Sem I (GE) Part (1) Unit:- 1 Class taken:- 30-08-22

 Time:- 2:00 pm

**Scarcity, choice, and opportunity costs**

Economic resources are scarce. Faced with this scarcity, we must choose how to allocate our resources. Economics is the study of how societies choose to do that. Microeconomics focuses on how individuals, households, and firms make those decisions.

## Key terms

| **Term** | **Definition** |
| --- | --- |
| **Scarcity** | The fact that there is a limited amount of resources to satisfy unlimited wants |
| **Economic resources** | Things that are inputs to production of goods and services. There are four economic resources: land, labor, capital, and technology. Technology is sometimes referred to as entrepreneurship. |
| **Land** | Natural resources that are used in the production of goods and services. Some examples of land are lumber, raw materials, fish, soil, minerals, and energy resources. |
| **Labor** | Work effort used in the production of goods and services. Some examples are the number of workers and number of hours worked. |
| **Capital** | Physical goods that are produced and used to produce other goods. Examples of capital would be machinery, technology, and tools such as computers; hammers; factories; robots; trucks, and trains used to transport goods; and other equipment employed in the production of a good or service. |
| **Technology** | (sometimes called **entrepreneurship**) The ability to combine the other productive resources into goods and services. |
| **Occam's razor** | the logical principle that states you should make no more assumptions than the minimum amount needed to perform analysis; in economics, we use the concept of Occam's razor when we invoke the ceteris paribus assumption. |
| ***ceteris paribus*** | A Latin phrase essentially meaning "all else equal", which is used in economics to emphasize the idea that the only changes you should be thinking about are the ones that are explicitly described; for example, if we are talking about how someone reacts to a change in the price of a good, you should assume the only thing changing is price and not preferences, income, or anything else. |
| **normative statements** | statements that describe opinions or how things ought to be. |
| **positive statements** | statements of fact or description of how something actually is. |

## Key Takeaways

### Scarcity and Choice

Scarcity is why economics exist: we wouldn't have to worry about how scarce resources are allocated if those resources were unlimited. It should be emphasized that economics is primarily concerned with the scarcity of **resources**.

### Positive vs. normative analysis

Economic analysis tends to focus mostly on **positive analysis**, that is, the description of phenomena, facts, and concepts. It can be tempting to analyze things using **normative analysis**, that is, describing things as they ought to be.

However, you shouldn't interpret that to mean that normative thinking is completely absent in economics and especially in policy-making: both are important for well-formed policy.

Economic models

A **model** is a simplification of a concept or process that is used to better understand that process by cutting away as much as possible to focus on key aspects. For example, a map is a model of how roads are laid out and where they intersect. Maybe there is other useful or interesting information, like the location of an interesting mural or the world's best taco stand, but if we are just interested in getting to the store, we don't need that, we just need to know how to get there.

Economists rely on models because it's impossible to capture the full complexity of human interaction, let alone try to do it in a straightforward and easy to read way!

#### The Problem of Scarcity:

We live in a world of scarcity. People want and need variety of goods and services. This applies equally to the poor and the rich people. It implies that human wants are unlimited but the means to fulfil them are limited. At any one time, only a limited amount of goods and services can be produced. This is because the existing supplies of resources are extremely inadequate. These resources are land, labour, capital and entrepreneurship.

These factors of production or inputs are used in producing goods and services that are called economic goods which have a piece. These facts explain scarcity as the principal problem of every society and suggest the Law of Scarcity, The law states that human wants are virtually unlimited and the resources available to satisfy these wants are limited.

#### The Problem of Choice

Since are live in a world of scarcity, a society can produce only a small portion of goods and services that its people want. Therefore, scarcity of resources gives rise to the fundamental economic problem of choice. As a society cannot produce enough goods and services to satisfy all the wants of its people, it has to make choices.

A decision to produce one good requires a decision to produce less of some other good. So choice involves sacrifice. Thus every society is faced with the basic problem of deciding what it is willing to sacrifice to produce the goods it wants the most.

For instance, the more roads a country decided to construct the fever resources will there be for building schools. So the problem of choice arises when there are alternative ways of producing other goods. The sacrifice of the alternative (school buildings) in the production of a good (roads) is called the opportunity cost.

There are a number of problems that can arise from choices that are made by people, whether they are individuals, firms or government. Choices or alternatives (or opportunity cost) are illustrated in terms of a production possibility curve.

A production possibility curve shows all possible combinations of two goods that a society can produce within a specified time period whose resources are fully and efficiently employed.

PP1 is the production possibility curve in Fig. 1 which shows the problem of choice between two goods X and Y in a country. Good X is measured on the horizontal axis and Good Y on the vertical axis. PP cue shows all combinations of X and Y good that can be produced by the country with all its resources fully and efficiently employed.

If the country chooses to produces more of X good, it would have to sacrifice the production of some quantity of Y good. The sacrifice of some quantity of Y good is the opportunity cost of producing some extra quantity of good X.

The PP1 curve is downward sloping because to produce more of good X involves producing less of Y good in a fully employed economy. Moving from point В to D on the PP{ curve means that for producing XX, more quantity of good X, YY quantity of good Y has to be sacrificed.





Both point’s В and D represent efficient use of country’s resources. Point R which is inside the bounder of PP curve implies inefficient use of resources. Point К which is outside the boundary of PPX curve is an unattainable combination because the country does not possess sufficient resources to produce two combination of X and Y goods.