Macroeconomics

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Introduction

The flexibility of economics integrates various topics and concepts. These variables are important as they help make sense of the external environment and the way in which most countries and business function. In this essay, several important topics such as comparative advantage, scarcity and the production possibility curve have been discussed to provide a further expansion about the use of the same.

Discussion

Production Possibility Curve

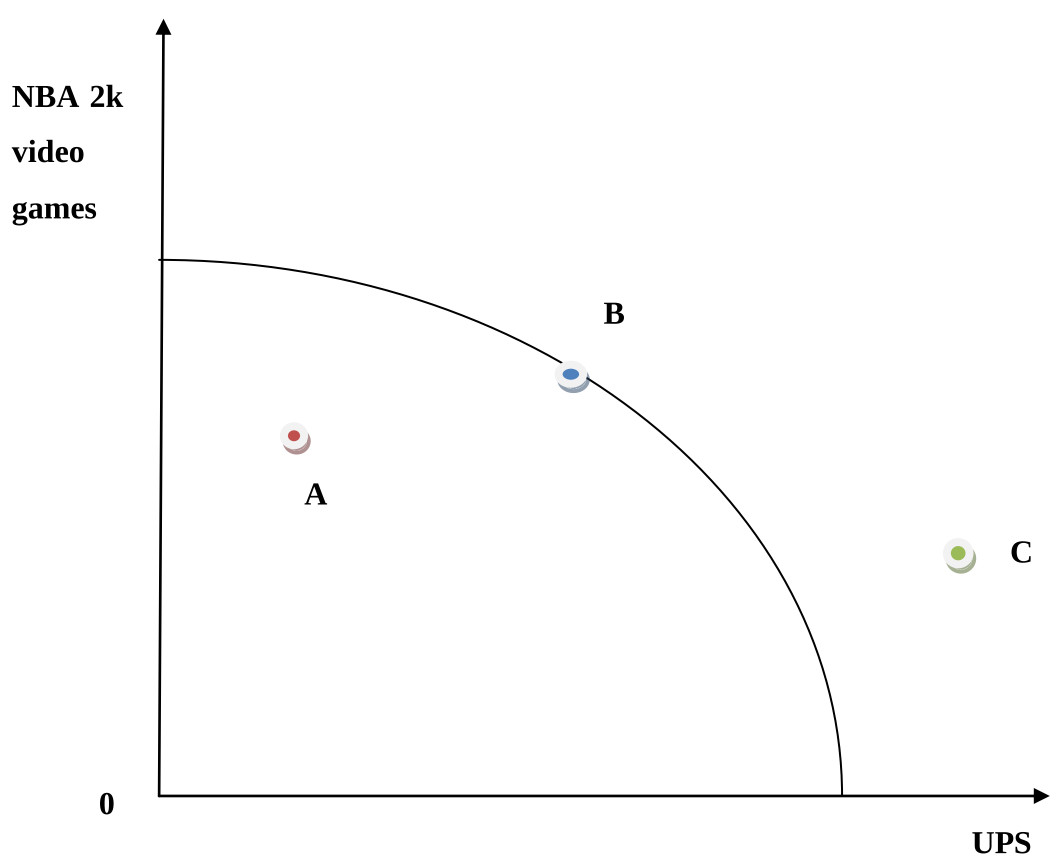

Figure 1: Production Possibility Curve

(Source: Created by the learner)

The production possibility curve is the curve showing the different combinations of two commodities that can be produced with the available resources and technology. The curve above shows the different combinations of activities like playing NBA 2k video games and UPS work that can be done using the limited labor and physical capital. Combination A represents the present position, where the labor and physical capital devoted to both video games (NBA 2k) and work (UPS), are inefficient. This means that the available resources are not being properly utilized at this point. Combination B is the point that the individual seeks to achieve in the short run, where there is efficient allocation of resources that are available. Any point lying on this curve is associated with a full and efficient utilization of the available resources. The individual here chooses a combination involving more of playing video game and less of working. The third combination, combination C is the most desirable but unattainable. This is the point that the individual wishes to reach in the end by increasing the availability of both labor and capital. At this point, the individual chooses more of working and less of playing.

Differences between a market system and a command economy

Economics is the study of how society allocates its scarce resources to satisfy its innumerable wants (hendersonsocial.weebly.com, 2018). Based on this, economic systems seek to provide an answer to the three core economic questions:

What to produce?

How to produce?

How to allocate/ distribute?

How an economic system provides an answer to the above-mentioned questions and the characteristic features of the system, draw a line of distinction between the economic systems. The two main economic systems are the market system and command economy.

Basis of distinction	Market economy	Command economy

Ownership of resources	Private ownership of the resources is allowed, various parties have the ownership of the different resources that are available.	Resources are under the control of the government and cannot be privately held
Government intervention	This economy does not provide government much authority to influence the economic activities, thus imposing a laissez faire.	In a command economy, everything is in the hands of the government.
Division of labor	Market is based on division of labor.	Division of labor is not involved
Setting up prices	The prices of goods and services is determined by the interaction of the market forces of demand and supply. The invisible hand operates in such an economy.	Government decision makers determine the prices in this economy
Distribution of income	There is a greater chance of unequal income distribution in this economy.	Because of significant government interference, there is fairly equal income distribution.

Table 1: Differences between a market system and a command economy

(Source: Created by the learner)

Market system- a market economy, also known as the capitalist economy, is an economy where the decisions regarding the production, distribution and investment are taken on the basis of the market forces of demands and supply.

Therefore, the three economic questions are, what to produce, how to produce and how to allocate, are answered by the freely operating market forces. These questions are answered in a way in which both the producers and consumers find it beneficial.

Command economy- It is the system where the three basic economic questions are answered in the manner determined by the government, and not by free market operations. Everything functions as per the command of the government. There is consumer sovereignty, which means that the producers can produced only those commodities that the people in general wish to consume. Government makes the decisions regarding the method of production of the goods and the allocation of such goods and services (encyclopedia.com, 2018).

Scarcity and its meaning in the contemporary world

Scarcity is the most basic economic problem that is characterized by unlimited human wants and needs, countered by limited resources. Scarcity says that society does not have sufficient productive resources required to satisfy their limitless wants. Under this situation, an individual has to allocate his scarce resources among his unlimited wants based on his priorities (Staff, I, 2018). On the contrary, a situation of shortage arises when consumers demand more goods than the producers are willing to willing to supply. The main point of difference between the two is that scarcity is permanent, while shortage is temporary. Shortage is related to price, while scarcity is deals with the scarce resources (ankenyschools.org, 2018).

The main economic resources, or factors of production, can be split into four categories:

Land- land is defined as the natural resources amenable to human control like forests, etc. This is considered scarce because not all resources provided by nature can be controlled by human

Labor- labor is the capability to exert physical and mental talent. Labor is restricted because this capability is not unlimited.

Capital- capital is referred to as the produced means of production. So, it is man-made. The limited availability of capital makes it a scarce resource.

Entrepreneurship- The ability to combine the other resources in an appropriate way, and to take risks and innovate is called entrepreneurship. This is scarce in the sense that all entrepreneurs might not be enterprising and might not be willing to take risks (ankenyschools.org, 2018).

Opportunity cost is the value of the sacrifice of the next best alternative to a commodity, to produce the said commodity. This is basically the value of what is forgone by choosing one commodity or action over the other(cengage.com.,2018). Every action of individuals consumes scarce resources like time and money. If the resources would have been unlimited then the problem of choosing one commodity or action over the other would not have arisen. The concept of opportunity cost would then have no significance. The process of decision making involves the choosing the option that gives more utility or satisfaction to the person compared to the other.

Comparative Advantage

Comparative advantage is the ability of a nation to make goods and services at an opportunity cost that is lower in comparison to that faced by the other countries. The US, because of its sound financial condition, has had a comparative advantage in case of the following industries:

Agricultural goods- The US agricultural trade had shown surpluses varying between $0.7billion to $1.7 billion, between 1960 and 1967. Thereafter, considerable deterioration took place in the agricultural produce and surplus of the US as it came down to $0.5 billion.

Fuels and lubricants- Trade in this industry showed a consistent surplus from 1925 to 1940. This was significantly affected by the world wars. After the wars, the imports of lubricants picked up and there was no longer a surplus in trade.

Chemicals- The pattern of trade in case of chemicals was slightly different. In the early times, the trade of chemicals was roughly balanced. Then, a small surplus was witnessed in 1938-40. The imports of such products picked up in the late 1960s.

Capital goods- Because of great technological revolutions and innovations, capital goods showed a trade surplus all through the period 1925-1970. The imports before the First World War were flat varying in the range of $10million-$40million. But the compared to this, the exports were significantly high in the range of $400million- $600million. After wars, the trade surplus in capital goods bumped up high. This figure of surplus exceeded $10billion in the 1970s. Since, then it has consistently shown an upward trend.

Consumer goods (excluding food and beverages) - The trend of the consumer goods surplus is in great contradiction to the capital goods. Even before the world wars, the imports of consumer goods, in comparison to the exports, were considerably high. But in the post war period, the decline in surplus dwindled away(Brookings.edu, 2018).

At present, the US shows comparative advantage in trade in the following industries:

Crude oil and other refined products- Fuel exports amounting to around $88billion in 2011, which was much greater than the imports, which indicates that US has a comparative advantage in this industry. This industry has always been a stronghold of the US.

Automotive industry- The automotive industry of US showed a surplus every year until 1968, but then there was a trade deficit during the world war phase. However, post the wars, this industry has shown a remarkable and smooth trade surplus year after year.

Pharmaceutical industry- A great export surplus is witnessed in this US industry.

The four determinants of elasticity

Elasticity can be defined as the degree of responsiveness of the buyers/ suppliers to the change in the price level of the commodity. That is to say, how much the quantity demanded or supplied of a commodity changes due to a change in the price level. Elasticity of a commodity depends on the following factors:

Nature of the commodity- commodities can be classified into necessities, comforts, and luxuries. Necessities like food, clothing, etc display a low elasticity as their consumption cannot be postponed. Comforts have elasticity lower than luxuries, but higher than necessities. Luxuries such as TV sets, Air conditioners, etc. display a very high level of elasticity.

Availability of substitutes- a commodity like coffee has a close substitute like tea existing in the market. So, the elasticity of coffee is going to be high. On the contrary, commodities like electricity, which do not have close substitutes, depict low demand elasticity.

Possibility of postponing consumption- commodities whose consumption date can be postponed, like luxuries, are highly elastic but the commodities like necessities, whose consumption cannot be postponed, display a low elasticity of demand.

Income level of the consumer- people who have a high level of income are not much affected by price changes and thus, have a low elasticity. Poor people, in contrast, assign importance to small price changes as well, so their response to price changes is high (econ.lse.ac.uk., 2018).

Conclusion

The above discussion helps expand upon the way in which, these concepts and theories form an important base of modern economics.

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