Scarcity

L.Robbins scarcity definition: *Economics is the science which studies human behavior as a relationship between ends and scarce means which have alternative uses.*

Characteristics Of Robbins Definition

Following are the main characteristics of Robbins' definition

1. **Unlimited Wants**
   According to Prof Robbins definition, human wants are unlimited. On satisfaction of one wants, another want arises immediately, and this sequence continues forever.
   Scarce Means
   Robbin's definition stated that on one side human needs are unlimited yet on the other side, the means to satisfy these wants, like- time, power, money, etc. are also limited. Due to this, many of man's needs remain unsatisfied.
   Alternative Use of Scarce Means
   In Robbins's view though the to 'satisfy man's needs are scarce, yet he has alternative uses. In other words, he can use every resource in various objectives and activities. For example – such a resource like land can be use in many ways, such as it can be used for agriculture or for building a house or to establish a factory etc.
   Variation in the Intensity of wants
   Robbins definition states that the intensity of man's needs is different. Some wants are more intense than the others. Since our means are limited and all wants cannot be satisfied with the limited means; as a result, we have to select some more intense wants from our unlimited wants and the less intense wants have to be either dropped or postponed to a future date.

Three Basic Economic Problems of Society

The economic problem is at times referred to as the basic, central or fundamental economic problem. It is one of the crucial economic theories in the functioning of any economy in this world. Due to scarcity, choices have to be made by consumers, businesses and governments.
Scarcity can be caused by the possible lack of availability in resources, from individuals insatiable desires, or from a combination of the two. Due to the fact that resources are scarce and many of our desires are substantial, a choice needs to be made about how to use scarce resources in the most effective way.

1. What to produce ?(Problem of Allocation)

Each and every economy must determine what products and services, and what volume of each, to produce. In some way, these kinds of decisions should be coordinated in every society. In a few, the govt decides. In others, consumers and producers decisions act together to find out what the society's scarce resources will be utilized for. In a market economy, this 'what to produce?' choice is made mainly by buyers, acting in their own interests to fulfill their needs. Their demands are fulfilled by organizations looking for profits.
Customers rule the '**what**?' decision. They 'vote' for certain products and services by spending money on those they like. Each and every manufacturer has to offer what buyers want so that they can compete effectively against other manufacturers. Government authorities also perform some part in making 'what?' decisions. For example, a law demanding all ladies to wear a helmet generates demand for helmets, and profit-seeking businesses will produce them.

2. How to produce ?(Problem of Choice of Techniques of Production)

This basic economic problem is with regards to the mix of resources to use to create each good and service. These types of decisions are generally made by companies which attempt to create their products at lowest cost. By way of example, banking institutions have substituted the majority of their counter service individuals with automatic teller machines, phone banking and Net banking. These electronic ways of moving money, utilizing capital as opposed to labour resources, have decreased the banks' production costs.
The initial approach to production, using a resource combination which includes a small capital and much labour, is labour-intensive while the second, utilizing a little labour and a lot of capital, is capital-intensive. Each one of these 'how' decisions was made based on lowest cost and accessible modern technology.

3. For whom to produce ?(Problem of Distribution)

This **basic economic question** is focused on who receives what share of the products and services which the economy produces. The portion of production which each person and family can consume is determined by their income. Income is distributed in line with the value of resources we have to sell.
The for whom decision can even be dependent upon skills shortages, in which case organizations will provide higher incomes to attract workers with rare skills. In the same way, high wages may be required to attract employees to rural locations.

Opportunity Cost

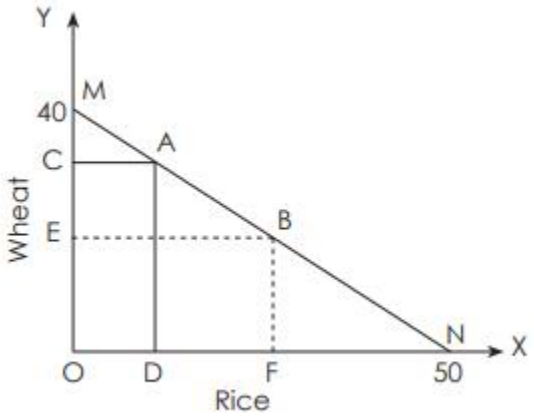
Opportunity cost refers to what you have to give up to buy what you want in terms of other goods or services. When economists refer to the **"opportunity cost"** of a resource, they mean the **value of the next-highest-valued alternative use** of that resource. If, for example, you spend time and money going to a movie, you cannot spend that time at home reading a book, and you can't spend the money on something else. If your next-best alternative to seeing the movie is reading the book, then the opportunity cost of seeing the movie is the money spent plus the pleasure you **forgo** by not reading the book

Opportunity costs are the costs of the next best alternative forgone. Therefore, we can deduce two important aspects:

1. The opportunity costs of a product are only the best alternative forgone and not any other alternative.
2. These costs are viewed as the next-best alternative goods that we can produce with the same value of factors which are more or less the same.

   Formula of Opportunity cost = Return of Investment from the best option available – Return of investment from the chosen option.

Opportunity Cost Graph –



Let's assume that the farmer can produce either 50 quintals of rice (ON) or 40 quintals of wheat (OM) using this land. Now, if he produces rice, then he cannot produce wheat.

Therefore, the OC of 50 quintals of rice (ON) is 40 quintals of wheat (OM).

Further, the farmer can choose to produce any combination of the two crops along the curve MN (production possibility curve). Let's say that he chooses the point A as shown above.

Therefore, he produces OD amount of rice and OC amount of wheat. Subsequently, he decides to shift to point B. Now, he has to reduce the production of wheat from OC to OE in order to increase the production of rice from OD to OF.

Therefore, the OC of DF amount of rice is CE amount of wheat.

What is the Difference between Sunk Cost and Opportunity Cost?

The sunk cost can be defined as the financial cost which is already invested and now it cannot be incurred or money you cannot get back.

For example, if a company purchases 1000s of laptops for $1000000, then that money is sunk i.e. the company cannot get the money back for those laptops. To get that money back we need to get the amount higher than the purchase price.

Opportunity cost is how much less return of investment a company received because of investing capital somewhere else.

Types of Opportunity Cost in Production

- Explicit Cost
- Implicit Cost
- Marginal Opportunity Cost

What is Explicit Cost?

Explicit costs are the cost which includes the monetary payment from the producers. For example, if the company is paying $1000 per month in food by providing free lunch and breakfast, then its explicit OC is $1000. The expenditure on food could have been used somewhere else.

What is Implicit Cost?

Implicit cost aka notional cost can be defined as the OC which a company used in order to produce something. For example, a company purchased small electronic devices to produce mobile phones, laptops, etc. This cost is used to produce something, the electronic devices are not sold or rented.

What is Marginal Opportunity Cost?

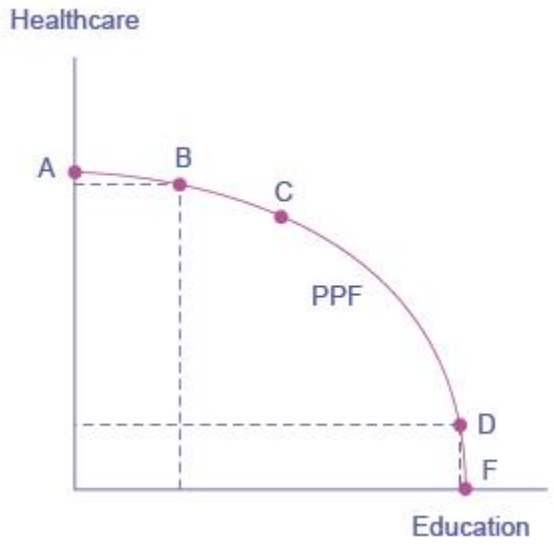
Marginal opportunity cost is a cost required to produce something extra. For example, currently a company is producing 1000 burgers per day, but due to heavy demand, they are running out of the burgers. So, the company decided to hire more people and cook more burgers.

Now marginal opportunity cost will include – payment of new employees, cost required for ingredients required to cook more burgers, profit company was missing before and many other extra costs required for producing additional burgers.

Production Possibilities Frontier

- The Production Possibilities Frontier (PPF) is a graph that shows all the different combinations of output of two goods that can be produced using available resources and technology. The PPF captures the concepts of scarcity, choice, and tradeoffs.
- The shape of the PPF depends on whether there are increasing, decreasing, or constant costs.
- Points that lie on the PPF illustrate combinations of output that are **productively efficient**. We cannot determine which points are **allocatively efficient** without knowing preferences.
- The slope of the PPF indicates the opportunity cost of producing one good versus the other good, and the opportunity cost can be compared to the opportunity costs of another producer to determine comparative advantage.

> Society has limited resources (e.g., labor, land, capital, raw materials) at any point in time, there is a limit to the quantities of goods and services it can produce. Suppose a society desires two products, healthcare and education. This situation is illustrated by the production possibilities frontier in this graph.



In the graph, healthcare is shown on the vertical axis and education is shown on the horizontal axis. If the society were to allocate all of its resources to healthcare, it could produce at point A. But it would not have any resources to produce education. If it were to allocate all of its resources to education, it could produce at point F. Alternatively, the society could choose to produce any combination of healthcare and education shown on the production possibilities frontier. Society can choose any combination of the two goods on or inside the PPF. But it does not have enough resources to produce outside the PPF. Most important, the production possibilities frontier clearly shows the tradeoff between healthcare and education. Suppose society has chosen to operate at point B, and it is considering producing more education. Because the PPF is downward sloping from left to right, the only way society can obtain more education is by giving up some healthcare. That is the tradeoff society faces.

Assumptions of Production Possibility Curve

The production possibility curve is based on assumptions as the market keeps changing constantly.

Assumption 1:- According to the production possibility curve, the economy is assumed to have only two goods which represent the entire market.

Assumption 2:- The supply of resources to the economy is assumed to be fixed or stay constant.

Assumption 3:- The technology or the techniques of production are assumed to be constant.

Assumption 4:- The production possibility curve assumes that all the resources are used efficiently and fully. But in reality, these are not used or utilised entirely.

Features of Production Possibility Curve

The features of production possibility curve are as follows:

1. The PPC is a downward sloping curve i.e. from left to right. This is because it indicates that, to increase the production of one commodity, production of another has to be reduced.

2. The PPC stands concave to its point of origin on the graph which is a result of the increasing marginal rate of transformation.
3. The shape of the PPC will also depend on whether there are increasing, decreasing, or constant costs of production.
4. The points lying on the PPC show combinations of output that can be produced by efficient utilization of resources. One is unable to determine which points are allocatively efficient if one does not know the preferences.

Microeconomics

Initially, there was only one "**economics**." The Great Depression of the 1930s saw the emergence of the area of macroeconomics and after that, the field of economics has been broadly 'split' into two distinct areas of study:

1. microeconomics
2. **macroeconomics.**

The word 'micro' is derived from the Greek word '*mickros*' meaning small.

It is that branch of economics theory which deals with the behavior of individual economic units in the economy such as individual households, individual firms, industries, etc. Microeconomics deals with small segments of society.

It deals with- how individual businesses decide how much to produce and at what price to sell it and how individual consumers decide on how much of something to buy.

In other words, microeconomics analyses individual consumer's and firms' market behavior in an attempt to understand their decision-making processes.

Here problems of individual economic units are studied, such as the equilibrium of a consumer, equilibrium of a firm, and industry.

Microeconomics deals with the central problems of an economy 'what, how, and for whom to produce.' *Thus instead of studying 'economic forest' as a whole, microeconomics looks at its individual parts (i.e., trees)*

Examples of microeconomics are:

1. Individual income,
2. The demand of a commodity,
3. Supply of a commodity,
4. The output of a firm, etc

Components

Microeconomics studies how the prices of goods and services are determined in the market. Theories that explain market price determination are called Price Theories. These are the vital components of microeconomics.

1. *Theory of Price* - It determines how prices of goods and services are determined in the market through the interaction of market forces.
3. *Theory of Demand* - It analyses how a consumer allocates his income to different uses so that he maximizes his satisfaction.
2. *Theory of Supply* - It analyses how a producer decides what to produce and how much. The producer focuses on the maximization of profit

Uses of microeconomics

Microeconomics is very useful. Microeconomics offers us a wide variety of principles that can help us making decisions. It can help us to making important decisions. Microeconomic tools are essential for the analysis and evaluation of public policy.

1. *To understand market and forecast changes*: studying microeconomics helps in understanding how markets work and forecasting how various events impact the prices and quantities of products in markets.
2. *For decision-making*: We use economic analysis in our day to day life, for instance, to decide how to spend a specified period of time, what career to pursue, and how much to spend and save the money we earn. Similarly, Managers also use economic analysis to decide how and what goods and services to produce, how much to produce, and what should be the price of them. Decision-making requires studying the choices made by households, firms, and government and how these choices affect the markets for goods and services.
3. *To evaluate government policies*: Every economy is influenced by government policies. Through economic analysis, we determine how a government performs its roles in the economy. Government policies affect individual firms. The study of microeconomics helps in evaluating the effect of monetary, fiscal, regulatory, and trade policies on individual firms.

Limitations of microeconomics

1. Microeconomics **fails** to explain how the economy functions as a whole.
2. It **cannot** explain the problems such as unemployment, poverty, illiteracy, and other problems prevailing at the country level.

Macroeconomics

The word ‘Macro’ is derived from the Greek word ‘Makro’ (meaning “large”) and combining it with economics, this branch deals with the production, performance, behaviour, structure, and decision-making of an economy as a combination of all entities, rather than individual firms or markets

Basis of Difference Between Micro & Macro Economics	Macroeconomics	Microeconomics
Definition	It aims to study the economy as a whole and covers different market segments.	Focusing on an individual level, Microeconomics studies a specific market segment in an economy.
Central Approach	Takes an **expansive approach** by studying the whole economy.	More of an **individual-centric approach** as it is concerned with businesses and households and analyses consumer behaviour, resource allocation and human choices.
Concerned with	Also called as the **income theory** because it describes the changing levels of national income of an economy during a certain period of time.	Referred to as the **price theory,** it deals with factor pricing such as rent, interest, wage, profits, etc. for land, labour, capital and enterprise and explains how different prices are decided.
Factors	National income, GDP, distribution, employment, general price level, money, etc	Demand, supply, factor pricing, product pricing, economic welfare, production, consumption, etc.
Importance	Preserves stability in the broad price level and **solves the major issues of the economy** like deflation, inflation, rising prices (reflation), unemployment and poverty, etc.	Plays a significant role in **regulating the prices of a product** alongside the prices of various factors of production (labour, land, entrepreneur, capital, etc) within the economy.
Applications	It helps in strengthening policies and **uniform resource distribution at the economy level** such as unemployment, inflation level etc.	It helps in developing policies to **facilitate appropriate resource distribution at the firm level**.
Examples	National Income & Savings; Aggregate Demand; Inflation Rates, GDP; Rate of Employment, Poverty, etc.	Individual Income & Savings; Determining the price of a specific good or commodity; Consumer Equilibrium; Output generated and produced by a specific firm.

Relationship Between Micro and Macroeconomics

The similarities between Micro and Macroeconomics are based on the factor that they both study the different economic problems.

Microeconomics studies the economic problem of scarcity and choice at an individual level and how an individual makes these economic decisions and **Macroeconomics expands it further to the economy as a whole** thus studying how a country is able to take large-scale decisions of making economic budgets, tackling inflation, competition across markets and much more. **The relationship between Micro and Macroeconomics is that they are dependent on each other** because microeconomic variables largely rely on macroeconomic variables and similarly macroeconomics depend on the microeconomic variables in an economy.