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Principle of microeconomic

Question's

Question -> 1

:-> Explain the meaning of Economic problem and state the basic Causes behind Economic problem?

Answer :=> An Economic problem generally means the problem of making choices that occurs because of the Scarcity of resources. It arises because people have unlimited desires but the means to satisfy that desire is limited. Therefore, Satisfy that desires is limited. Therefore, Satisfying all human needs is difficult with limited means.

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Causes of Economic problem

• Scarcity of resources :⇒ Resources like labour, land and capital are insufficient as compared to the demand. Therefore, the economy cannot provide everything that people want.

• Unlimited Human Wants :⇒ Human being's demand and wants are unlimited which means they will never be satisfied. If a person's one want is satisfied, they will start having new desires, people's want are unlimited and keep multiplying therefore, cannot be satisfied because of limited resources

• Alternative Uses :⇒ Resources being scare, the same resources are used for different purposes. and it is therefore essential to make a Choice among resources. for instance, petrol is used in Vehicles and is also used for generators, running machines. etc Therefore the Economy should now make a Choice within the alternative uses.

List of Economic problems :-

(A) What to produce ?

- A Country cannot produce all goods because it has limited resources.
- It has to make a Choice between different goods and services.
- Every Economy has to decide what goods and Services should be produced.
- Example :- If a farmer has a single

piece of agricultural land, than he has to make a choices between two goods, i.e whether to grow rice or wheat

- Similarly, our government has to decide where to allocate funds, for the production of defence goods or consumer goods, and if both, then in what proportion.

(B) How to produce ?

- This problem refers to the choice of technique of production. It arises when there is an availability of more than one way to produce goods and services

- There are mainly two technique of production These are :-

- labour intensive technique (greater use of labour)

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- Capital intensive technique (greater use of machines)

- labour intensive technique promotes employment whereas Capital intensive technique promotes efficiency and growth

(c) For whom to produce?

- The society cannot satisfy all the wants of all the people. Therefore, it has to decide who should get how much of the total output of goods & service.

- Society has to make choice of whether luxury goods or normal goods have to produced. The distribution per proportion directly relates to the purchasing power of the economy.

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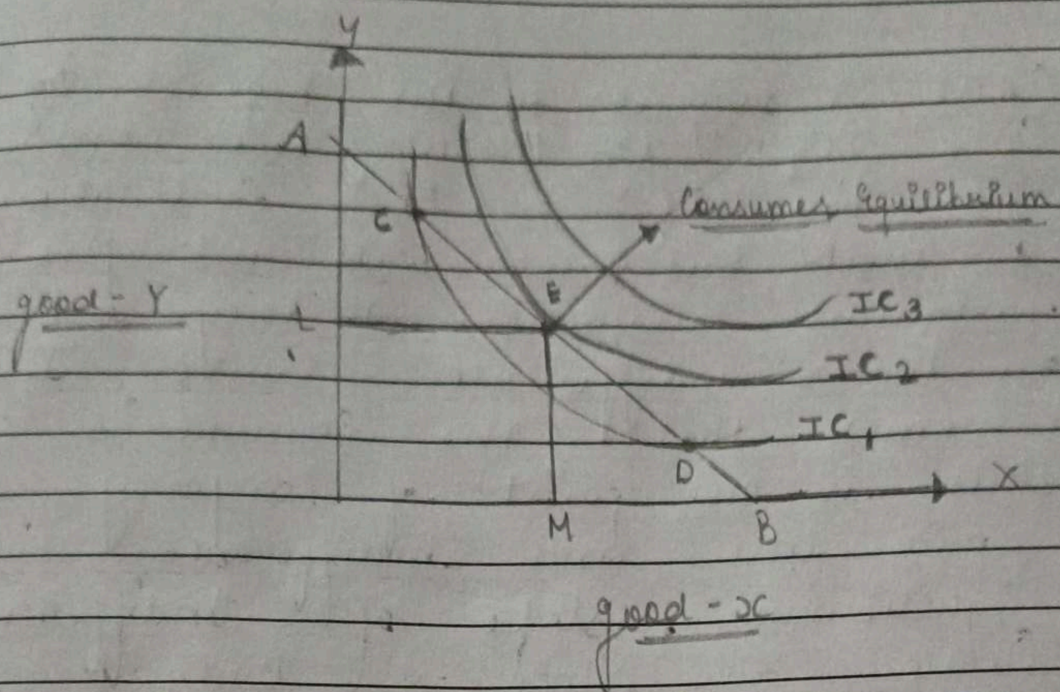
Question :- 2

Explain Consumer Equilibrium with the help of indifference Curve.

Answer :- Consumer's Equilibrium refers to a situation when a Consumer maximises his Satisfaction, spending his given income across different goods and services. In term of IC analysis, a Consumer attains equilibrium when :-

1) IC and the budget line are Tangent to each other, i.e when the slope of IC equals the price ratio of the goods.

2) IC is Convex to the origin, at the point of Equilibrium



In fig AB is the budget or price line. IC_1, IC_2 and IC_3 are difference curves. A consumer can buy any of the combinations, A, B, C, D and E of good X and good Y shown on the price line AB. He cannot attain any combination on IC_3 as it is above the price line AB. He can buy those combinations which are not only on the price line AB but also coincide with the highest indifference curve which is IC_2 in this case. Out of A, B, C, D and E combinations, the consumer will be in equilibrium at combinations 'E' because at this point, the price line

(AB) is tangent to the highest ~~Ind~~ Indifference Curve IC_2. No Doubt, the Consumer can buy 'C' and 'D' combinations as well but these will not give him maximum satisfaction as they are situated on lower indifference Curve IC_1

It means that the consumer's equilibrium points is the point of tangency of price line and indifference Curve.

At equilibrium, slope of Indifference Curve = Slope of Budget or price line or $MRS_{xy} = \frac{P_x}{P_y}$

also At, point E, IC_2 is Convex to the origin. Accordingly, equilibrium is stable In a state of equilibrium the Consumer is buying OL amount of good Y and OM amount of good X. It is here that he is maximising his Satisfaction Any departure from this point would only mean lesser Satisfaction.

Question → 3

Explain the law of variable proportions and explain its three stages and why the second stage is the best?

Answer → law of Variable proportion is regarded as an important theory in Economics It is referred to as the law which states that when the quality of one factor of production is increase, while keeping all other factors constant, it will result in the decline of the marginal product of the factors.

Law of Variable proportion is also known as the law of proportionality. When the Varible factor becomes more, it can lead to negative value of marginal product.

The law of Variable proportion can be understood in the following way.

When variable factor is increased while keeping all other factors constant, the total product will increase initially at an increasing rate, next it will be increasing at a diminishing rate and eventually there will be decline in the rate of production.

Stages of law of Variable proportion :-

The law of variable proportions has three stages, which are discussed below :-

1. First Stage or stage of Increasing returns : In this stage, the total product increase at the increasing rate. This happen because the efficiency of the fixed factors increase with addition of variable input to the product.

2. Second stage or stage of Diminishing return :- In this stage, the total product increase at a diminishing rate until it reaches the maximum point. The marginal and average product are positive but

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diminshing gradually.

3. Third stage or stage of Negative Returns :-

In this stage, the total product decline and the marginal product become negetive.

* The second stage of law of Variable proportions is best because In this stage total product increases at a diminishing rate until it reaches the maximum point. The marginal and Average product are positive but diminishing gradually.

Question :⇒ 4

Explain the meaning of monopalistic Competition and describd its Characteristic ?

Answer ⇒ Defination :⇒ Monopalistic Competition refers to a market situation in which there are large number of firm which sell closely related but differentiated products. Markets of product like - Soap, tooth paste, A.C etc are examples of monopalistic Competition.

Features of monopolistic Competition :⇒

1. Large Number of Sellers :- There are large number of firms selling closely related but not homogeneous products. Each firm acts independently and has a limited share of the market. So, an individual firm has limited Control over the market

price. Large number of firms leads to Competition in the market.

2. Product Differentiation :- Each firms is in a position to exercise some degree of monopoly. (inspite of large number of sellers) through product differentiation. Product differentiation refers to differentiating the products on the basis of brand, size, colour, shape etc. The product of a firm is close but not perfect substitute of other firm.

Implication :- of 'product differentiation' is the buyers of a product differentiate between the same product producted by different firms. Therefore, they are also willing to pay different prices for the same product produced by different firms. This gives some monopoly power to an individual firm to influence market price of its product

3. Selling Costs :- Under monopolistic Competition products are differentiated & these difference are made known to the buyers through selling costs. Selling costs refers to the expenses incurred on marketing, Sales promotion and advertisement of the product. Such Costs are incurred to persuade the buyers to buy a particular brand of the product in preferences to Competitor's brand. Due to this reason, Selling Costs Constitute a Substantial part of the total Cost under monopolistic Competition

4. Freedom of Entry and Exit :- Under monopolistic Competition, firms are free to enter into or exit from the industry at any time. They

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wish. Free Entry and Exit of firms means that there are no barri before the firm for entering into the industry and leaving the industry. New firm can enter when they find that the existing firms are earning abnormal profits. With this entry, output of the industry increasing which leads to fall in the pieces of the product. This continues till each firm is earning only normal profit

The existing firms leave when they face losses are wiped out. It ensures that there are neither abnormal porfit nor any abnormal losses to a firm in the long run.

~~However~~, It must be noted nor any that Entry under monopolistic

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Competition is not as easy and free as Under perfect Competition.

5. Lack of perfect knowledge :- Buyers and sellers do not have perfect knowledge about the market Condition. Selling Costs create artificial Superiority in the minds of the Consumers and it become very difficult for a Consumer to Evaluate different products available in the market. As a result, a particular product (although highly priced) is preferred by the Consumers. Even if other less priced products are other less priced products are of the same quality.

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6. Pricing Decision :- A firm under monopolistic Competition is neither a price taker nor price maker. However, by producing a unique product or Establishing a particular reputation, Each firm has partial Control over the price. The Extent of power to control price depends upon how strongly the buyers are attached to his brand.

8. Non - Price Competition :- In addition to price Competition non - price Competition also Exists under monopalstic Competition. Non - Price Competition refers to Competing with other firms by offering free gifts, making

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favourable credit terms etc. without changing prices of their own products.

Firms under monopolistic competition compete in a number of ways to attachet customer. They use both price competition (competing with other firms by reducing price of the product) and Non-price competition to promote their sales.

Under monopolitic competition, Each firm is the sole producer of a particular brand or product"

So, monopolistic competition is a market structure, where there is competition among a large number of monopolists.