Basic Problems of an Economy

Meaning of Economic Problem

The demand for goods and services arises from human wants. No individual in the whole world can fulfil all his/her wants. Wants are unlimited and means are limited. Thus, this scarcity of means in relation to wants brings forth the economic problem of how many resources should be used in satisfying different wants. In this way, one has to choose a set of wants from among unlimited wants which are to be satisfied with limited resources. Scarcity means a situation where only a limited amount of goods can be produced because of the existence of limited amount of resources.

Causes of Economic Problem

Professor Lionel Robbins provided the following reasons for the emergence of economic problem:

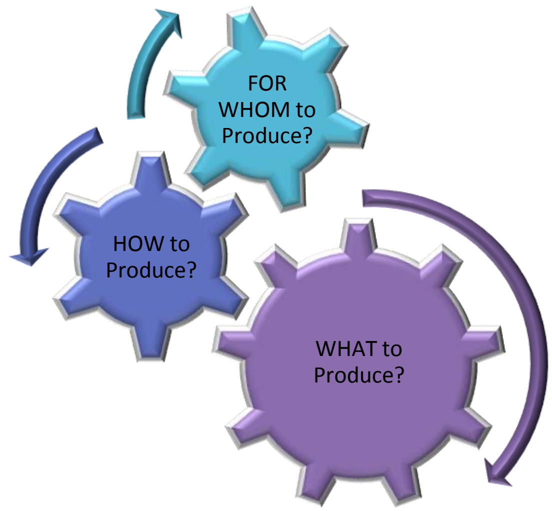
- Unlimited wants: Human wants are unlimited because there is no end to human wants. As and when one demand is satisfied, another one arises, and this cycle is endless. Many of the wants recur and have to be satisfied again. Moreover, there is an increase in human wants with the development of education, technology and civilisation. Again, human wants differ according to urgency. Therefore, an individual lists various wants on the basis of urgency and chooses the one that is the most important.
- Limited resources: This means that the amount of resources required to produce goods and services are less as compared to their demands. Resources include land, labour, capital and enterprise. Because of this scarcity, the economy is not able to produce goods and services which are required by citizens.
- Alternative uses of resources: Resources are not limited and can be used alternatively; for example, using electricity for lamps and televisions. Therefore, choices have to be made between different alternative uses. These characteristics make the resources scarce. Thus, every economy is forced to choose better alternative uses of resources.

Economising of Resources

Making the best use of available scarce resources is known as the problem of economising of resources. Hence, the problem of choice making is called an economic problem. Professor Friedman said, “Whenever limited resources are used to satisfy different ends, an economic problem arises.” According to Eric Roll, “Economic problem is essentially a problem arising from the necessity of choice; choice of the manner in which limited resources with alternative uses are disposed of”. In brief, the problem of choice making arising out of limited means and unlimited wants is called economic problem.

Central Problems

Central problems of an economy are the problems faced by and common to all kinds of economic systems (capitalism, socialism and mixed economy). These include problems with decision making about what to produce, how to produce and whom to produce. This is because it is not possible for any economy to produce an unlimited variety of goods with limited resources.



- What to produce?
  Land, labour, capital, machines, equipment and natural means are limited. All demands of every individual in the economy cannot be satisfied, so society has to decide the commodities which are to be produced and the quantities in which they are to be produced. If we produce one commodity, it could lead to neglecting the production of another commodity. If we assume all factors of production in the economy to be fully absorbed and still want to increase the production of one commodity, then we need to withdraw resources from the production of other commodities.
- How to produce?
  After the decision regarding the goods to be produced is taken, the next problem as to what techniques should be adopted to produce the commodity arises. This function is related to the allocation of resources to production techniques which have to be used during the production of goods and services. The production of goods and services can occur in two ways—labour-intensive technique and capital-intensive technique. The labour-intensive technique involves more of labour and less of capital in the output, while it is the reverse for the capital-intensive technique. Therefore, the economy has to decide about the techniques of production on the basis of the cost of labour and capital.
- For whom to produce?
  'For whom to produce' is the third problem of allocation of resources. This relates to the distribution of national products among various individuals. It is true that sharing of national products is directly influenced by the income of an individual. People having a higher income will definitely possess higher purchasing capacities. Therefore, for proper and equal distribution of goods and services, there should be equality of income among all the people of society. To achieve this situation, Karl Marx suggested that the distribution of national income should be according to the contributions made by each individual to the total production, i.e. the individual must receive income exactly equal to what he/she produces. Thus, we see that every economy faces the problem of allocating its national resources to the production of different goods and services and of distributing the produced goods and services among individuals within the economy.

Production Possibility Curve

The production possibility curve (PPC) is a curve showing various combinations of two goods which can be produced by maximum utilisation of given resources and technology in an economy. It is also known as the transformation curve or production possibility boundary/frontier.

PPC is also known as the transformation curve because the movement along the curve indicates that if more than one commodity is to be produced, then factor inputs will have to be withdrawn from the production of one commodity (say jute) and transferred to the production of another commodity (say cotton).

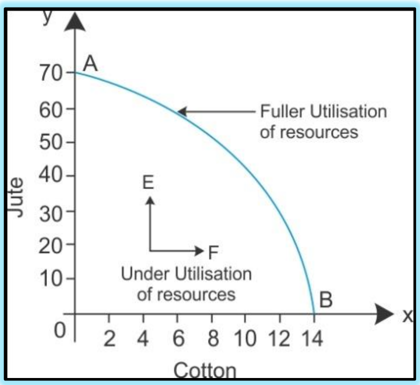
PPC is also known as production possibility boundary because it states the maximum quantity of goods which can be produced with the given amount of resources.

Characteristics of PPC

- Slopes downwards to the right: PPC slopes downwards from left to right. It is because in a situation of fuller utilisation of the given resources, production of both goods cannot be increased simultaneously. More of commodity A can be produced only with less production of commodity B.
- Concave to the point of origin: It is because to produce each additional unit of commodity A, more units of commodity B will have to be sacrificed. Opportunity cost of producing every additional unit of commodity A tends to increase in the loss of production of commodity B. Production will act upon the law of increasing marginal opportunity cost.

Problem of Under Utilisation of Resources

In an economy, if national resources are not fully utilised, then the total output in the economy will be less than the potential output. In the given diagram, any point such as E, F inside the curve AB shows under utilisation of the available resources. In this situation, the actual output is less than the potential output. For example, in India, labour is under-utilised or less than fully employed; therefore, there is mass unemployment.



Economic Growth and Economic Development

Economic growth is an increase in the national income or per capita output over a period. It is a sign of quantitative growth in the country. On the other hand, economic development is a process where the real per capita income of a country increases over a period with a decrease in poverty ratio, unemployment and income inequality.

- Differences between economic growth and economic development:
  - Economic growth has a single dimension; economic development is multi-dimensional.
  - Economic growth reflects only quantitative changes; economic development shows both quantitative and qualitative changes.
  - Economic growth shows change in the output; economic development shows changes in the output along with technology and institutional arrangements.
  - Economic growth is spontaneous; economic development is either regulated or controlled.
  - Economic growth is possible without development; economic development is not possible without growth.