

NCERT Microeconomics Solutions for Class 12 Chapter 1

1. Discuss the central problems of an economy.

The central problems of an economy are

- i) What to produce?
- ii) How to produce?
- iii) For whom to produce?

i) What to produce?

Every society faces a scarcity of resources. Because we live in a finite world, our resources have to be allocated based on our collective needs and wants as a society. This creates a problem of choice, where we might have to choose between the different products that can be produced with the same available resources. For example, consider the practice of agriculture in a village. Food production and distribution depend upon agriculture. The agricultural output of a given economy depends upon finite resources like water, manpower, fertilizers, farming equipment, etc. Therefore, the farmer has to decide what to produce based on what people want. If people tend to eat more rice and less wheat in a given region, production of wheat and rice will correspond to that tendency. (But, factors like import and export can also influence such decisions) The problem of how much to produce also has to be determined en masse. (I.e. keeping in mind the population and the demand)

ii) How to produce?

There are various techniques that people and governments can choose from when they are producing a good or service. For instance, based on the way in which capital and labour are utilized, production can happen through capital-intensive or labour-intensive methods.

iii) For whom to produce?

Every society has some degree of inequality among its members. So, when we are asking 'for whom to produce?' we are trying to determine who eventually benefits from the activity of economic production. Producing more luxury good will mean that only the rich can afford to consume them. In contrast, producing an extensive range of everyday goods at affordable prices can benefit low-income groups.

2. What do you mean by the production possibilities of an economy?

The production possibilities of an economy refer to the capability of an economy to produce different goods with the available resources, accessible technologies and other means of production.

3. What is a production possibility frontier?

The production possibility frontier (PPF) can be illustrated using a mathematical curve that showcases the balance between the production levels of two different products within limited resources. For example, if a food producer can either produce 50 mangoes or 25 oranges with the same amount of resources, the production possibility of the two can be plotted in a graph. And this gives us the production possibility frontier. PPF is calculated under the assumption that the production of product A can increase only when the production of product B is compensated. PPF data is often used by companies to determine the relative costs of producing one product over another. This data is then analysed to effectively make decisions when allocating finite resources and to increase profits.

4. Discuss the subject matter of economics.

The subject matter of economics is often categorised into two main branches - Microeconomics and Macroeconomics. Economics is often defined as the study of production, distribution and consumption of goods and services. Another way of looking at economics would be in terms of scarcity and how society organises the exchanges that happen between various scarce resources.

In this vein, microeconomics is about individual consumers and businesses whose decisions and behaviour affect the economy and vice versa. For example, a topic like the costs of production would come under microeconomics.

On the other hand, Macroeconomics is all about how the economy functions as a whole. For example, topics like national income and aggregate quantitative measures like deflation and inflation would come under macroeconomics.

5. Distinguish between a centrally planned economy and a market economy.

Centrally planned economy

- In a centrally planned economy, all the major economic decisions are taken by the government.
- The government owns the means of production and distribution.
- Prices are set by the government
- An example of a centrally planned economy would be North Korea.

Market economy

- In a market economy, the various economic decisions are left to the free market or the laws of supply and demand.
- Private ownership of the means of production and distribution
- Prices are determined by the relative demand and supply of the products.
- An example of a market economy would be South Korea.

6. What do you understand by positive economic analysis?

Positive economic analysis is purely about economic facts, objective measurements and processes. In this type of economic analysis, one might study the cause and effect relationships between various economic factors and phenomena. For example, the association between oil prices and currencies.

7. What do you understand by normative economic analysis?

The normative economic analysis contains value-based propositions, suggestions and hypotheses related to various economic problems. An evaluation of 'good' and 'bad' based on some ideology is often a feature of normative economic thinking. In other words, normative economics is all about 'what should be' rather than 'what is'. Some examples would be concepts like Universal Basic Income or a statement like "Taxes should be abolished"

8. Distinguish between microeconomics and macroeconomics.

Microeconomics

- Deals with the behaviour, choices and incentives of individuals or individual companies.
- Pioneered by economists such as Alfred Marshall
- Can be used to explain consumer behaviour, the theory of price and marketing principles.

Macroeconomics

- Deals with the economy as a whole, including governments, corporations and regulatory institutions.
- Pioneered by economists such as J.M. Keynes
- Can be used to explain aggregate market performance, unemployment, growth and overall market predictions.