



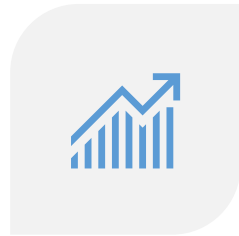
# ECONOMICS ECON 1101

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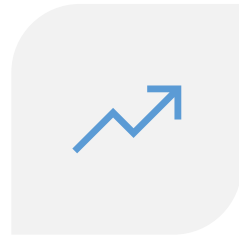
# The Economic Problem: Scarcity and Choice



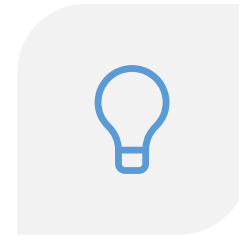
WHY STUDY  
ECONOMICS??



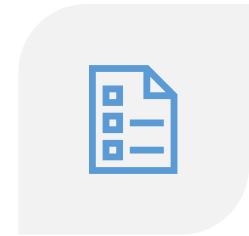
POSITIVE VS  
NORMATIVE  
ECONOMICS



MICROECONOMICS  
VS  
MACROECONOMICS



SCARCITY AND  
EFFICIENCY



CHOICE QUESTIONS  
AS PER THE  
ECONOMIC SYSTEM

# Why should I study economics? Let us count the ways.


Many study economics to help them get a good job.

Some people feel they should understand more deeply what lies behind reports on inflation and unemployment.

Or people want to understand what kinds of policies might slow global warming or what it means to say an iPad is “made in China.”



Over the last half-century, the study of economics has expanded to include a vast range of topics. Here are some of the major subjects:

- Economics explores the behavior of the financial markets, including interest rates, exchange rates, and stock prices.
  - The subject examines the reasons why some people or countries have high incomes while others are poor; it goes on to analyze ways that poverty can be reduced without harming the economy.
  - It studies business cycles—the fluctuations in credit, unemployment, and inflation—along with policies to moderate them.
  - Economics studies international trade and finance and the impacts of globalization, and it particularly examines the thorny issues involved in opening up borders to free trade.
  - It asks how government policies can be used to pursue important goals such as rapid economic growth, efficient use of resources, full employment, price stability, and a fair distribution of income.
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**Economics** is the study of how societies use scarce resources to produce valuable goods and services and distribute them among different individuals.

There are two key ideas that run through all of economics: that goods are scarce and that society must use its resources efficiently. Indeed, the concerns of economics will not go away because of the fact of scarcity and the desire for efficiency.

But no society has reached a utopia of limitless possibilities. Ours is a world of **scarcity, full of economic goods**. A situation of scarcity is one in which goods are limited relative to desires. An objective observer would have to agree that, even after two centuries of rapid economic growth, production in the United States is simply not high enough to meet everyone's desires. If you add up all the wants, you quickly find that there are simply not enough goods and services to satisfy even a small fraction of everyone's consumption desires. Our national output would have to be many times larger before the average American could live at the level of the average doctor or major-league baseball player. Moreover, outside the United States, particularly in Africa, hundreds of millions of people suffer from hunger and material deprivation.

Given unlimited wants, it is important that an economy make the best use of its limited resources. That brings us to the critical notion of efficiency. **Efficiency** denotes the most effective use of a society's resources in satisfying people's wants and needs. By contrast, consider an economy with unchecked monopolies or unhealthy pollution or government corruption. Such an economy may produce less than would be possible without these factors, or it may produce a distorted bundle of goods that leaves consumers worse off than they otherwise could be—either situation is an inefficient allocation of resources.

**Economic efficiency** requires that an economy produce the highest combination of quantity and quality of goods and services given its technology and scarce resources. An economy is producing efficiently when no individual's economic welfare can be improved unless someone else is made worse off

Economics is today divided into two major subfields, microeconomics and macroeconomics. Adam Smith is usually considered the founder of **microeconomics**, the branch of economics which today is concerned with the behaviour of individual entities such as markets, firms, and households. In *The Wealth of Nations* (1776), Smith considered how individual prices are set, studied the determination of prices of land, labour, and capital, and inquired into the strengths and weaknesses of the market mechanism. Most important, he identified the remarkable efficiency properties of markets and explained how the selfinterest of individuals working through the competitive market can produce a societal economic benefit. Microeconomics today has moved beyond the early concerns to include the study of monopoly, the role of international trade, finance, and many other vital subjects.



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**Positive economics** deals with questions such as:

- Why do doctors earn more than janitors?
- Did the North American Free Trade Agreement (NAFTA) raise or lower the incomes of most Americans?
- Do higher interest rates slow the economy and lower inflation?

Although these may be difficult questions to answer, they can all be resolved by reference to analysis and empirical evidence. That puts them in the realm of positive economics.

**Normative economics** involves ethical precepts and norms of fairness.

- Should unemployment be raised to ensure that price inflation does not become too rapid?
- Should the United States negotiate further agreements to lower tariffs on imports?
- Has the distribution of income in the United States become too unequal?
- There are no right or wrong answers to these questions because they involve ethics and values rather than facts.

While economic analysis can *inform* these debates by examining the likely consequences of alternative policies, the answers can be resolved only by discussions and debates over society's fundamental values.



Every human society—whether it is an advanced industrial nation, a centrally planned economy, or an isolated tribal nation—must confront and resolve three fundamental economic problems. Every society must have a way of determining *what* commodities are produced, *how* these goods are made, and *for whom* they are produced.

**What** commodities are produced and in what quantities? A society must determine how much of each of the many possible goods and services it will make and when they will be produced. Will we produce pizzas or shirts today? A few high-quality shirts or many cheap shirts? Will we use scarce resources to produce many consumption goods (like pizzas)? Or will we produce fewer consumption goods and more investment goods (like pizza-making machines), which will boost production and consumption tomorrow?

**For whom** are goods produced? Who gets to eat the fruit of economic activity? Is the distribution of income and wealth fair and equitable? How is the national product divided among different households? Are many people poor and a few rich? Do high incomes go to teachers or athletes or autoworkers or venture capitalists? Will society provide minimal consumption to the poor, or must people work if they are to eat?

**How** are goods produced? A society must determine who will do the production, with what resources, and what production techniques they will use. Who farms and who teaches? Is electricity generated from oil, from coal, or from the sun? Will factories be run by people or robots?

- A **market economy** is one in which individuals and private firms make the major decisions about production and consumption. A system of prices, of markets, of profits and losses, of incentives and rewards determines *what*, *how*, and *for whom*. Firms produce the commodities that yield the highest profits (the *what* ) by the techniques of production that are least costly (the *how* ). Consumption is determined by individuals' decisions about how to spend the wages and property incomes generated by their labor and property ownership (the *for whom* ). The extreme case of a market economy, in which the government keeps its hands off economic decisions, is called a **laissez-faire** economy.
- By contrast, a **command economy** is one in which the government makes all important decisions about production and distribution. In a command economy, such as the one which operated in the Soviet Union during most of the twentieth century, the government owns most of the means of production (land and capital); it also owns and directs the operations of enterprises in most industries; it is the employer of most workers and tells them how to do their jobs; and it decides how the output of the society is to be divided among different goods and services. In short, in a command economy, the government answers the major economic questions through its ownership of resources and its power to enforce decisions.
- No contemporary society falls completely into either of these polar categories. Rather, all societies are **mixed economies** , with elements of market and command.
- Economic life is organized either through hierarchical command or decentralized voluntary markets. Today most decisions in the United States and other high-income economies are made in the marketplace. But the government plays an important role in overseeing the functioning of the market; governments pass laws that regulate economic life, produce educational and police services, and control pollution. Most societies today operate mixed economies.

