Unit 1: The Basic Economic Problem

1.1.1 Finite resources and unlimited wants:

The basic economic problem:

Human wants are unlimited but resources are scarce so the problem arrives: what to produce and who to produce it for?

This leads to **opportunity cost** - the next best alternative forgone.

Resource Allocation: Deciding the best use of scarce resources to satisfy as many needs and wants as possible.

Consumption: using up of goods and services tp satisfy human needs and wants.

Production: using resources to make and sell different goods and services.

Factors of Production: Resources used in the production of Goods and Services.

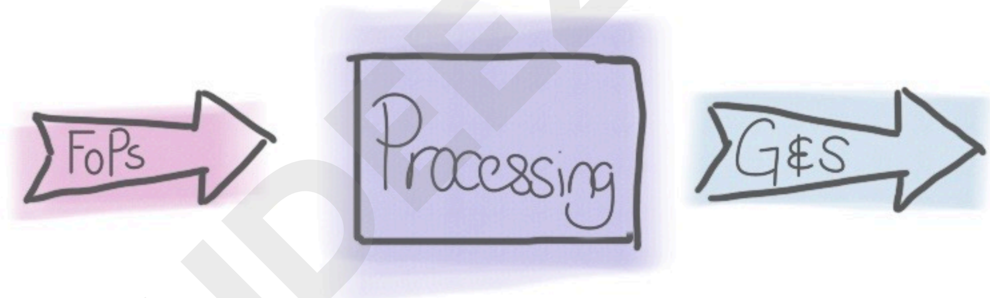

Diagram 1-A illustrates the production process.

1.1.2 Economic and Free goods

Free goods: Any resources that are not scarce are called free goods (requires to conscious effort to obtain). For eg: air, sea water

Economic goods: a consumable item that is useful but scarce in relation to its demand. Has a price and human effort is required to obtain these goods.

Consumers: People and organizations which buy economics goods and services to satisfy their wants are known as consumers.

Consumption expenditure: total amount of spending by consumers

Consumer Good: Goods that satisfy the immediate demand for the consumers.

Consumer Durables: Last a long time (cars, furniture, washing machines, TVs). Takes ages to wear out.

Non-durable: goods that are perishable and used up quickly. (food, drinks, matches)

Consumer Services: Services provided by firms to satisfy needs and wants (bankers, doctors, insurance agents, teachers etc.)

Capital Goods: They are human-made resources used in the production of other goods and services (screwdrivers, lorries, power stations, drills, tractors etc.)

1.2.1 Definition of factors of production and their rewards.

Factors of production:

Scarce resources used in production of goods and services.

- **CAPITAL**: Human-made resources that help in the production of other goods and services.
- **ENTERPRISE:** Labour with the business know-how and skill to organize production in a firm.
- **LABOUR:** AKA: Human Resources, human skills and efforts
- **LAND:** Natural Resources

Factor Reward:

Payments different FoPs require and receive in order to participate in productive activity.

EG:

- **Rent** - for land owners (farm land, office building etc)
- **Wages** - for labour - labour is supped in return for wages (can vary a lot)
- **Interest** - Investment in capital goods → expensive. Money invested in capital goods is also called capital. Interest goes to financial organisation supplying the money.
- **Profit** - for enterprises.
  - A firm must pay rent, wages and interprets in order to organize productivity in the firm.
  - Cost of production
  - Enough revenue/income must be generated to cover its costs → to keep producing the products.
  - The surplus money earned (that is left over after the cost of production) is the profit.

1.2.2 Mobility of factors of production

Factor mobility: refers to the ease with which resources or factors of production can be moved form on productive activity to the other without incurring signifi cant costs or a loss of output.

Possibilities

- within a firm
- Between firms in the same industry
- Between industries
- Between different countries

Importance

- Allows FoPs to be moved into their best possible usage.
- Enables firms to import the way thy produce different goods and services as the quantity and quality of factors of production changes. (eg: switching from labour to capital)
- Enables the firms to change the type of goods and services they are producing to match the consumer demand (better allocation of resources)

Types of immobility

- Geographical Immobility
  - The immobility influenced by geographical factors
  - Ex:
    - Workers reluctant to move to different location for jobs due to family ties/costs/difference in systems (jobs, educational)/lack of information/restriction on movement of workers (visa).
    - Farmlands are geographically immobile
- Occupational immobility
  - Inability to move jobs because of the lack adaptability
    - Ex:
      - A driver can't become a doctor without years of training.
      - Farmland can be used for many different purposes (from farming to providing space for homes and factories) thus is occupationally mobile.

1.2.3 Quality and quantity of factors of production

The FoPs are divided into four sectors:

Capital

- Man made resources used for production:
    - technological advances - can increase quality and quantity of capital
    - Investment by firms and government - can increase quantity of capital
    - R&D - can increase quality of capital

Enterprise

- Is a special kind of labour that holds the knowledge of business know-how. (can run a firm):
    - education and training - increases the quality and quantity of Enterprise
    - Government grants - can encourage more startups, thus the quantity of enterprises.

Land

- Consists of all the natural resources used for production:
    - Exploration and discovery of new mine locations of non renewable resources can increase the quantity in the short run.
    - Growing more trees - increases the quantity of land
    - Recycling - increases the quantity of land
    - Quality can be increased by technological advancements

Labour

- labour is the use of humans in the production of goods and services:
    - education and training - can increase the quality of labour
    - Healthcare - can increase the quality and quantity of labour
    - Migration - can effect the quantity of labour

*The acronym **CELL** can be used to memorize the four categories of the FoPs.*

1.3.1 definition of opportunity cost

The value of the next best alternative forgone.

1.3.2 the influence of opportunity cost on decision making

- *Choosing* between saving and borrowing
- *Choosing* which item to produce with a lump of metal
- *Choosing* which job to apply for and whether or not working extra hours for more pay is worth the cost.
- What to build on the field? Farm? Sports stadium?

1.4.1 Definition of PPC

- *PPC stands for **Production Possibility Curve** (sometimes called PPF) and shows the maximum combined output of two or more products a firm/economy can produce with its available resources.*
- Products are being used efficiently if they are producing their maximum output
- Shows the opportunity cost of one product in terms of the other
- If the production of two different products is on the curve, then they are being produced in the most efficient way, if they are inside the curve then they are not being produced efficiently. Any point outside the curve can't be attained with the current level of resources.

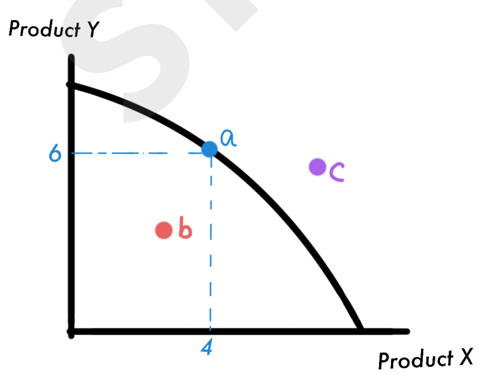

Diagram: 1-B

-In diagram 1-B, production at point 'a' is on the curve meaning that the products are being produced in the most efficient way possible where for every 4 units of product x, 6 units of product y are being produced.

- Point b is inside curve, meaning that resources aren't being used in the most efficient way.

-Point c lies beyond the curve, production at that point isn't possible with the current level of resources.

1.4.2 Points under/on/beyond the PPC

- Points on the curve show that the products are being produced to the maximum efficiency
- Points under the curve show that the resources aren't being utilized effectively
- Points outside the curve are unattainable with the current level of resources (suggest trade)

1.4.3 Movements along the PPC

- Show opportunity cost
- Show re-allocation of resources from one to the other

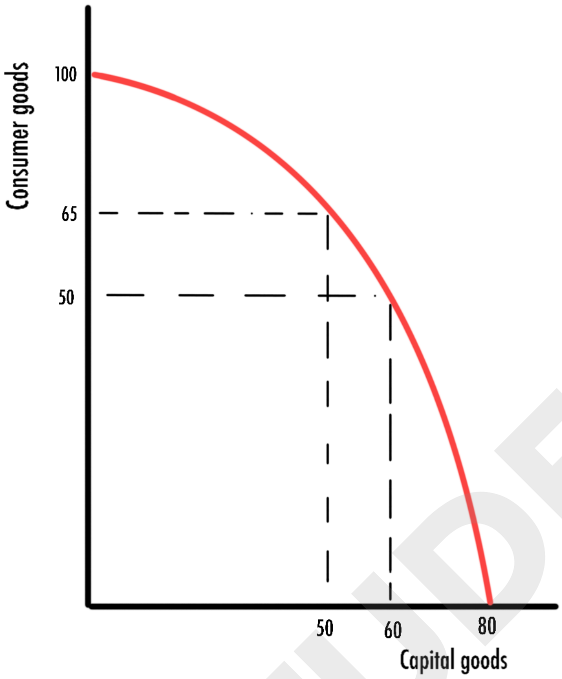

Diagram 1-C illustrates a PPC for capital and consumer goods

- Diagram 1-C The opportunity cost of producing 10 more units capital goods is 15 less units of consumer goods.

1.4.4 shifts in PPC

Outward shift

- Shows that the economy has the capacity to produce more goods each period that it did before.
- There was an increase in the quantity or the quality of natural resources.
- If the economy uses this capacity to produce more goods than it did previously, the size of the economy will increase, which causes economic growth.

Caused by:

- More natural resources discovered
- The supply of labour increases due to inward migration or natural population growth
- The stock of capital equipment has increased
- Technological improvement - more advanced capital and production processes
- Education and training to improve skills
- Improvement in healthcare reduce the days lost as sick days
- Investment in modern businesses - roads/telecommunication increases.

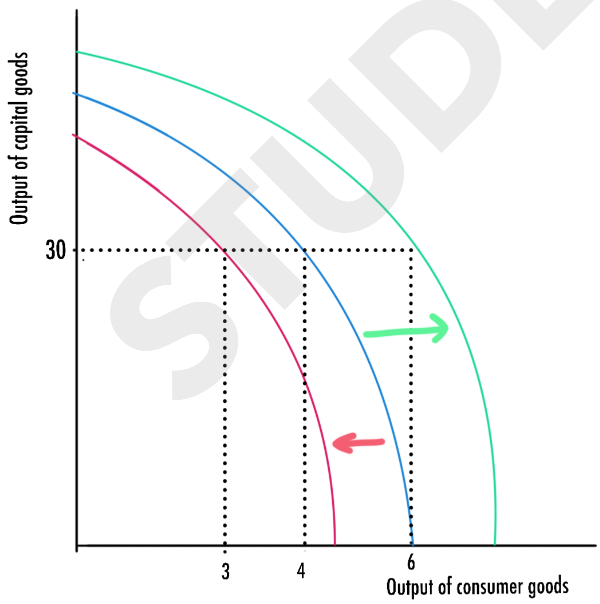

Diagram 1-D illustrates the shifts in the PPC.

Inwards shift

The quality and quantity of the resources, capacity to produce goods has decreased.

The total output of goods will fill and there will be negative economic growth.

Caused by:

- Non renewable resources are depleted (eg: overfishing/farming)
- The supply of labour and enterprise falls (eg: outward migration)
- Capital equipment wears out and not replaced
- Workforce and enterprise skills decline if education and training is reduced
- Aging infrastructure due to the lack of new investment networks.