

Basic Economic Concepts

CDS Economics · ECC01

CDS Level : High Priority

Basic Economic Concepts forms the conceptual foundation for all other economics chapters. CDS tests this with *application questions* — not just definitions, but “which factor of production does X refer to?” or “which economic system best describes India?” Nail the vocabulary and the logic.

✦ **CDS Pattern:** Opportunity cost application • Factor of production → its reward • Central economic problems • Economic systems classification • Micro vs Macro distinction

1. Scarcity, Choice & Opportunity Cost

🏠 The Central Economic Problem

- ▶ **Economics:** The social science studying how individuals, firms, and nations make choices to satisfy unlimited wants with limited (scarce) resources.
- ▶ **Scarcity:** The fundamental economic problem — resources (land, labour, capital) are finite; human wants are infinite. Scarcity forces *choice*.
- ▶ **Opportunity Cost:** The value of the *next best alternative forgone* when a choice is made. E.g., if India spends Rs 1 lakh crore on defence, the opportunity cost could be healthcare or education spending of the same amount.
- ▶ **Production Possibility Curve (PPC):** Shows maximum combinations of two goods an economy can produce with given resources. Points inside PPC = inefficient; on PPC = efficient; outside = not currently attainable.

2. Three Central Problems of an Economy

- ▶ **What to Produce?** Which goods/services and in what quantities? E.g., should India produce more consumer goods (wheat, clothes) or capital goods (machines, dams)?
- ▶ **How to Produce?** Which technique/method? Labour-intensive (uses more workers) vs Capital-intensive (uses more machines). Relevant for India where labour is abundant.
- ▶ **For Whom to Produce?** Who gets the output? Distribution of income — price mechanism in market economies; government rationing in socialist economies.

3. Factors of Production & Their Rewards

LAND

Reward: Rent

All natural resources; fixed supply; includes minerals, forests, rivers

LABOUR

Reward: Wages / Salary

Human physical and mental effort; can be skilled or unskilled

CAPITAL

Reward: Interest

Man-made means of production: machines, tools, buildings; NOT money itself

ENTREPRENEUR

Reward: Profit

Organises other factors; bears risk; creates enterprise; may also earn loss

- ✦ **Key Distinction:** Capital in economics = physical capital (machines, factory). Money/finance is sometimes called “financial capital” but rewards go to the entrepreneur (profit) not capital (interest). CDS often tests: which factor earns profit? = Entrepreneur.

4. Economic Systems

- ▶ **Market/Capitalist Economy:** Resources owned by private individuals. Price mechanism answers all 3 central problems. Examples: USA, UK. Profit motive drives production. Adam Smith’s “Invisible Hand.”
- ▶ **Socialist/Command Economy:** Resources owned by the state. Central planning authority makes all decisions. Examples: Former USSR, Cuba, North Korea. Equality but may lack efficiency/innovation.

- ▶ **Mixed Economy:** Both private and public sectors coexist. Combines market efficiency with government intervention for equity. **India = Mixed Economy.** Public sector in strategic industries; private sector for consumer goods.

Micro vs Macro Economics

- ▶ **Microeconomics:** Studies individual economic units — a firm, a household, a market. Focuses on specific prices, resource allocation, consumer behaviour. “Trees” view of the economy.
- ▶ **Macroeconomics:** Studies the economy as a whole — GDP, inflation, unemployment, interest rates, national income. “Forest” view of the economy. Coined by Ragnar Frisch (1933).
- ▶ **Examples:** “Why does petrol price rise?” = Micro. “Why does India’s inflation rise?” = Macro.

CDS PYQ

Basic Economic Concepts — CDS I & II Pattern

Q1. Which of the following is the reward for entrepreneurship as a factor of production? (CDS I 2023)

- (a) Rent (b) Wages (c) Interest (d) Profit

Answer: (d) Profit

Factor → Reward: Land=Rent; Labour=Wages; Capital=Interest; Entrepreneur=Profit (or Loss). The entrepreneur is the residual claimant — after paying all other factors, whatever remains is profit. The entrepreneur also bears the risk of loss.

Q2. Opportunity cost is best defined as: (CDS II 2022)

- (a) The total cost of producing a good (b) The cost of the next best alternative forgone (c) The price paid in the market (d) The cost of all alternatives

Answer: (b) The cost of the next best alternative forgone

Opportunity cost is the value of what you sacrifice when you make a choice. E.g., if you use land to build a school, the opportunity cost is the hospital or factory you could have built instead. It is NOT the monetary price — it’s the foregone alternative value.

Q3. Which economic system is characterised by the coexistence of both public and private sectors, as seen in India? (CDS I 2024)

(a) Market economy (b) Command economy (c) Mixed economy (d) Traditional economy

Answer: (c) Mixed economy

India = Mixed Economy since independence. Public sector controls railways, defence, banking (partially), heavy industries. Private sector operates in consumer goods, IT, services. Post-1991 liberalisation expanded private sector but government still regulates key areas.

Q4. Which of the following is NOT a factor of production? (CDS II 2023)

(a) Land (b) Labour (c) Money (d) Capital

Answer: (c) Money

The four factors of production are: Land, Labour, Capital, and Entrepreneurship. Money is NOT a factor of production in economics — it facilitates exchange but does not directly produce goods. Capital = physical capital (machines, buildings, tools). CDS consistently tests this money vs capital distinction.

Q5. The study of the economy as a whole, including national income and general price levels, is called: (CDS I 2022)


(a) Microeconomics (b) Macroeconomics (c) Econometrics (d) Development Economics

Answer: (b) Macroeconomics

Macro = economy-wide analysis: GDP, inflation, unemployment, balance of payments.
Micro = individual unit: a firm's pricing, a consumer's choice. Econometrics = statistical/mathematical methods applied to economic data. Development Economics = long-run economic growth theories.

 **TRICKY**

CDS Application-Level Questions

 **T1. "Capital" earns interest as its factor reward. But a factory owner uses her own capital and calls it profit. Is this a contradiction?**

No contradiction — implicit vs explicit cost:

The interest that her own capital could earn elsewhere (if invested in a bank) is an *implicit cost* (opportunity cost). True economic profit = Revenue - *All costs including implicit costs*. Accounting profit ignores implicit costs. So: factory owner's accounting profit includes implicit interest on her own capital. Her *economic profit* is after deducting

that opportunity cost. CDS may ask: economic profit vs accounting profit. Economic profit = Accounting profit - Implicit costs.

Rapid Revision – ECCo1

Core Concepts

- ∴ Scarcity = limited resources + unlimited wants
- ∴ Opportunity cost = next best alternative forgone
- ∴ 3 central problems: What, How, For Whom
- ∴ PPC = inside (inefficient); on (efficient); outside (unattainable)

Factors & Rewards

- ∴ Land → Rent
- ∴ Labour → Wages/Salary
- ∴ Capital → Interest (physical capital NOT money)
- ∴ Entrepreneur → Profit (or Loss; bears risk)

Economic Systems

- ∴ Market = private ownership; price mechanism
- ∴ Command = state ownership; central planning
- ∴ Mixed = both; India = Mixed economy
- ∴ Micro = individual units; Macro = whole economy

CDS Traps

- ∴ Money ≠ Capital (money is NOT a factor of production)
- ∴ Entrepreneur earns Profit (NOT interest)
- ∴ India = Mixed (NOT capitalist or socialist)
- ∴ Economic profit < Accounting profit (implicit costs)

Quick Booster – ECCo1

Factor Rewards

- Land = Rent
- Labour = Wages
- Capital = Interest
- Entrepreneur = Profit
- Entrepreneur also bears LOSS risk

Systems

- USA = Market/Capitalist
- India = Mixed economy
- North Korea = Command/Socialist
- Adam Smith = "Invisible Hand" (market)

Key Definitions

- Scarcity = limited resources
- Opportunity cost = next best forgone
- Micro = individual; Macro = aggregate

- Macro coined by Ragnar Frisch (1933)

- Capital = machines/tools (NOT money)

- Mixed = public + private both exist



Mock Tests



Economics Quiz



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