

Lesson – 13

Central Problems of an Economy

Summary

The central problems of an economy arise because of improper adjustment between unlimited wants and limited resources. It is universal in nature for every type of economy of the world whether it is developed or developing economy. This concept provides a basis for every economy how to make plans and strategies for optimum utilization of available resources to meet the objectives of economic growth and development. In this chapter we will discuss about the concept of production possibility curve with the help of tabular and graphical presentation. We will also learn about how various types of central problems of an economy are explained with the help of production possibility curve.

Why do Economic Problems Arise



Unlimited Wants

- A person needs food, water, clothing and shelter in order to survive.
- People, by nature, want more than what they just need for survival. If one want is satisfied, many others crop up and this goes on endlessly.

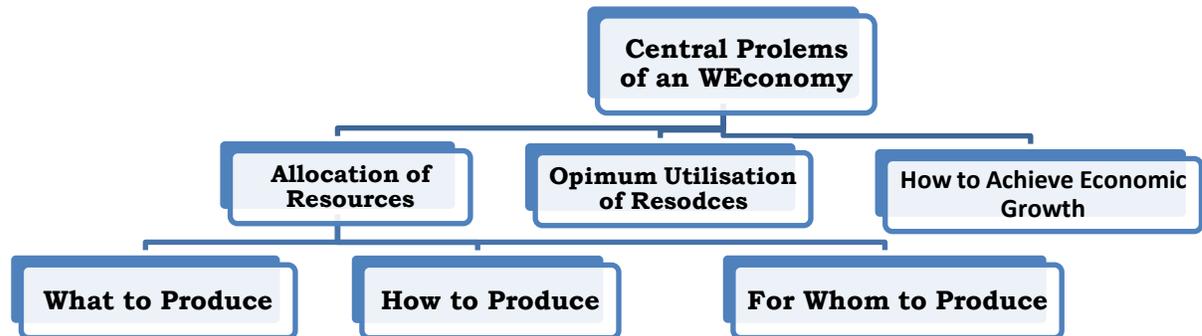
Limited Resources

- Resources are scarce in relation to our wants and economy cannot produce all what people want. It is the principal reason for existence of economic problems in all economies.

Alternative Uses of Resources

- Resources can be put to alternative uses. As a result, the economy has to make a choice between the alternative uses of the given resources.

Central Problems of an Economy



Allocation of Resources

What to produce?

- The fact that resources are scarce leads to the problem of 'what to produce' and in what quantities to produce.
- An individual producer needs to decide on how to employ the sources that are available for production.

How to produce?

- This problem is related to technique of production.
- A technique of production could be either labor intensive or capital intensive.
- In a production process when more units of labor are used in proportion to capital, it is termed as a labor intensive technique.
- Alternatively, when the proportion of capital used is more than labor,

- the production process is called a capital intensive technique.

For whom to produce?

- The problem of 'for whom to produce' relates to how the value of the produced output of an economy gets distributed amongst different people.
- The problem of for whom to produce tells us how the different factors of production are compensated for their work.

Other Central Problems of the Economy

Optimum Utilization of Resources

Optimum utilization of resources has the following implications –

- a) All resources must be Utilized**

- Every economy must ensure that scarce resources are utilized and not left idle or unemployed.

b) Efficient Utilization of resources

- Under utilization of resources creates economic problems.
- Every economy must try and adopt techniques of production that ensure efficient utilization of resources.

Growth of resources

- Resources must grow to satisfy the constantly increasing wants in an economy. So, how can resources grow in an economy? Resources can increase if –
- a) There are quantitative changes in the resources. (Increase in quantity of available resources)
 - b) There are qualitative changes in resources. (Technological Improvement).
- Growth of resources occurs when the physical availability of resources increases and/or there is technological up gradation or an improvement in the quality of resources.

Concept of Production Possibility Curve

Definition - Production possibility curve is the graph which indicates the various production possibilities of two commodities when resources are fixed. ... It is also called the production possibility frontier or product transformation curve.

PPC is based on the following assumptions –

- The resources available are fixed.
- The resources available are fixed.
- The resources are fully employed.
- The resources are efficiently employed.

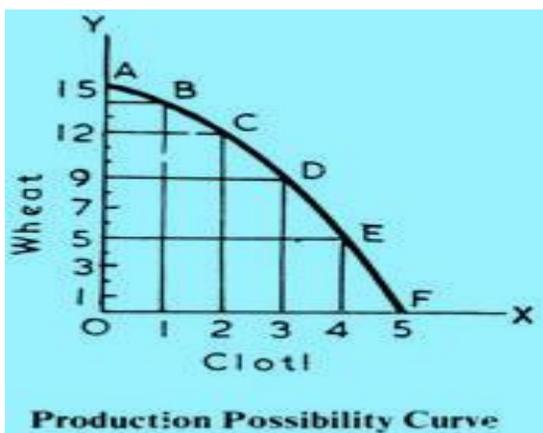
Production Possibility Schedule

It shows tabular presentation of the possible production of two commodity with the given amount of resources and technology of an economy.

possibility	Wheat (Units)	Cloth (Units)	MRT
A	15	0	-
B	14	1	1
C	12	2	2
D	9	3	3
F	5	4	4
E	0	5	5

Production Possibility Curve

The graphical presentation of producing probable combination of two commodities with the given level of resources and technology is known as production possibility curve.



Properties of PPC

- PPC slopes downward: This means that more of a good can be produced only by sacrificing some quantity of the other good.
- PPC is concave to the point of origin.
- MRT (Marginal rate of transformation) measures the rate of change of PPC or simply the slope of PPC

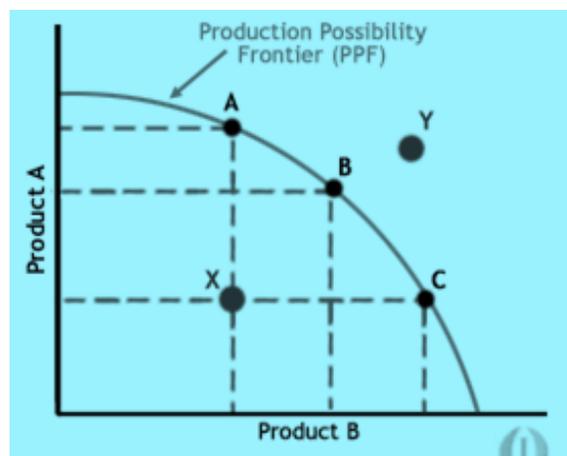
$$\text{MRT} = \frac{\text{Change in Wheat}}{\text{One unit change in cloth}}$$

The curve is based on the following assumptions -

- Quantity of factors of production is fixed
- Full employment
- Technology is given
- There are two goods produced

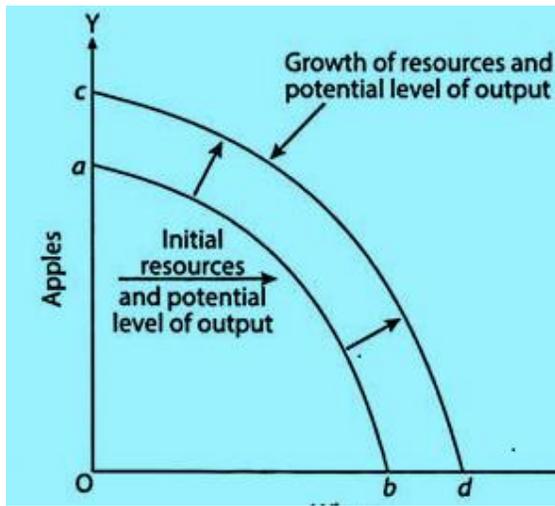
Under Utilization or Inefficient Utilization of Resources

- As we know any point on the production possibility curve represents full and efficient utilization of resources.
- When the economy functions at a point inside the production possibility curve, then it shows that there exists either underutilization or inefficient utilization of resources.
- Point X is showing under utilization of resources where as points A, B, C show optimum utilization of resources in the below given graph.



Growth of Resources

- Growth of resources occurs when the physical quantum of resources increases or when there is a rise in the productivity level of resources.
- Growth of resources implies increase in production.



Evaluate Yourself

Q. Sketch out central problems of an economy.

Q. Distinguish between labour – intensive technique and capital – intensive technique.

Q. Draw diagram to show inefficient use of resources and growth of resources.

Q. Explain the concept of PPC with the help of schedule and diagram.