

**MICRO ECONOMICS**  
**CHAPTER-1**  
**INTRODUCTION**

**I. Choose the correct answer (each question carries 1 mark).**

1. The scarce resources of an economy have
  - a) Competing usages
  - b) Unlimited usages
  - c) Single usages
  - d) None of the above
2. Which of the following is an example of micro economic study?
  - a) National Income
  - b) Consumer behaviour
  - c) Unemployment
  - d) Foreign trade
3. Which of the following is a macroeconomic variable?
  - a) Individual demand
  - b) Aggregate demand
  - c) Firms output
  - d) Market Price of a good
4. Central Problems of an economy includes
  - a) What to produce
  - b) How to produce
  - c) For whom to produce
  - d) All of the above
5. Traditionally, the subject matter of economics has been studied under the following broad branches.
  - a) Micro & Macro Economics
  - b) Positive & Normative Economics
  - c) Deductive & Inductive
  - d) None of the above

Ans:

1) a 2) b 3) d 5) a
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**II. Fill in the blanks: (Each question carries 1 mark)**

- 1 Scarcity of resources gives raise to \_\_\_\_\_
- 2 In a centrally planned economy all important decisions are made by \_\_\_\_\_
- 3 In reality, all economics are \_\_\_\_\_

**Ans: 1) Choice 2) Government 3) Mixed Economics**

**III. Match the following: (Each question carries I mark)**

A	B
1. Market Economy	a. Government
2. Service of a Teacher	b. Private sector
3. Centrally planned economy	c. Skill
4. Positive economics	d. Evaluate the Mechanism
5. Normative economics	e. Functioning of Machanism

**Solution**

A	B
1. Market economy	Private sector
2. Service of a Teacher	Skill
3. Centrally planned economy	Government
4. Positive economics	Functioning of Mechanism
5. Normative economics	Evaluate the Mechanism

**IV. Answer the following questions in a sentence/work. (Each question carries 1 mark)**

**1. Why does the problem of choice arise?**

An economic problem arises because we have to satisfy unlimited wants out of limited resources having alternative uses.

**2. What is market economy?**

An economy, in which, the means of production are owned, controlled and operated by the private sector is called market economy.

**3. What do you mean by centrally planned economy?**

An economy in which, means of production are owned, controlled and operated by the government is called centrally planned economy.

**4. Give the meaning of micro economy?\**

The study of the economic behaviour of individual agents, such as particular price, particular demand, supply, individual savings etc., is called micro economics

**5. What do you mean by positive economics?**

The study of what was and what is under the given set of circumstances is called positive economics.

**6. What is normative economics?**

A normative economics is one which studies the rightness and wrongness of things, it also tells how things ought to be.

**V. Answer the following questions in 4 sentences:**

**(Each question carries 2 marks)**

**1. Mention the central problems of an economy.**

- 1) What is produced and in what quantities
- 2) How are these goods produced.
- 3) For whom are these goods produced.

**2. Distinguish between Micro and Macro economics.**

The following are the important differences between Micro and Macro economics.

<b>Micro Economics</b>	<b>Macro Economics</b>
1) Micro Economics is mainly concerned with the study of the behavior of individual economic units of the economy,	1) Macro Economics studies the behaviour of aggregates of the economy as a whole
2) Micro economics is the price theory.	2) Macro economics is also known as income and employment theory.
3) Micro economics studies the partial equilibrium in the economy.	3) Macro economics studies the general equilibrium in the economy.
4) Micro economics is an unrealistic study and is not much useful	4) Macro economics is more realistic study and used to solve several economic problems.

**3. Distinguish between positive and normative economics.**

<b>Positive Economics</b>	<b>Normative Economics</b>
1) Positive Economics deals with what is or how the economic problems are actually solves	1) Normative Economics deals with what ought to be or how the economic problems should be solved.
2) Positive Economics can be verified with actual data.	2) Normative Economics cannot be verified with actual data.
3) Positive Economics aims to make real description of an economic activity	3) Normative Economics aims to determine the ideals.
5) Positive Economics is based upon facts, and thus, not suggestive.	4) Normative Economics is based upon individual opinion and therefore, it is suggestive in nature.

**4. What do you mean by production possibility set?**

The collection of all possible combinations of the good and services that can be produced from a given amount of resources and a give stock of technological knowledge is called the productions possibility set.

**5. What is opportunity cost?**

Opportunity cost is the cost of next best alternative scarified in order to produce a good.

**For example:**

- 1) If more of scarce resources are used in the production of corn less resources are available for the production of cotton and vice versa.
- 2) A plot of land is a resource. This land can be used for different purposes like, for agriculture, or for constructing a factory or a school. If we use the land for agriculture, the community will be deprived of a factory or a school.

**6. What is production possibility frontier?**

A graphical representation of all the possible combinations of two goods that can be produced with the given resources and technology is called production possibility frontier.

**V. Answer the following questions in 12 sentences:**

**(Each question carries 4 marks)**

**1. Briefly explain the production possibility frontier.**

Due to scarcity of resources, we cannot satisfy all our wants. Even if an economy uses all its resources in the best possible manner, its capabilities are restricted due to scarcity of resources. As we cannot have everything that we want, we are forced to make economic decisions. These decisions take the form of choices among alternate goods and services, that will best satisfy our wants. Thus, the society must decide, what to produce out of an almost infinite range of possibilities.

**Meaning of production possibility frontier.**

**A graphical representation of all the possible combinations of two goods that can be produced with the given resources and technology is called production possibility frontier.**

**Assumptions for Production Possibility Frontier.**

1. The amount of resources in an economy is fixed, but these resources can be transferred from one use to another;
2. With the help of given resources, only two goods can be produced;
3. The resources are fully and efficiently utilised.
4. The level of technology is assumed to be constant.

The concept of PPF can be better understood with the help of following imaginary schedule.

<b>Possibilities</b>	<b>Corn</b>	<b>Cotton</b>
A	<b>0</b>	<b>10</b>
B	<b>1</b>	<b>9</b>
C	<b>2</b>	<b>7</b>
D	<b>3</b>	<b>4</b>
E	<b>4</b>	<b>0</b>

Consider an economy which can produce corn or cotton by using its resources. The above table gives some of the combinations of corn and cotton that the economy can produce. When its resources are fully utilised.

If all the resources are used in the production of corn, the maximum amount of corn that can be produced is 4 units.

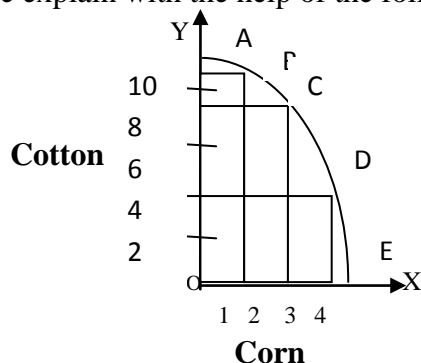
If all resources are used in the production of cotton, at the most, 10 units of cotton can be produced.

The economy can also produce 1 unit of corn and 9 units of cotton or 2 units of corn and 7 units of cotton or 3 units of corn and 4 units of cotton.

There can be many other possibilities. The figure illustrates the production possibilities of the economy.

Any point on or below the curve represents a combination of corn and cotton that can be produced with the economy's resources. The curve gives the maximum amount of corn that can be produced in the economy for any given amount of cotton and vice-versa. This curve is called the production possibility frontier.

This can be explain with the help of the following diagram.



The above production possibility frontier gives the combinations of corn and cotton that can be produced when the resources of the economy are fully utilised. Note that a point lying strictly below the production possibility frontier represents a combination of corn and cotton that will be produced when all or some of the resources are either underemployed or are utilised in a wasteful fashion.

If more of the scarce resources are used in the production of corn, less resources are available for the production of cotton and vice versa. Therefore, if we want to have more of one of the good, we will have less of the other good.

## 2. Briefly explain the central problems of an economy.

Production, distribution and exchange of goods and services are the basic economic activities of life. In the course of these activities, every society has to face the problem of multiplicity of wants, scarcity of resources and problem of choice. Because of this scarcity, every society has to decide how to allocate the scarce resources.

Every economy whether simple or complex, capitalist or controlled or mixed, developed or under developed, will have to solve the following three fundamental economic problems.

### 1) What is produce and in what quantities?

The first central problem of an economy is to decide what to produce and how much to produce. The problem “**What is produce**” is the **problem of choice** between commodities and this problem arised due to scarcity of resources.

Every economy has limited resources and thus, cannot produce all the goods, More of one good or service, usually less of others.

**For example:**

- 1) Whether to produce more of food, clothing, housing or to have more of luxury goods.
- 2) Whether to have more agricultural goods or to have industrial products and services.

What goods are to be produced and how much is to be produced depends on the economic system of the country.

**2) How are these goods produced?**

The next problem of an economy is to decide as how to produce goods and services. The problem “**how are these goods produced**” is the **problem of choice of technique**. There are two alternative methods of production. They are,

**a) Labour intensive Technique:**

Under this technique, more labour is used in production than capital. With this technique more employment can be generated for the society.

**b) Capital intensive technique:**

In this technique more capital is used in production than labour. It produces goods on large scale with the use of high technology.

Each technique has its own merits and demerits. If labour intensive technique is employment generating, it produces goods of low quality at higher cost.

Thus a society has to choose the right technique of production between these two techniques depending on the resources and requirements.

**3) For whom are these goods produced:**

Another basic problem of the economy is to decide for whom the goods shall be produced. This problem refers to selection of the category of people who will ultimately consume goods, i.e.,

- 1) Whether to produce goods for more poor and less rich or more rich and less poor.
- 2) Who gets how much of goods that are produced in the economy.

Thus, every economy faces the problem of allocating the scarce resources to the production of different possible goods and services and of distributing the produced goods and services among the individuals within the economy. The allocation of scarce resources and the distribution of the final goods and services are the central problems of any economy.

**3. Write a short note on a centrally planned economy.**

**An economy in which, means of production are owned, controlled and operated by the government is called planned economy.**

**For Examples:** North Korea, Cuba, China and Vietnam.

Centrally planned economy is the complete opposite of capitalism. In this system economic activities will be carried on through a central machinery or authority. It means in a centrally planned economy economic activities are controlled by the central government rather than the private business people. The Govt. organises all economic activities and distributes various goods among the consumers on the basis of its own decisions.

**Features of Central Planned Economy:**

The important features of centrally planned economy they are:

- 1. State ownership over means of production:** All the means of production are owned by the government.
- 2. Decision – making by government:** Government takes all the decision regarding consumption, production and investment.

3. **Level of Competition:** There does not exist any element of competition under centrally planned economy.
4. **Social welfare motive:** All decisions aim to maximize social welfare.
5. **Planning Mechanism guides all decisions:** Production, allocation and distribution of resources take place through planning. There is no role for market or price mechanism.
6. **The central authority may try to achieve a particular allocation of resources** and a consequent distribution of the final combination of goods and services which is thought to be desirable for society as a whole.

**For example:** If it is found that a good or service which is very important for the prosperity and well-being of the economy as a whole, e.g. education or health service, is not produced in adequate amount by the individuals on their own the government might try to induce the individuals to produce adequate amount of such a good or service or, alternatively, the government may itself decide to produce the good or service in question.

#### 4. Write a short note on market economy.

**An economy, in which, the means of production are owned, controlled and operated by the private sector is called market economy.**

**For Example:** USA, Japan, Australia, UK, Canada.

In the market economy, all the means of production are owned by private individuals and business firms. They will be a complete liberty either to use or not to use these resources. The one and the only aim of the owners of the property is to earn profits by utilising this property.

#### **Features of Market Economy:**

1. **Private ownership over means of production:** All the means of production (i.e., land, labour, capital and enterprise) are owned and managed by private sector
2. **Independent decision making:** Private sector is free to take all decisions regarding production, consumption and investment independently.
3. **Level of competition:** There exists still competition among different.
4. **Profit Motive :** All the decisions are generally guided by the profit motive.
5. **Non- Interference of Government:** The government does not interfere in any economic activity.
6. **Price Mechanism guides all decisions:** A Market economy works through price mechanism. It is a process where price is determined by market forces of demand and supply. It helps in solving central problems (i.e. what, how and for whom to produce) of economy.