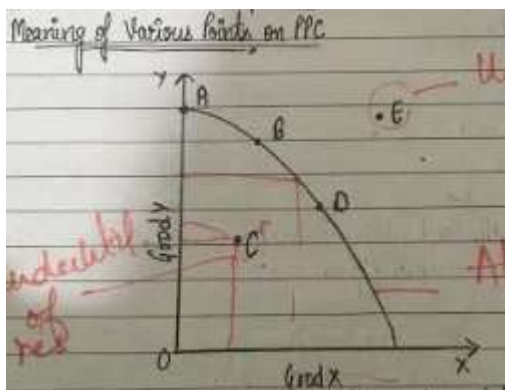
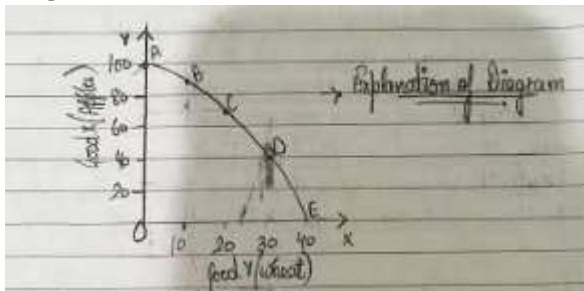
- b. **HOW MUCH TO PRODUCE:-** Economy has to decide the quantity of each commodity i.e. selected. It means it involves a decision regarding the quantity to produce of consumer and capital goods.
2. **HOW TO PRODUCE:-** It is related to choice of technique of production. The goods must be produced in such a way that it gives most efficient output to the economy. Basically, they exist two types of techniques of production which are as follows:-
- a. **LABOUR INTENSIVE TECHNIQUE:-** Use of more than machines in the process of production.
- b. **CAPITAL INTENSIVE TECHNIQUE:-** Machines are used to maximise the output. **USES OF LIT, CIT**
- If country selects LIT, then the units of labour employed will be greater than the units of goods produce. As a result, employment opportunities will increase but total production of the economy will go down.
 - If CIT is selected then the production goes up lacking behind the employment opportunities which lead to the problem of unemployment and poverty.
3. **FOR WHOM TO PRODUCE:-** It is related to the distribution of national produce in the economy. Goods and services are produced for those who have the purchasing power or income to buy them.
- a. Social justice is promoted if more goods are produced for poor as it will reduce in equality or promote equality.
- b. By producing for the poor people, profits of producer will remain low, low profit would low investment, implying low GDP growth. Thus, there is problem of choice of social equality or GDP growth.
- ❖ **PRODUCTION POSSIBILITY CURVE:-** (POSSIBILITY ANOTHER NAME – transformation curve, transformation frontier, production possibility boundary)
- It is graphical representation of alternative production possibilities of two goods produce by an economy due to limited productive resources. Thus, it shows the different possible combination of two goods which can be produced with the available resources. As resources of economy are scarce it has to choose between two different goods.
 - Although, resources are fixed in quantity yet they can be shifted from production of good 1 to another good i.e. production of good 1 is decreased or more production of another good.
- ❖ **ASSUMPTION:-**
- Resources are fixed or given or limited or constant.
 - Technology most remain constant.
 - With the help of given resources, only two goods can be produced.
 - Resources are fully and efficiently utilised.
 - Resources are not equally efficient in the production of all the products.

PRODUCTION POSSIBILITY

Combinations	Good X (Apples)	Good Y (Wheat)	MRT/MOC Δloss/Δgain
A	100	0	-
B	90	10	1:1
C	70	20	2:1
D	40	30	3:1
E	0	40	4:1

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Diagram:



- In the above figure point C under utilisation of resources. Point E is non-flexible region (beyond the capacity of economy).
- Remaining points i.e. A, B, D represent full utilisation of resources.

IMPORTANT NOTE:- All the points which lies on the line of PPC shows that the resources are fully and efficiently utilised. The difference between any two points simply represents the different combinations of goods i.e. at point D, the production of good X is more than that of good Y and at point B, the production of good Y is more than that of good X. But at both the points the resources are fully and efficiently utilised.

- Quantity of wheat is shown on x-axis and apples is on Y-axis. Combination A shows 100 lakh tonnes of apples can be produced without any production of wheat. Similarly, combination E shows 40 lakh tonnes of wheat can be produced without any production of apples. Combination B shows 90 lakh tonnes of apples can be produced with 10 lakh tonnes of wheat combination C shows 70 lakh tonnes of apples and 20 lakh tonnes of wheat. Lastly, combination D shows that apples can be produced with 30 lakh tonnes.
- **OPPORTUNITY COST:-** The next best alternative i.e. forgone (leaving something) is known as opportunity cost. It is cost of availing one opportunity in term of losing another opportunity. In other words, it is cost of shifting resources from one unit to another.
- **MARGINAL OPPORTUNITY COST / MARGINAL RATE OF TRANSFORMATION:-** It is rate at which quantity of output of one good is sacrificed to produce one more unit of other good. In other words, it is the rate by which producer decreases the production of one good as to increase the production of another good.

EXAMPLE:- Opportunity cost per unit of additional output of crop 2 when some resources are shifted from 1 opportunity to other.

$$\text{MOC} = \frac{\Delta \text{loss of output of crop 1}}{\Delta \text{Gain of output of crop 2}}$$

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❖ DIFFERENCE BETWEEN MARGINAL OPPORTUNITY COST AND TOTAL OPPORTUNITY COST

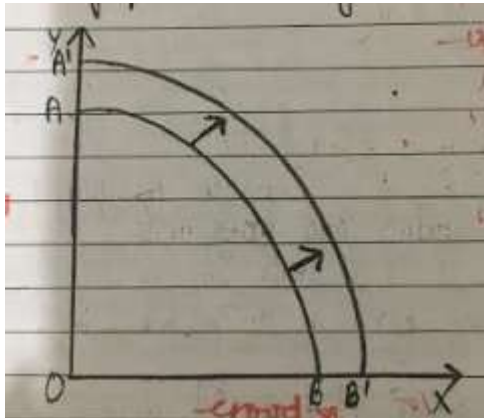
Basis	Marginal opportunity cost	Total opportunity cost
Meaning	MOC is the ratio between loss of output when some resources are shifted from use 1 to use 2.	TOC is not the ratio. It refers to total loss of output when resources are shifted from use 1 to use 2.
Scope	MOC indicates the cost of one more unit of output when some resources are shifted from use 1 to use 2.	TOC indicates the cost of unit produces when resources are shifted from use 1 to use 2.

Q. Shift and rotation of PPC?

Ans. PPC shift because of change in technology and resources of both the goods.

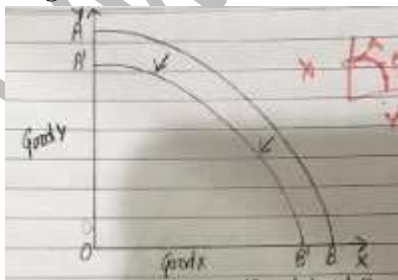
1. **RIGHTWARD SHIFT:-** If the resources and technology of both the goods at more advance and effective then curve will shift parallel. This is so because the country will now become more advanced in producing the goods. As a result, the production of both the goods will increase and the curve shift parallel towards right. The production of good Y increases from A and to A1 and production of good X increases from B to B1.

Diagram:



2. **LEFTWARD SHIFT:-** If technology and resources of both the goods have become outdated, then it will ultimately decrease the production of the economy. Hence, the curve will shift parallel towards the Y-axis as the country is now bound to produce less amount of both the goods.

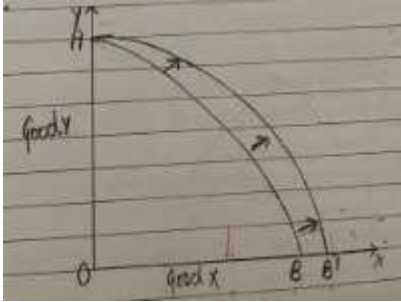
Diagram:



- ❖ **ROTATION OF PPC:-** The curve will rotate if there is a change in technology and resources of one good, keeping the technology and resources of the other good constant.
 - a. **INCREASE IN TECHNOLOGY OF GOOD X:-** The above rotation implies that the technology and resources of good X increase while keeping the technology and resources of good Y constant. If the technology of good X increases, then the PPC rotates towards the right of good X only.

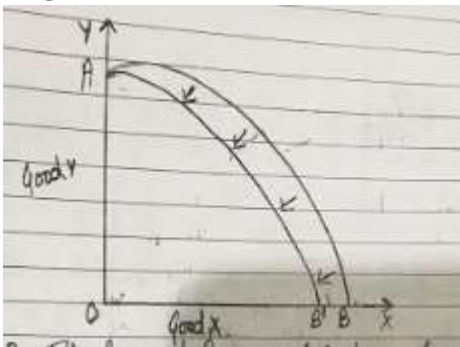
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Diagram:



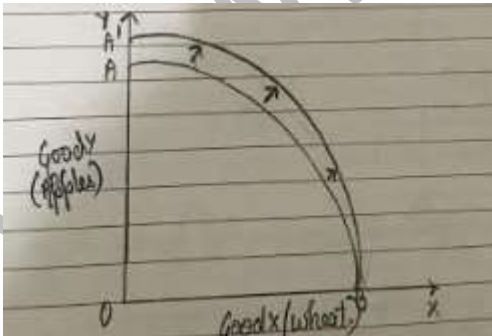
- b. **DECREASE IN TECHNOLOGY AND RESOURCES OF GOOD X:-** When the technology of resources good X decreases then economy would be bound to produce less amount of good X due to lack of technology i.e. production of good X decreases from B to B1, keeping the production of good Y constant.

Diagram:



- c. **INCREASE IN TECHNOLOGY AND RESOURCES OF GOOD Y:-** When the technology of good Y increases, the firm would produce more of good Y with same quantity of good X. hence, the production of good Y increases. In the graph the production of good Y increases from A to A1, whereas the production of good X remains constant. As a result, the PPC will rotate towards right.

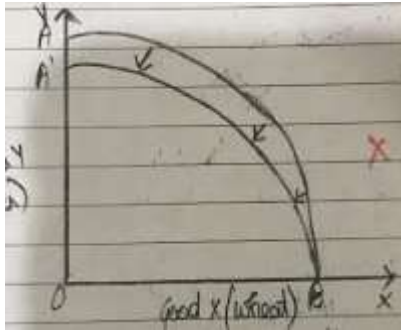
Diagram: -



- d. **DECREASE IN TECHNOLOGY AND RESOURCES OF GOOD Y:-** Decrease in technology of good Y reduces x quantity of production keeping the production of good X constant i.e. The production of good y decreases from A to A1 due to lack of technology and production of good X remain constant and PPC rotates leftwards.

Diagram:-

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- ❖ **DEMONETIZATION**:- It is act stripping a currency unit of its status as a legal tender. The opposite demonetization is remonetisation in which form of payment is restored as legal tender.
- ❖ **MAKE IN INDIA**:- It is a initiative launched by government of India to encourage multi-national as well as national company to manufacture there product in India. It was launched by prime minister Narendra Modi 2014.
- ❖ **SWACHH BHARAT ABHIYAAN**:- It is a campaign by government India to clean streets, roads and infrastructure of the countries 4041 cities and towns.
- ❖ **FEATURE OF PPC**:-
 1. **PPC SLOPES DOWNWARD**:- With the given resources increase in output of good 2 is possible only when there is decrease in output of good 1.
 2. **PPC IS CONCAVE TO ORIGIN**:- Because it has an increasing slope i.e. increasing marginal opportunity cost. It further shows that more and more resources are shofterd from Crop 1 to Crop 2.

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