

103: Principles of Economics (POE)

For JAIBB

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Suggestion:

- *Read 4 star and 5 star marked chapter if you have time shortage to read all chapter.*
- *Must read short notes and difference from all chapter.*
- *MetaMentor Center suggest to read whole note to find 100% common in exam. We cover everything in our note.*

| Important | Details | Number of Question common in previous years |
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| *****All short note from all chapter and end of note ***** | | |

Syllabus

Module-A: Economics: Introduction

Definition; Micro Vs. Macro; Positive Vs. Normative Economics, Scarcity, Resources, Opportunity Cost, Circular Flow, Production Possibility Curve, Economic Models. Economic Systems — Market Economy and Regulated economy.

Module-B: Basics of Microeconomics

Market forces of Demand and Supply; Market Equilibrium; Shifts and Changes in the Demand and Supply; Consumer's equilibrium — Utility analysis and Indifference Curve Analysis; Consumer Surplus; Price Ceiling and Floor, Elasticity and its application.

Module-C: Production and Cost

Concepts of Production; Production in the Short run; Short-run Costs of Production; Relations between Short-run Cost and Production; Production Isoquants and Isocost Curves, Optimal Combination of Inputs; Optimization and Cost; Expansion Path and Returns to Scale; Long Run Costs, Relationship between SR and LR Cost.

Module-D: Market Structure

Various Forms of Markets; Characteristics of Perfect Competition — Profit Maximization in the Short run (SR) and long run (LR); Nature of Monopoly and Monopolistic Competition- SR and LR Equilibrium under Monopoly and Monopolistic Competition; Strategic Decision Making in Oligopoly Markets.

Module-E: Market Failure and Market Intervention

Concepts of Market Failure and Externalities, Market Failure and Policy Intervention in the financial sector.

Module-F: Macroeconomics

Overview of Macroeconomics; National Income & Accounts; Govt. Income and Expenditure Accounts; Monetary Account; Balance of Payment Account; Interactions among all these macro accounts; Macro-economic Policies (Monetary and Fiscal Policy) and macro-economic equilibrium.

Module-G: Macroeconomic Performance of Bangladesh

Indicators of macroeconomic performance; National Income, Savings, Investment, Capital formation, Inflation, Unemployment etc.

Module-A:

Economics: Introduction

Q-01. Define Economics. How Microeconomics and Macroeconomics are different? BPE-99th.

Economics is a social science that examines how individuals, businesses, and societies allocate limited resources to satisfy unlimited wants and needs. It encompasses microeconomics, focusing on individual behavior in markets, and macroeconomics, studying the overall behavior of the economy. Economists analyze concepts such as supply and demand, production, costs, and factors influencing economic growth, unemployment, and inflation. They use theoretical frameworks, mathematical models, and empirical methods to understand economic phenomena and make predictions. Economics informs public policy decisions and explores various subfields like behavioral economics, environmental economics, and international economics. Ultimately, it provides valuable insights into the functioning of economies and guides decision-making at individual and societal levels.

| Aspect | Microeconomics | Macroeconomics |
|----------------------------|---|---|
| 1.Scope | Focuses on individual economic agents and markets | Focuses on the economy as a whole |
| 2.Level of Analysis | Examines specific economic units, such as households | Analyzes aggregate variables, such as GDP and inflation |
| 3.Concern | Studies individual consumer behavior and firm decisions | Studies overall economic growth and stability |
| 4.Key Topics | Supply and demand, market equilibrium | Economic growth, unemployment, inflation |

Q-02. What are the two subfields into which economics is divided? Explain what each subfield studies.

Economics is generally divided into two subfields: microeconomics and macroeconomics.

- 1. Microeconomics:** Microeconomics focuses on the behavior and decision-making of individual economic agents such as consumers, firms, and households. It examines how these agents allocate their scarce resources to fulfill their needs and wants. Microeconomics analyzes various economic concepts like supply and demand, market structures, consumer behavior, production decisions, and pricing strategies.
- 2. Macroeconomics:** Macroeconomics studies the overall behavior of an economy as a whole. It looks at aggregate variables such as national income, employment, inflation, and economic growth. Macroeconomics examines the relationships and interactions between different sectors of the economy, such as government policies, monetary and fiscal policies, international trade, and financial markets. It focuses on understanding the factors that influence the overall performance of an economy, addressing issues like economic fluctuations, unemployment, inflation, and long-term economic development.

Q-03. Write down the features of Micro Economic and Macro Economics. BPE-96th. Or, "Microeconomics and Macroeconomics are interdependent and complement each other"- Explain the notion by describing the features of both Micro and Macroeconomics. BPE-98th.

Features of Microeconomics:

1. **Focus on Individual Units:** Studies behavior of individual consumers, producers, and markets.
2. **Demand and Supply Analysis:** Examines how prices and quantities are determined in individual markets.
3. **Consumer and Producer Behavior:** Analyzes decisions about resource allocation and goods production.
4. **Market Structures:** Includes competition, monopoly, and oligopoly dynamics.
5. **Price Mechanism:** Explains how resources are distributed based on price changes.

Features of Macroeconomics:

1. **Aggregate Perspective:** Deals with national and global economic variables like GDP and inflation.
2. **Policy Formulation:** Involves monetary and fiscal policies for economic stabilization.
3. **Economic Growth:** Examines long-term growth factors such as investment and savings.
4. **Employment Trends:** Studies unemployment and labor market dynamics.
5. **Inflation and Trade:** Analyzes the effects of price levels and international trade.

Interdependence:

Micro and macroeconomics complement each other. Micro-level insights, like consumer behavior, influence macro-level outcomes like national income, while macroeconomic policies affect individual markets and agents.

Q-04. Classify the following topics as relating to microeconomics or macroeconomics: a. a family's decision about how much income to save; b. the effect of government regulations on auto emissions; c. the impact of higher national saving on economic growth; d. a firm's decision about how many workers to hire; e. the relationship between the inflation rate and changes in the quantity of money.

- a) **Microeconomics:** A family's decision about how much income to save is a microeconomic topic as it focuses on individual or household-level economic decisions.
- b) **Microeconomics:** The effect of government regulations on auto emissions can be considered a microeconomic topic as it involves specific regulations and their impact on individual firms or the automobile industry.
- c) **Macroeconomics:** The impact of higher national saving on economic growth is a macroeconomic topic as it pertains to the overall economy and the relationship between saving and economic performance at a national level.

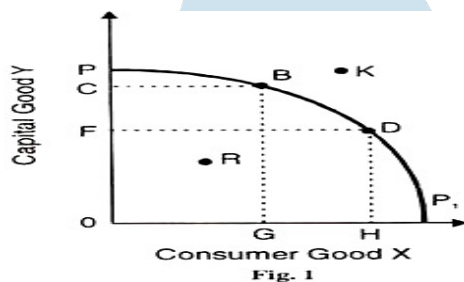
- d) **Microeconomics:** A firm's decision about how many workers to hire is a microeconomic topic as it deals with the internal decision-making of a specific firm and its labor choices.
- e) **Macroeconomics:** The relationship between the inflation rate and changes in the quantity of money is a macroeconomic topic as it examines the broader relationship between the overall price level (inflation) and the money supply in the economy.

Q-05. What are the fundamental problems of Economics? Explain with diagram. BPE-96th.

Or, what are the three (03) basic questions an economy confronts? Briefly explain. BPE-98th. BPE-5th.

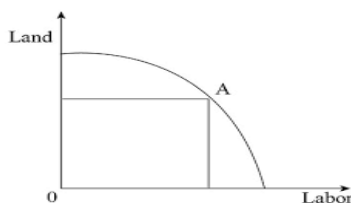
Or, Discuss the basic questions of “what”, “how” and “for whom” as used in economics. Give specific examples of these questions with respect to the use of a country’s limited resources.

1. What to Produce and in What Quantities?



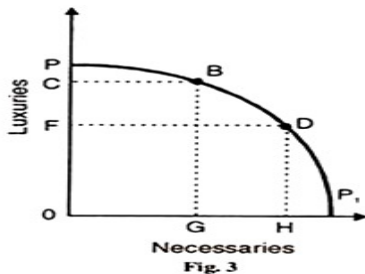
- The diagram for this problem, typically a production possibility frontier (PPF), shows the trade-off between two goods (like X and Y).
- Points on the PPF curve (B or D) represent efficient production levels, where increasing the production of one good results in the decrease of the other due to limited resources.
- Points inside the curve (R) indicate inefficient use of resources, while points outside are unattainable with current resources.
- For instance, a country may decide to allocate resources to produce necessities like food, healthcare, and education, as well as luxury goods like electronics or vehicles

2. How to Produce these Goods?



- The graph illustrates a Production Possibility Frontier (PPF), showcasing the trade-offs between land and labor in production. Point A represents the current allocation of land and labor, while other points along the curve indicate possible adjustments to resource allocation.
- For instance, a producer may decide between utilizing more land or labor depending on their availability and relative costs, influencing the efficiency and outcomes of production

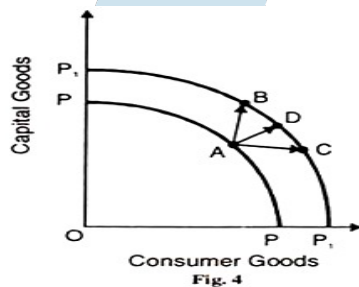
3. For Whom is the Goods Produced?



This can be represented by income distribution charts showing how the produced goods are distributed among different segments of society (Luxuries good for rich and Necessaries good for poor).

It involves considerations of equity and fairness in resource allocation, ensuring basic needs are met for all individuals.

4. How Efficiently are the Resources being Utilized?



Efficiency is often illustrated by whether the economy is operating on its PPF curve. Inside the curve means resources aren't fully utilized (point A) while on the curve (B, D, C) indicates maximum efficiency.

5. Is the Economy Growing?



Economic growth can be depicted by an outward shift in the PPF curve over time (From PP to P1P1), showing that more of both goods can be produced due to increased resources or technological advancements.

Q-06. What are positive and normative economics? BPE-97th. BPE-6TH

Positive economics and normative economics are two different approaches to studying economics:

1. **Positive Economics:** This deals with facts and cause-and-effect relationships. It tries to understand and explain how the economy actually works. For example, a positive economic statement might be, "If government taxes increase, consumer spending decreases." It's like being a scientist who observes and reports what happens, without giving opinions.
2. **Normative Economics:** This is about what should be or what ought to happen. It involves value judgments and opinions on economic policies. For instance, a normative economic statement could be, "The government should lower taxes to increase consumer spending." It's more like being a policymaker who recommends actions based on personal beliefs about what's good or bad.

In short, positive economics describes economic behavior as it is, while normative economics focuses on economic policy and what the goals of the economy should be.

Q-07. Give examples of positive and normative statements.

Positive statements:

1. "The unemployment rate in the country is 5%."
2. "Increasing the minimum wage will lead to higher labor costs for businesses."
3. "The demand for smartphones has increased by 10% in the past year."
4. "Government spending on education has a positive correlation with literacy rates."

Normative statements:

1. "The government should increase taxes on high-income earners to reduce income inequality."
2. "Smoking should be banned in all public places."
3. "The minimum wage should be raised to ensure a living wage for all workers."
4. "The government should provide free healthcare for all citizens."

Positive statements describe facts, observations, or statements that can be empirically tested and proven. Normative statements, on the other hand, express opinions, values, or subjective judgments about what should or ought to be done. They involve subjective interpretations and preferences, and cannot be proven or disproven purely based on evidence.

Q-08. Identify positive and normative statements from the following:

- a. the new law will reduce national income;**
- b. New Bank Companies Act is a good piece of legislation;**
- c. Parliament ought to pass law X;**
- d. President should veto the new law.**

Positive statement: **a. The new law will reduce national income.**

Normative statements: **b. New Bank Companies Act is a good piece of legislation.**

c. Parliament ought to pass law X.

d. President should veto the new law.

Q-09. Discuss the importance of multiplicity of wants and scarcity of resources in the study of economics.

- 1. Resource allocation:** Scarcity necessitates making choices about how limited resources are allocated among unlimited wants.
- 2. Price determination:** Multiplicity of wants and scarcity drive the forces of supply and demand, which determine prices in the market.
- 3. Economic efficiency:** Understanding the trade-offs between wants and resources allows economists to study how to allocate resources efficiently to maximize societal welfare.
- 4. Opportunity cost:** Scarcity highlights the concept of opportunity cost, where choosing one want over another incurs the cost of forgoing alternative uses of the limited resources.
- 5. Market dynamics:** Multiplicity of wants and scarcity drive market dynamics, such as competition, innovation, and the quest for efficient resource utilization.

Q-10. 'Scarcity brings in the problem of choice'- Explain. BPE-98th.

Scarcity refers to the limited availability of resources in comparison to the unlimited wants and needs of individuals and society. It creates a situation where choices have to be made due to the inability to fulfill all desires. Since resources are scarce, individuals and society must make decisions about how to allocate these limited resources among various competing needs and wants. This necessitates making choices, prioritizing certain options over others, and sacrificing alternative uses of resources. Thus, scarcity brings forth the problem of choice, forcing individuals and society to decide on the most desirable uses of scarce resources to maximize satisfaction and well-being.

Q-11. What is the relevance of Opportunity Cost in economics? BPE-98th.

Opportunity cost is a fundamental concept in economics that represents the value of the best alternative forgone when making a choice or decision. It highlights the notion that when resources are allocated to one particular use, there is an inherent cost of not being able to allocate those resources to an alternative use. Understanding opportunity cost is crucial because it helps individuals, businesses, and policymakers make rational decisions

by evaluating the trade-offs involved. It allows for the comparison of benefits and costs across different options, aiding in efficient resource allocation and maximizing overall economic efficiency. By considering opportunity cost, decision-makers can make more informed choices and assess the true cost of their decisions.

Q-12. Briefly discuss about the Economic Models.

Economic models are simplified representations of the real world used to understand, explain, and predict economic phenomena. They are like maps that highlight key features of an economy, leaving out less important details. Here's a brief overview:

1. **Simplification:** Economic models simplify complex economic activities to make them easier to understand. They use assumptions to focus on specific elements.
2. **Representation:** Models can be represented in various forms, like graphs, equations, or diagrams. For example, a supply and demand graph in microeconomics.
3. **Predictions:** They help economists predict how changes in one area (like interest rates) can affect the whole economy.
4. **Analysis:** Models allow for analysis of economic policies and theories. They show potential outcomes of different economic decisions.
5. **Limitations:** They are based on assumptions, so they may not perfectly depict real-life scenarios.

Overall, economic models are crucial tools for economists to analyze and interpret the complex dynamics of the economy.

Q-13. Briefly discuss about the Economic Systems.

Economic systems are the ways countries organize and manage their economic activities, like producing, distributing, and consuming goods and services. There are three main types:

1. **Capitalist System (Market Economy):** Here, individuals or private companies own and operate businesses. Prices and production are determined by supply and demand in the market. Example: The United States.
2. **Socialist System (Planned Economy):** The government controls major industries and resources. It decides what to produce, how much, and sets prices. Example: Cuba.
3. **Mixed Economy:** This is a blend of capitalist and socialist systems. Both the government and private sector play significant roles in the economy. The government regulates certain sectors while others are left to the market. Example: India. Each system has its own way of addressing economic challenges and achieving goals like growth, efficiency, and equity

Q-14. "Economic models are used to test economic theories"-Explain the notion with example. BPE-97th. BPE-5th.

"Economic models are used to test economic theories" means that models provide a structured way to analyze and validate the concepts proposed in economic theories.

For example, consider the theory of supply and demand, which suggests that the price of a good rises as demand exceeds supply and falls when supply exceeds demand. An economic model for this theory might use graphs to represent the relationship between supply, demand, and price. Economists can then use real-world data to test this model, like observing how the price of a product changes in response to changes in demand or supply. If the model's predictions match real-world observations, it supports the theory. If not, it might indicate the theory needs adjustment or that the model's assumptions are too simplistic. This process of testing with models helps refine economic theories, making them more accurate representations of the real world.

Q-15. What are the economic resources that we use to produce goods and services? Explain. BPE-97th.

Or, what are the four factors of production? Discuss. BPE-99th. BPE-6th.

Economic resources, also known as factors of production, are the inputs we use to produce goods and services. They are generally categorized into four main types:

1. **Land:** This includes all natural resources like water, minerals, forests, and land itself. These resources are used to produce food, build homes, and in manufacturing.
2. **Labor:** This is the human effort used in production. It includes the work done by people in various jobs, from manual labor to professional services.
3. **Capital:** This refers to the tools, machinery, buildings, and technology used in the production process. It's not just money, but all kinds of physical assets used to create goods and services.
4. **Entrepreneurship:** This is the skill and risk-taking ability of individuals who bring together the other three resources to produce goods and services. Entrepreneurs organize the business, make decisions, and bear the risks.

These resources are essential in the production process and their availability and quality can greatly impact an economy's output and efficiency

Q-16. Interpret 'Capital' as a factor of production.

Capital, as a factor of production, encompasses man-made resources such as machinery, equipment, buildings, infrastructure, and technology. It plays a vital role in the production process by transforming raw materials into finished goods and services. Capital is distinct from land and labor and is essential for enhancing productivity and efficiency.

Accumulated through savings and investments, capital enables businesses to expand, innovate, and improve their production capabilities. It is a key driver of economic growth, as it facilitates the creation of wealth, generates income, and contributes to the overall prosperity of an economy.

Q-17. Explain 'Human Resources' and 'Entrepreneurship' as factors of production.

Human resources, as a factor of production, encompass the skills, knowledge, labor, and capabilities of individuals who contribute to the production process. They are the

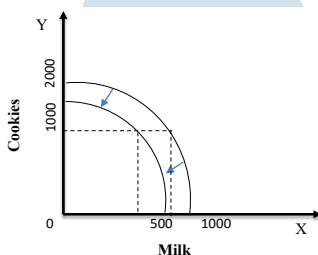
workforce that brings their physical and mental efforts to various occupations and roles. The quantity and quality of human resources significantly impact productivity and economic growth. Investments in education, training, and healthcare are essential for developing human resources and enhancing their productivity.

Entrepreneurship, on the other hand, refers to the ability to identify market opportunities, mobilize resources, and take risks to create new ventures. Entrepreneurs play a vital role in driving innovation, initiating business ventures, and creating employment opportunities. They bring together various factors of production and coordinate their efficient utilization to maximize productivity and achieve business success. Entrepreneurship is a key driver of economic development and progress.

Q-18. Draw and explain a production possibilities curve for an economy that produces milk and cookies. What happens to this frontier if disease kills half of the economy's cows?

Or, What is the Production Possibilities Curve (PPC)? BPE-98th. BPE-5th.

Or, Explain Production Possibility Curve (PPC). BPE-96th



The **Production Possibilities Curve (PPC)** showcases the maximum output combinations of two goods or services an economy can achieve when all resources are fully and efficiently utilized. In this graph, we're considering milk and cookies.

Your graph represents a PPC where:

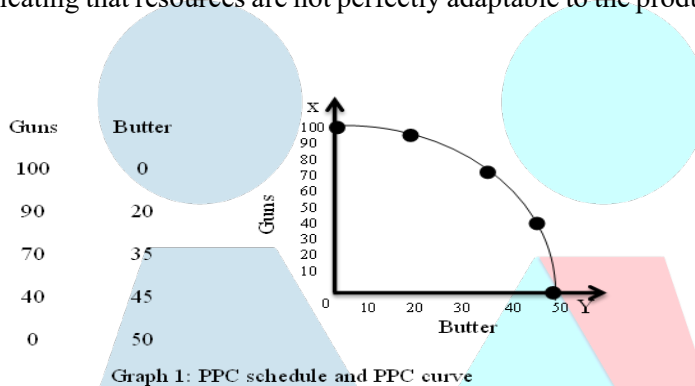
- On the X-axis, we have the quantity of milk.
 - On the Y-axis, we have the number of cookies.
1. **Efficiency and Trade-offs:** Any point on the curve (like where the dashed lines intersect the curve) indicates efficient production. Producing more of one good requires producing less of the other. For instance, producing 500 units of milk leads to producing 1000 cookies.
 2. **Unattainable Production:** Points outside the curve are unattainable with current resources.
 3. **Underutilization:** Points inside the curve indicate inefficiency.

Effect of Disease: If disease kills half of the economy's cows, milk production would drastically reduce. The PPC would shift inwards, particularly along the X-axis (milk). This means that to maintain the same cookie production, milk production would have to decrease even more than before. Alternatively, to keep producing the same amount of milk,

cookie production would have to decrease. The new curve would be closer to the origin, illustrating the reduced production capacity due to the loss of cows.

Q-19. Use a production possibilities frontier to describe the idea of “efficiency.”

The production possibilities Curve (PPC) assumes that the economy resources are fully utilized and efficiently allocated to the production of the two goods. It also assumes a fixed level of the technology during the period being analyzed. The curve drawn concave to the origin, indicating that resources are not perfectly adaptable to the production of both goods.



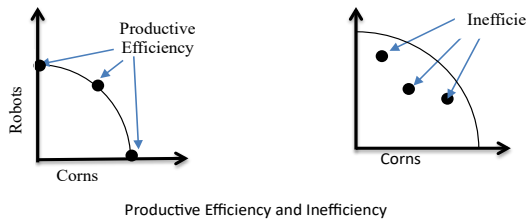
In a typical PPC graph, have two axes representing the production of two different goods or services. Let's use a classic example of a PPC that depicts the production of guns and butter in an economy:

- Guns are often associated with military production, while butter represents civilian goods or services.
- The x-axis represents the quantity of guns produced.
- The y-axis represents the quantity of butter produced.

The PPC curve itself represents the combination of guns and butter that an economy can produce when it allocates its resources most efficiently. Points on the curve indicate that resources are fully utilized, and there is no wasted potential. In other words, the economy is operating at maximum efficiency.

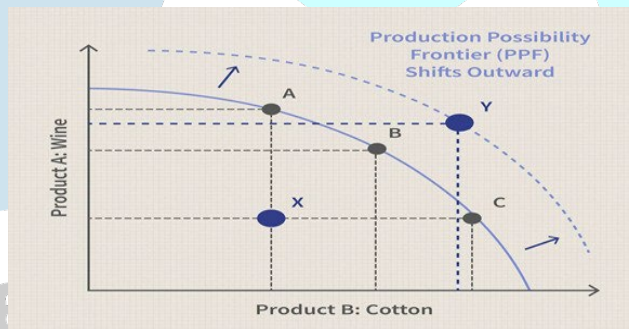
Efficiency on the PPC can be described in two main ways:

1. **Allocative Efficiency:** This occurs when an economy produces the mix of goods and services that best satisfies the preferences and needs of its population. On the PPF, allocative efficiency occurs when the economy is operating on the curve, meaning it is producing the right combination of guns and butter based on society's preferences.
2. **Technical Efficiency:** This refers to the economy's ability to produce the maximum quantity of goods possible, given its current level of technology and resource allocation. Technical efficiency is represented by the PPF itself; points on the curve reflect the most efficient use of available resources and technology.



Efficiency in this context implies that resources are not wasted, and the economy is making the most of its limited resources. If the economy operates inside the PPF curve-second graph (points below the curve), it indicates that resources are underutilized, and the economy is not reaching its full production potential. Conversely, if the economy tries to operate beyond the PPF curve, it is unsustainable and implies that resources exceed their capacity, resulting in inefficiency or even a breakdown in production.

Q-20. What happens to the PPC frontier of an economy if advanced technical education improves the overall skills and knowledge of human capital? Explain with a diagram. BPE-98th.



Explanation: Advanced technical education improves the skills and knowledge of human capital, leading to increased efficiency and productivity in an economy. This causes the Production Possibility Curve (PPC) to shift outward, indicating that the economy can produce more of both goods.

Diagram Explanation:

- **Original PPC (Solid Line):** Shows the initial production capacity for Product A (Wine) and Product B (Cotton).

- **Shifted PPC (Dashed Line):** Illustrates the new, higher production capacity due to improved human capital.
- **Points on Graph:**
 - **A, B, C:** Points on the original PPC.
 - **Y:** A point on the shifted PPC, showing higher production levels for both goods.

Conclusion: The outward shift of the PPC demonstrates economic growth, as the economy can now produce more wine and cotton than before due to enhanced skills and knowledge.

Q-21. 'A point inside the production possibilities frontier is efficient, but not feasible' Do you agree? Explain.

I do not agree with the statement that "a point inside the production possibilities frontier is efficient, but not feasible." In fact, the opposite is true. A point inside the production possibilities frontier (PPF) is feasible but not efficient.

Feasibility means that the economy has enough resources and technology to produce at that point — and since it's within the boundary of the PPF, it is attainable with existing resources. However, efficiency means fully utilizing all available resources to produce the maximum possible output. A point inside the PPF reflects underutilization of resources — such as unemployment or idle capital — and therefore is considered inefficient.

In contrast, points on the PPF represent both feasible and efficient outcomes, and points outside the PPF are not feasible with current resources and technology.

Q-22. 'A point inside Production Possibility Frontier is feasible, but not efficient' Do you agree? Explain with example. BPE-5th.

Yes, I agree with the statement that "A point inside the Production Possibility Frontier (PPF) is feasible, but not efficient."

A point inside the PPF represents a combination of goods and services that an economy can produce with its current resources and technology, so it is feasible or attainable.

However, such a point also indicates that not all resources are being fully or efficiently utilized, meaning the economy could produce more output without requiring additional resources—hence it is not efficient.

Suppose an economy can produce two goods: rice and cloth. Its PPF shows the maximum possible combinations it can produce using all available land, labor, and capital.

- If the economy is operating at point X, inside the PPF, it might be producing 300 tons of rice and 200 meters of cloth.
- However, a point on the PPF, say point Y, could be 400 tons of rice and 300 meters of cloth, using the same resources more effectively.

This means point X is feasible—it's within the economy's production capacity—but it is not efficient because the economy could increase output of one or both goods by better using its resources (e.g., reducing unemployment, improving skills, or better allocation)

Q-23. 'A point on the production possibilities curve is feasible and efficient.'- Explain.

I agree with the statement that "a point on the production possibilities curve is feasible and efficient." Feasibility refers to the ability to achieve a particular combination of goods and

services using available resources and technology. A point on the production possibilities curve indicates that resources are fully employed and allocated efficiently, maximizing output given the existing constraints. It represents the optimal use of resources to produce a combination of goods and services. Therefore, a point on the production possibilities curve is both feasible, as it can be achieved with existing resources, and efficient, as it represents the maximum output attainable.

Q-24. Why do economists sometimes offer conflicting advice to policymakers?

1. **Diverse Perspectives:** Different theoretical frameworks and approaches lead to varying interpretations.
2. **Data Limitations:** Incomplete and interpretive nature of economic data contributes to differing conclusions.
3. **Value Judgments:** Varied normative views shape economists' policy recommendations.
4. **Uncertainty and Complexity:** Complexity of economic systems and uncertainties result in different assessments.
5. **Policy Objectives:** Differing prioritization of policy objectives influences economists' advice.

Q-25. Opportunity Cost: BPE-96th. BPE-98th. BPE-5th.

Or, What is an opportunity cost? Suppose a person holds cash BDT 1 lakh, which, if he places for a term deposit, will generate BDT 5,000 as interest. Instead, he decides to enroll in a professional course with that amount of money. What is the opportunity cost of the enrollment? Explain. BPE-99th.

Definition: Opportunity cost is the value of the next best alternative foregone when a decision is made. It highlights the trade-offs involved in choosing one option over another.

Example:

- If a student spends time studying for an exam instead of working a part-time job, the opportunity cost is the wages they would have earned.
- If a company invests in new machinery, the opportunity cost might be the alternative projects or investments it could have undertaken with the same funds.

Answer of Second part of the question:

The opportunity cost of enrolling in the professional course is the **BDT 5,000 interest** the person would have earned by placing BDT 1 lakh in a term deposit. Opportunity cost represents the benefits foregone when choosing one option over another. Here, by spending the money on the course, the person gives up the chance to earn interest from the deposit. Additionally, the opportunity cost could also include other possible uses of the money, such as investing in a business or saving for future needs.

Q-26. 'The circular-flow diagram illustrates that, in markets for the factors of production, where households are sellers, and firms are buyers.'- Do you agree? Explain.

Or, What is the circular flow model in economics? What are the elements on sectors

that make up a circular flow? Explain. BPE-98th.

Yes, I agree with the statement that the circular-flow diagram illustrates that, in markets for the factors of production, households are sellers, and firms are buyers. Let me explain this concept in more detail:

The circular-flow diagram is a simplified representation of an economy that helps us understand the flow of goods, services, and payments between different economic agents, primarily households and firms. It consists of two main sectors:

Household Sector: Households represent individual consumers and families within the economy. They are the primary owners of the factors of production, which include labor, land, capital, and entrepreneurship. In other words, households supply the factors of production to the economy.

Business (Firm) Sector: Firms, on the other hand, represent businesses or producers within the economy. They use the factors of production supplied by households to produce goods and services. Firms purchase these factors to engage in their production



Now, let's break down the flow of economic activity in the circular-flow diagram:

- Households supply factors of production to firms. This includes the sale of labor (in the form of wages and salaries), land (rent), capital (interest and returns on investments), and entrepreneurship (profit).
- Firms, in turn, use these factors of production to produce goods and services. For instance, they hire labor to produce goods, rent land for production sites, and invest in capital goods to enhance production efficiency.
- Firms sell the goods and services they produce to households and other entities, generating revenue.
- Households purchase these goods and services, and in doing so, they become consumers in the product markets.
- Households receive payments (income) from firms in the form of wages, rents, interest, and profits. This income is a result of their ownership of the factors of production.
- This income, earned by households, is used to consume goods and services produced by firms, creating a continuous flow of income and spending in the economy.

Q-27. Explain major economic systems following a historical perspective.

- **Feudalism:** Lords controlled land, while peasants worked for them in exchange for protection and a share of the harvest.
- **Capitalism:** Private ownership, free markets, and profit-driven production characterize this system.
- **Socialism:** It advocates for collective ownership and wealth redistribution for a more egalitarian society.
- **Communism:** The goal is a classless society with common ownership and distribution based on needs.
- **Mixed Economy:** It combines elements of capitalism and socialism, with both private enterprise and government intervention.

Q-28. What is Market Economy and Regulated Economy? Between them which one is better for economic development? BPE-96th. BPE-5th.

A **Market Economy** is a system where supply and demand determine prices and production. Businesses and consumers make most of the decisions, and the government plays a limited role. It's like a big open market where everyone can buy and sell freely. A **Regulated Economy**, on the other hand, has significant government control. The government makes decisions about what to produce, how much to produce, and sets prices. It's like having rules and limits on what can be sold and bought.

Which is better for economic development?

A mix of both systems, called a **Mixed Economy**, is often considered best. Market economy promotes competition, innovation, and efficiency, while regulation ensures social welfare, fair prices, and protection against market failure. So, a country can grow faster and reduce inequality by balancing free market forces with smart government regulations.

Example: Bangladesh follows a mixed economy with both private and government roles.

Q-29. You win BDT100 in a basketball pool. You have a choice between spending the money now and putting it away for a year in a bank account that pays 5 percent interest. What is the opportunity cost of spending the BDT100 now?

The opportunity cost of spending the BDT100 now instead of putting it away in a bank account that pays 5 percent interest for a year is the potential interest earnings that could have been gained if the money was saved.

To calculate the opportunity cost, we need to determine the amount of interest that would be earned on the BDT100 over one year at a 5 percent interest rate.

Using the formula for calculating simple interest: $\text{Interest} = \text{Principal (BDT100)} \times \text{Interest Rate (5\%)} \times \text{Time (1 year)}$

$\text{Interest} = 100 \times 0.05 \times 1 = \text{BDT5}$

Therefore, the opportunity cost of spending the BDT100 now is BDT5, which represents the potential interest earnings that could have been gained if the money was saved for a year in the bank account.

Q-30. Market economy and free market economy:

A market economy is a system where resources and goods are exchanged through voluntary transactions between buyers and sellers. It is based on the principles of supply and demand, where prices are determined by market forces. In a free market economy, there is limited government intervention, allowing individuals and businesses to make their own decisions about what to produce, how to produce, and for whom to produce. This promotes competition, innovation, and efficiency. People have the freedom to choose and pursue their own interests, while the market guides the allocation of resources and the distribution of goods and services.

31.What is the fundamental economic problem? Explain the role of opportunity cost in resource allocation.BPE-6th

The fundamental economic problem arises because human wants are unlimited, but resources such as land, Labour, capital, and entrepreneurship are limited. This condition is called scarcity. Since everything cannot be produced at the same time, society must make choices. Therefore, every economy must answer three basic questions:

1. What to produce? (Which goods and services should be made)
2. How to produce? (Which method—labour-intensive or capital-intensive)
3. For whom to produce? (How the output will be distributed)

Opportunity cost plays a central role in making these choices. It means the value of the next best alternative sacrificed when a decision is made. Because using a resource in one way means giving up its alternative use, opportunity cost helps decide the most efficient option. For example, if Tk. 50,000 is kept at home instead of depositing in a bank, the lost interest is the opportunity cost. Thus, opportunity cost guides individuals and governments to allocate scarce resources where they create the highest benefit.

Mathematical Problem

Q-01. A person has BDT 1,00,000. If he puts this money in a one-year term deposit at 5% simple interest, he will earn interest. Instead, he decides to spend the full amount on a professional course.

- a) Calculate the interest he would earn from the term deposit.
- b) What is the opportunity cost of enrolling in the course?

Ans:

Given:

- Principal $P = \text{Tk. } 1,00,000$
- Interest rate $r = 5\% = 0.05$
- Time $t = 1$

a) Interest $= P \times r \times t$

Interest $= 1,00,000 \times 0.05 \times 1$

$= \text{Tk. } 5,000$

Interest from term deposit = Tk. 5,000

b) Opportunity Cost:

Opportunity cost = value of next best alternative forgone

= interest income from term deposit

= 5,000

= 5,000

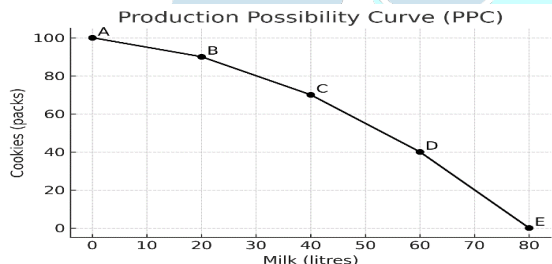
Q-02. An economy can produce only milk and cookies. The following table shows some possible output combinations on its Production Possibilities Curve (PPC):

| Point | Milk(liters) | Cookies (packs) |
|-------|--------------|-----------------|
| A | 0 | 100 |
| B | 20 | 90 |
| C | 40 | 70 |
| D | 60 | 40 |
| E | 80 | 0 |

a) Is point C (40, 70) on the PPC efficient?

b) What is the opportunity cost (in cookies) of increasing milk output from 20 to 40 liters (from B to C)?

c) What is the opportunity cost (in milk) of increasing cookies from 40 to 70 packs (from D to C)?



a) Yes, point C is efficient.

Because:

- Any point on the PPC (A, B, C, D, E) represents full and efficient use of resources.
- Since C lies on the curve, it is an efficient combination of milk and cookies.

b) Point B: 20 milk, 90 cookies

Point C: 40 milk, 70 cookies

When milk increases from 20 to 40 litres, cookies fall from 90 to 70.

Decrease in cookies = $90 - 70 = 20$ packs

Opportunity cost = **20 packs of cookies**

c) Point D: 60 milk, 40 cookies

Point C: 40 milk, 70 cookies

When cookies increase from 40 to 70 packs, milk falls from 60 to 40 litres.

Decrease in milk = $60 - 40 = 20$ liters

Opportunity cost = **20 liters of milk**

Case Study

Case -1: FoodLand Bangladesh Ltd. and the Problem of Choice.

FoodLand Bangladesh Ltd. produces two food items: bread and butter. The company has limited workers, limited ovens, and limited raw materials. Because of these scarce resources, FoodLand cannot produce unlimited amounts of both products. The production manager prepares a PPC (Production Possibilities Curve) showing different combinations of bread and butter.

One combination, Point M, lies on the PPC, showing efficient use of all ovens and workers. Another combination, Point N, lies below the PPC, because many workers remain idle due to a temporary electricity shortage.

The CEO must decide between two major investment options:

1. Option 1: Spend Tk. 30 lakh on new butter-processing machines.
2. Option 2: Put the same Tk. 30 lakh in a bank deposit at 6% annual interest.

At the same time, FoodLand faces a policy debate:

- The marketing team says: “If the price of butter rises, demand will fall.”
- The public relations team says: “The government should control butter prices to protect low-income consumers.”

The CEO also wants to understand whether Bangladesh’s mixed economic system helps the company balance market freedom with government regulation.

Questions:

1. Identify which of the two statements are positive and which are normative. Explain why.
2. Using the PPC situation (Point M and Point N), explain feasibility and efficiency.
3. How does scarcity create the problem of choice for FoodLand Bangladesh Ltd.?
4. Why is Bangladesh considered a mixed economy? Explain one benefit of this system for FoodLand.
5. What is the opportunity cost of choosing the new machines instead of putting Tk. 30 lakh in a bank deposit at 6% interest? Show calculation.

Ans:

Q-1. Positive vs Normative

Statement 1: “If the price of butter rises, demand will fall.”

→ **Positive statement**

Because it is factual, testable, and based on cause-and-effect.

Statement 2: “The government should control butter prices to protect low-income consumers.”

→ **Normative statement**

Because it expresses an opinion about what ought to be done.

Q-2. Feasibility and Efficiency on the PPC:

Point N (inside PPC) **is** feasible but not efficient.

It is feasible because FoodLand can produce this combination with current resources.

It is inefficient because some workers and ovens are idle.

Point M (on PPC) **is** feasible and efficient.

It uses all available resources, showing maximum production capacity.

Q-3. FoodLand has limited ovens, workers, and raw materials.

Because resources are scarce, the company cannot produce unlimited bread and butter.

It must choose how much bread to produce and how much butter to produce.

Producing more of one good requires reducing the production of the other.

This trade-off creates the economic problem of choice, shown clearly by the PPC.

Q-4. Bangladesh is a mixed economy because both:

- Private businesses (like FoodLand) operate freely **and**
- The government regulates key sectors (prices, safety, food security).

Benefit for FoodLand:

A mixed economy provides market freedom to decide production levels, but also offers government support such as subsidies, price regulation, and protection of essential food items.

Q-5. If FoodLand chooses new machines, it gives up the bank interest.

Interest = Principal × Rate

= 30,00,000 × 0.06

= Tk. 1,80,000

Opportunity Cost = Tk. 1,80,000

Case -2: “EduCare Hospital Ltd. and the Use of Limited Resources”.

EduCare Hospital Ltd. is a private company that runs both a small hospital and a training institute for nurses in a developing country like Bangladesh. The company has limited doctors, nurses, classrooms, medical equipment, and funds. Because of this scarcity, it cannot expand both the hospital and the training institute at the same time.

Management prepares a Production Possibilities Curve (PPC) between:

X-axis: Number of hospital beds available

Y-axis: Number of students trained per year

One point, Point R, lies on the PPC, showing an efficient combination of hospital beds and trained students. Another point, Point S, lies inside the PPC, because some classrooms and machines are unused.

The CEO is considering two options for using an additional fund of Tk. 50 lakh:

1. Option A: Buy advanced medical equipment for the hospital.
 2. Option B: Keep the money in a fixed deposit at a bank at 7% annual interest.
-

During a discussion, two economists give two different statements:

1. “If the government increases health budget, the number of treated patients will increase.”
2. “The government should provide free healthcare for all poor patients.”

The CEO also notes that the country follows a mixed economy:

Private firms like EduCare can operate for profit.

The government still regulates health pricing, quality standards, and training courses.

Questions:

Q-1. Identify which of the two statements are positive and which are normative.

Explain.

Q-2. Using the PPC and the points R and S, explain the concepts of feasibility and efficiency.

Q-3. How does scarcity create the problem of choice for EduCare Hospital Ltd.?

Q-4. Why is the country’s system called a mixed economy? Explain one advantage of a mixed economy for EduCare Hospital Ltd.

Q-5. If EduCare chooses Option A (buy equipment), what is the opportunity cost in terms of interest income forgone from the bank deposit? Show the calculation clearly.

Ans:

1) Positive vs Normative

Statement 1: “If the government increases health budget, the number of treated patients will increase.”

- This is a **positive** statement.
- It is fact-based and can be tested with data. It describes “what is likely to happen”.

Statement 2: “The government should provide free healthcare for all poor patients.”

- This is a **normative** statement.
- It expresses an opinion about what **ought to be done** based on values and judgments.

2) Feasibility and Efficiency on the PPC

- **Point S (inside PPC) is feasible but not efficient.**
 - Feasible: The company has enough resources to produce this combination.
 - Not efficient: Some classrooms, beds, or machines are unused, so resources are underutilized.
- **Point R (on PPC) is feasible and efficient.** ◆
 - Feasible: It can be produced with existing resources and technology.
 - Efficient: All resources (doctors, nurses, equipment, classrooms) are fully and productively used.
 - No more of one output (beds or students) can be produced without reducing the other.

3) Scarcity and Choice:

Edu Care has limited doctors, nurses, funds, equipment, and space. Because of this scarcity, it cannot expand the hospital and the training institute without limit.

Therefore, it must make choices, such as:

- Should it allocate more resources to hospital beds (treat current patients)?
- Or should it allocate more resources to training students (increase future health workers)?

Every choice involves a trade-off. Producing more of one (beds) means producing less of the other (trained students). This is the economic problem of choice, directly caused by scarcity.

4) Mixed Economy and Benefit:

The country is a mixed economy because:

- **Private sector:** Firms like EduCare Hospital Ltd. are allowed to run hospitals and institutes for profit.
- **Government sector:** The state regulates health standards, sets some prices, gives subsidies, and sometimes runs public hospitals.

One benefit for EduCare:

- In a mixed economy, EduCare enjoys market freedom (to decide services, fees, and investments) and also gets support and stability from government policy (like tax benefits, subsidies, or recognition of their training programs).
- This balance helps EduCare grow while still serving social goals.

5) Opportunity Cost of Investment Choice:

If EduCare chooses Option A (buy equipment with Tk. 50 lakh), it gives up the interest it could have earned from the bank.

Interest if deposited = Principal \times Rate

= 50,00,000 \times 0.07

= Tk. 3,50,000

So, the opportunity cost of buying equipment is Tk. 3,50,000 of forgone interest income.

MetaMentor Center

Compare and contrast

Q-01. What is the difference between a positive and a normative statement. Give an example of each.

| Aspect | Positive Statements | Normative Statements |
|------------|--|--|
| Definition | Positive statements are based on objective analysis and facts. | Normative statements express opinions, judgments, or subjective values about what should or ought to be. |

| | | |
|-------------|--|--|
| Nature | Objective, based on facts and evidence | Subjective, based on opinions and values |
| Testability | Can be tested and proven true or false | Cannot be tested or proven true or false |

Q-02. Differentiate between positive and normative economics. BPE-99th.

| Aspect | Positive Economics | Normative Economics |
|------------|---|---|
| Definition | Describes and explains economic facts or phenomena as they are. | Focuses on what the economy should be, based on opinions and values. |
| Nature | Objective and fact-based. | Subjective and opinion-based. |
| Focus | Analyzes cause-and-effect relationships without judgment. | Proposes policies and improvements based on personal or societal goals. |

Q-03. Explain the difference between Market and Command Economy based on their characteristics. BPE-6th.

| Characteristic | Market Economy | Command Economy |
|-------------------|--|--|
| Definition | An economic system where supply and demand determine resource allocation with limited government intervention. | An economic system where the government centrally plans and controls production and resource allocation. |
| Ownership | Private individuals and businesses own most resources. | The state or government owns and controls most resources. |
| Pricing Mechanism | Prices are determined by market forces and competition. | Prices are set and controlled by the government. |

Q-04. Compare Microeconomics and Macroeconomics in terms of subject matter. BPE-6th

| Aspect | Microeconomics | Macroeconomics |
|----------------|--|--|
| Subject Matter | Study of individual economic units such as consumers, firms, and specific markets. | Study of the entire economy and aggregate variables like national output and employment. |
| Main Focus | Price determination and resource allocation in individual markets. | Determination of national income, overall price level, and economic stability. |
| Key Topics | Demand, supply, elasticity, production, cost, market structure, price mechanism. | GDP, inflation, unemployment, economic growth, monetary policy, fiscal policy. |

Chapter End

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