Basic economic problems
The basic economic problem that arises because people have unlimited wants but resources are limited. Because of scarcity (limited nature of resources), various economic decisions must be made to allocate resources efficiently.

- All societies face the economic problem, which is the problem of how to make the best use of limited, or scarce, resources.
- The economic problem exists because, although the needs and wants of people are endless, the resources available to satisfy needs and wants are limited.
- Choice and opportunity cost are two fundamental concepts in economics. Given that resources are limited, producers and consumers have to make choices between competing alternatives.
- All economic decisions involve making choices. Individuals must choose how best to use their skill and effort, firms must choose how best to use their workers and machinery, and governments must choose how best to use taxpayer's money.

Resource can be categorized as below
i) Economic Resources:
   Economic Resources are basic items that are used in all types of production, including natural, capital, and human resources.

ii) Natural Resources:
   Natural Resources are the resources from nature that are used in production, including land, raw materials, and natural process.

iii) Capital Resources:
   Capital Resources are the processed materials, equipment, and buildings which are used in production.

iv) Human Resources:
   Human Resource includes the efforts of people involved in production, including labour and entrepreneurship.
Needs and wants.

- Needs would be defined as goods or services that are required. This would include the needs for food, clothing, shelter and health care.
- Wants are goods or services that are not necessary but that we desire or wish for. For example, one needs clothes, but one may not need designer clothes. One does not need toys, entertainment, gems, etc.. One needs food, but does not have to have steak or dessert. One does not need glamorous trips, mall shopping, etc..
- By maintaining balance between needs and wants one can avoid basic economics problem.

Poverty

“A state or condition in which a person or community lacks the financial resources and essentials to enjoy a minimum standard of life and well-being that's considered acceptable in society.”

- Poverty is said to exist when people lack the means to satisfy their basic needs. In this context, the identification of poor people first requires a determination of what constitutes basic needs.
- These may be defined as narrowly as “those necessary for survival” or as broadly as “those reflecting the prevailing standard of living in the community.”

Absolute Poverty:

Absolute poverty refers to a condition where a person does not have the minimum amount of income needed to meet the minimum requirements for one or more basic living needs over an extended period of time, including:

- **Food**: Adults who have a body mass index that is below 17, or children who are over three standard deviations below certain age/weight/height criteria.
- **Safe drinking water**: Having to use surface water (i.e. rivers or streams), or having to spend at least 30 minutes to collect water from some source.
- **Sanitation facilities**: Lack of access to any type of toilet facility.
- **Health**: Lack of access to any type of health care, including immunizations, prenatal care, or treatment for serious illnesses.
- **Shelter**: Kids who live in places where there are more than four people to a room, adults who live in places with more than three people to a room, or adults and children who live in places with no floors.
- **Education**: School-age children who have not in the past or are not currently in school, or adults who have not attended school and cannot read or write.
- **Information**: Lack of access to any type of media, including radio, television, or computer.
- **Access to services**: Lack of access to schools, health services, etc.
Living in absolute poverty is harmful and can endanger your life. The standards set for absolute poverty are the same across countries. According to the World Bank, the global absolute poverty line is living on less than $1 a day.

**Relative poverty**

- Relative poverty is the condition in which people lack the minimum amount of income needed in order to maintain the average standard of living in the society in which they live.
- Relative poverty is considered the easiest way to measure the level of poverty in an individual country. Relative poverty is defined relative to the members of a society and therefore differs across countries.
- People are said to be impoverished if they cannot keep up with the standard of living as determined by society.
- Relative poverty also changes over time. As the wealth of a society increases, so does the amount of income and resources that the society deems necessary for proper conditions of living.
- For example, if you were a family of four (two adults and two children) living in America in 1963 with a yearly income less than $3,100, you would have been living in relative poverty. By 1992, this amount had increased to $14,228 a year.

**Causes of poverty:**

1. **Rapidly Rising Population:** The population during the last 45 years has increased at the rate of 2.2% per annum. On average, 17 million people are added every year to its population which raises the demand for consumption goods considerably.

2. **Low Productivity in Agriculture:** The level of productivity in agriculture is low due to subdivided and fragmented holdings, lack of capital, use of traditional methods of cultivation, illiteracy etc. This is the main cause of poverty in the country.

3. **Under Utilized Resources:** The existence of underemployment and disguised unemployment of human resources and underutilization of resources has resulted in low production in the agricultural sector. This brought a down fall in their standard of living.

4. **Low Rate of Economic Development:** The rate of economic development in India has been below the required level. Therefore, there persists a gap between level of availability and requirements of goods and services. The net result is poverty.

5. **Price Rise:** The continuous and steep price rise has added to the miseries of poor. It has benefited a few people in the society and the persons in lower income group find it difficult to get their minimum needs.

6. **Unemployment:** The continuously expanding army of unemployed is another cause of poverty. The job seeker is increasing in number at a higher rate than the expansion in employment opportunities.
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8. Shortage of Capital and Able Entrepreneurship: Capital and able entrepreneurship have important role in accelerating the growth. But these are in short supply making it difficult to increase production significantly.

9. Social Factors: The social set up is still backward and is not conducive to faster development. Laws of inheritance, caste system, traditions and customs are putting hindrances in the way of faster development and have aggravate the problem of poverty.

10. Political Factors: The Britishers started lopsided development in India and reduced Indian economy to a colonial state. They exploited the natural resources to suit their interests and weaken the industrial base of Indian economy.

Measures to reduce poverty

1. Employment opportunities: Poverty can be eliminated if the poor people are given the jobs according to their needs and talents. Self employment can also be provided to them. Government can set up institutions which trains them in some practices and skills.

2. Establishment of Small Scale Industries: Government should develop cottage, handicrafts and other small scale industries to in the backward regions of our country. Moreover this will transfer resources from the areas of surplus to the deficit solving the problem of urbanization.

3. Education: Government should take steps to spread awareness for education so that the people do not have to depend on others for their income. They can also protect themselves from exploitation by the greedy traders.

4. Reduce Inflation: Inflation tends to make poor poorer and rich richer. There should be a stability in the price level of the country. Government should also reduce the burden of tax on the poor and charge more on the richer class.

5. Check Population growth: Much of the problem of poverty can be solved if the population of the country can be reduced to a average level. This will make developmental plans successful and the poor people will have a greater share in the funds of the government.

6. Proper Utilization of Resources: Resources of the country should be utilized properly so that we can have the benefits of those free gifts of nature.

7. Uplift of Agriculture: Agriculture is the backbone of our country. It provides income to vast number of people. Hence the government should also concentrate on it and not only on the industries.
Unemployment

“Unemployment is defined as a situation where someone of working age is not able to get a job but would like to be in full time employment.”

- Unemployment is often used as a measure of the health of the economy.
- Unemployment (or joblessness) occurs when people are without work and actively seeking work. The unemployment rate is a measure of the prevalence of unemployment and it is calculated as a percentage by dividing the number of unemployed individuals by all individuals currently in the labor force.
- During periods of recession, an economy usually experiences a relatively high unemployment rate.

Types of Unemployment and causes

Unemployment can be divided into various parts which is described over here.

Cyclical unemployment

- Cyclical unemployment exists when individuals lose their jobs as a result of a downturn in aggregate demand (AD).
- If the decline in aggregate demand is persistent, and the unemployment long-term, it is called either demand deficient, general, or Keynesian unemployment. For example, unemployment levels of 3 million were reached in the UK in the last two recessions, between 1980 and 1982, and between 1990 and 1992.
- In the most recent recession of 2008-2010, unemployment levels rose to 2.4m in the last quarter of 2009, and are likely to peak at over 2.5m during 2010.

Demand deficient unemployment

- This is caused by a lack of aggregate demand, with insufficient demand to generate full employment.
Structural unemployment
- Structural unemployment occurs when certain industries decline because of long term changes in market conditions.
- For example, over the last 20 years UK motor vehicle production has declined while car production in the Far East has increased, creating structurally unemployed car workers.
- Globalisation is an increasingly significant cause of structural unemployment in many countries.

Regional unemployment
- When structural unemployment affects local areas of an economy, it is called ‘regional’ unemployment.
- For example, unemployed coal miners in South Wales and ship workers in the North East add to regional unemployment in these areas.

Classical unemployment
- Classical unemployment is caused when wages are ‘too’ high. This explanation of unemployment dominated economic theory before the 1930s, when workers themselves were blamed for not accepting lower wages, or for asking for too high wages.
- Classical unemployment is also called real wage unemployment.

Seasonal unemployment
- Seasonal unemployment exists because certain industries only produce or distribute their products at certain times of the year.
- Industries where seasonal unemployment is common include farming, tourism, and construction.

Frictional unemployment
- Frictional unemployment, also called search unemployment, occurs when workers lose their current job and are in the process of finding another one.
- There may be little that can be done to reduce this type of unemployment, other than provide better information to reduce the search time.
- This suggests that full employment is impossible at any one time because some workers will always be in the process of changing jobs.

Voluntary unemployment
- Voluntary unemployment is defined as a situation when workers choose not to work at the current equilibrium wage rate.
- For one reason or another, workers may elect not to participate in the labour market.
- There are several reasons for the existence of voluntary unemployment including excessively generous welfare benefits and high rates of income tax.
- Voluntary unemployment is likely to occur when the equilibrium wage rate is below the wage necessary to encourage individuals to supply their labour.
Measures to reduce unemployment

An improvement in the employability of the labour supply - so that the unemployed have the right skills to take up the available job opportunities. Policies should focus on improving the occupational mobility of labour.

An improvement in the incentives for people to search and then accept paid work - this may require some reforms of the tax and benefits system.

A sustained period of economic growth so that new jobs are being created - this requires that aggregate demand is sufficiently high for businesses to be looking to expand their workforces.

Improving skills and reducing occupational immobility

- Policies should provide the unemployed with the skills they need to find re-employment and improve the incentives to find work.
- Structural unemployment is the result of workers being occupationally immobile - improvements in education and training will increase the human capital of these workers, and therefore give them a better chance of taking the new jobs that become available in the economy.

Reflating Aggregate Demand

- The government can also use macro-economic policies to increase the level of aggregate demand. These policies might involve lower interest rates or lower direct taxes.
- It might also encourage foreign investment into the economy from foreign multinational companies.
- In the diagram below we see an increase in aggregate demand leading to an expansion of aggregate supply.
- Because of the increase in demand for output, the demand for labour at each wage rate will grow - leading to an increase in total employment.
Benefit and Tax Reforms
- Reducing the real value of unemployment benefits might increase the incentive to take a job – particularly if the real worth of unemployment benefits is well below the national minimum wage rate.
- Targeted measures are designed to help the long-term unemployed find re-employment (including the Government's "Welfare to Work Schemes").

Employment Subsidies
- Government subsidies for those firms that take on the long-term unemployed will create an incentive for firms to increase the size of their workforce.
- Employment subsidies may also be available for overseas firms locating in the UK.

Economic Growth and Unemployment
- A growing economy creates jobs for people entering the labour market for the first time. And, it provides employment opportunities for people currently unemployed and looking for work.

The chart above shows the level of real national output (GDP) and total employment in the economy since 1980. In both of the last two recessions (1980-81 and 1990-92), the number of people in work has fallen sharply.
- But a period of sustained economic growth (as experienced by the UK from 1993-2001) has led to a significant increase in employment levels.
- Indeed by the summer of 2001, employment in the British economy was at record levels. This has helped reduce the official measures of unemployment to a level not seen for over twenty-five years.
Inflation

According to Silverman, inflation is defined as, “inflation is the term given to the expansion of money supply, in excess of the amount justified by the state of the trade resulting in a general rise in prices”.

Coul born has beautifully defined the term as “too much money chasing too few goods”.

There are two kinds of inflation:

1. Demand pull inflation.
2. Cost push inflation.

Here we go to describe the above kinds of inflation in detail.

1. Demand pull inflation:
   - Some economists believe that inflation is caused by increase in aggregate demand for goods.
   - They say that demand may rise due to many causes including increased money supply for example; people may reduce savings and spend more.
   - As aggregate demand rises for goods and services, firms try to increase production. To this they need more workers, more machines and more raw materials.
   - If these resources are not available because they are already full employed, the firms will not be able to increase output. In this case, rising demand causes inflation.

2. Cost push inflation:
   - Some economists think that inflation occurs due to rising costs. When the firms pass on their increased costs to consumers in the form of higher prices inflation starts.
   - Important sources of rise in cost include workers demand for higher wages, increase in taxes.

Causes of inflation:

Causes of inflation can be described as below.

i) Population explosion:
   Our population is rising at a very fast that is 3%. On other hand the rate of growth of GNP is not very high that is 5.4%. Thus increase in national output is insufficient to solve the problem of scarcity of goods. Since independence, our population has increased four times.

ii) Political instability:
   A country's economy depends upon political stability. Political instability discourages investment and encourages speculation. Under such circumstances, the industrialist and businessman feel unsecure and cannot make good plans. The government also cannot adopt affective measures to control rise in prices.
iii) Imported inflation:
A very important cause of inflation in Pakistan is the existence of inflation in their countries. Since 1970’s most countries are experiencing inflation. The result in the Pakistan has to import machinery, raw material and other goods at higher prices.

iv) Nationalization:
Due to nationalization of industrial in 1992, people were discouraged to make investment in industrial. Moreover in Pakistan the nationalization industrial did not perform will. They becomes centers of in sufficient production, high prices and poor quality goods were result.

v) Wages increases:
The increase in wages of workers has also contributed to inflation. Increase in wages result in higher cost of production of goods. So their price rises.

vi) Climatic factors:
Pakistan economies heavily depend upon agriculture but due to weather condition many crops fall short of target, thus pushing up prices. For example cotton production remain stagnant and below target during previous years. Wheat production has also not kept pace with rising demand.

vii) Oil crises:
The oil prices in 1973 created by a large quantity of inflation throughout the world. Import of oil is a high Burdon on our foreign exchange resources. At present 25 persons of our exports are used to pay for oil. From time to time, oil exporting countries increase price of oil, which raises transport cost.

viii) Artificial scarcity of goods:
Frequent artificial scarcity of essential items is created (cement, ghee, oil, sugar, etc) and huge profits are charged. Similarly through smuggling, large quantity of essential goods is sent to Afghanistan and India.

Remedies of inflation:
It is the main objective of every government to take proper measures to control inflation.

The main measures which are used to control inflation are:

1. Monetary policy.
2. Fiscal policy.
3. Direct measures and other measures.
1. **Monitory policy:**
Monitory policy is a policy that influences the economy through changes in money supply and available credit. Monitory policy is adopted by central bank of country. The various monitory measures which are used to control inflation are grouped under heads.

   a. Qualitative control.
   b. Quantitative control.

There are:

1. Open market operations
2. Variation in bank rates
3. Credit rationing
4. Varying reserve requirements.

2. **Fiscal policy:**
Fiscal policy is the deliberate change in either government pending or taxes to simulate or slow down the economy. It is the budgetary policy of government relating to taxes, public expenses, public borrowing and deficit financing.

Fiscal policy is based upon demand management examples, raising or lowering the level of aggregate demand by controlling various expenses, government expenses, consumption expenses.

3. **Direct measures:**
It means the step of government like rationing of goods and freezing of prices and wages. The government can also increase voluntary savings of people by giving them various incentives.

**Other measure:**

1. **Increase in output:**
The most effective method to control inflation is to increase the supply of goods. For this purchase, industrial and agricultural output should be increased. However, Pakistan performance in this regard is unsatisfactory.

2. **Control of smuggling:**
All steps should be adopted to check these evils through publicity as well as punishment. Large quantity of wheat, ghee, and other essential commodities being smuggled to Afghanistan should be control.

3. **Industrial peace:**
Industrial peace should be control to maintain the supply of goods and avoid the danger of scarcity. The disturbance such as what happened at Karachi during the past years should be control.
4. **Control of money supply:**
Volume of credit and money supply should be control. This can be done if tight monitory policy is followed. Decrease in money supply means less purchasing power with the people.

5. **No deficit financing:**
Deficit financing should be disco tribute. The development expenses should be meat through taxation, savings. Excessive issue of currency should not be used to meet budget deficit.

6. **Population control:**
Measure should be adopted to decrees the rate of population growth. The campaign of population planning has already started showing some success.

7. **Simple living:**
Luxurious life style should be discouraged and simple living should be adopted. The political leaders should themselves adopt simple living and provide an example for others.