

PREFACE

The study of economics requires an understanding of major economic concepts and systems, the principles of economic decision-making, and the interdependence of economies and economic systems throughout the world.

Students:

- **Know some ways individuals and groups attempt to satisfy their basic needs and wants by utilizing scarce resources**
- **Explain how people's wants exceed their limited resources and that this condition defines scarcity**
- **Know that scarcity requires individuals to make choices and that these choices involve costs**
- **Understand how societies organize their economies to answer three fundamental economic questions: What goods and services shall be produced and in what quantities? How shall goods and services be produced? For whom shall goods and services be produced?**

CHAPTER 1

THE ECONOMIC PROBLEM

ECONOMY is the system of trade and industry by which the wealth of a country is made and used.

An economy is a system that attempts to solve the basic economic problems. The function of the economy is to allocate scarce resources among unlimited wants.

ECONOMICS is the study or social science of human behaviour in relation to how scarce resources are allocated and how choices are made between alternative uses. Economics studies mankind's activities, which are production, distribution (or exchange) and consumption of goods and services that are capable of satisfying human wants and desires.

Branches of economics are:

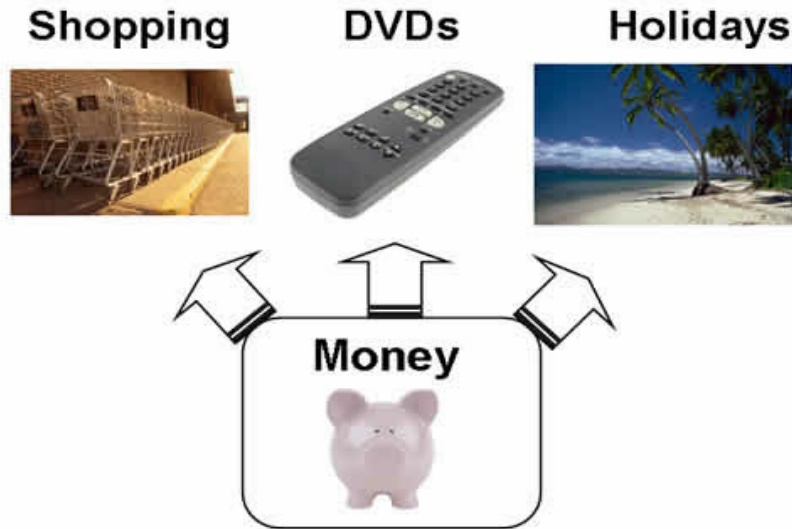
1. **Microeconomics** – this is the branch of economics that is concerned with the behaviour of individual entities such as market, firms and households e.g. how individual prices are set, how prices of land, labour, capital are set, inquires into the strength and weakness of the market mechanism.
2. **Macroeconomics** – is the branch of economics that is concerned with the overall performance of the economy e.g. studies the effect of unemployment on the economic, growth, inflation etc.
3. **Econometrics** – Application of mathematics to economic theories.
The branch of economics that uses the methods of statistics to measure and estimate quantitative economic relationships.

SCARCITY

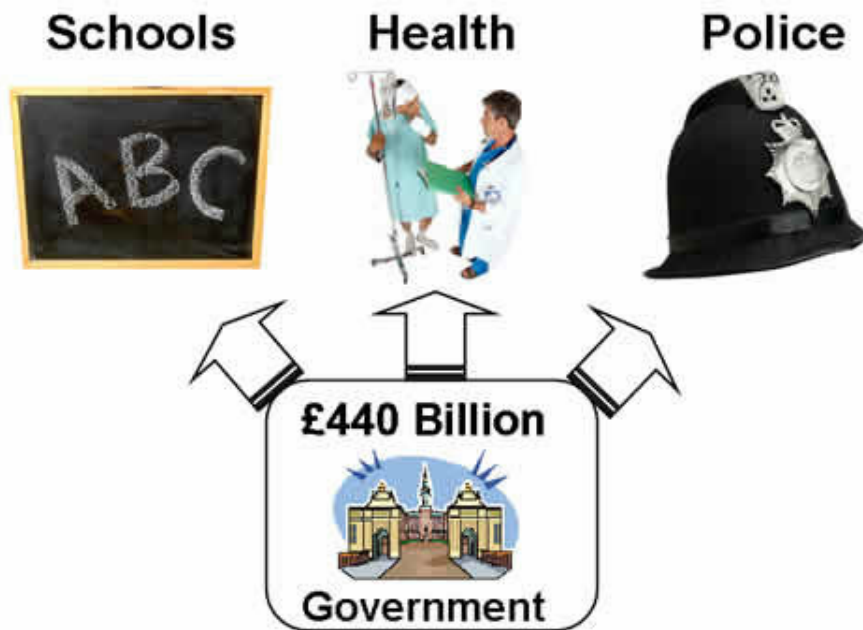
SCARCE RESOURCES

There are only a limited number of resources such as workers, machines, factories, raw materials etc. Yet there are a number of different ways in which they could be used.

Similarly people only have a limited amount of money. Yet they have lots of **needs** and **wants** to satisfy.



Also the Government has a limited amount of money!!! However, it is unable to satisfy all its wants.



The **BASIC ECONOMIC PROBLEM** arises because **resources are scarce**, but human **wants are unlimited**.

Any resources that are not scarce are called **FREE GOODS**. The air that we breathe seems without limit and so is considered to be a free good. However, with increasing pollution in the world, fresh, clean air may be scarce.

ECONOMIC CHOICE is deciding between different uses of scarce resources.

EFFICIENCY

A measure of **how well** workers, business, government or a country produces goods or services.

Efficiency is also producing at a lower cost or using fewer resources when making a product or providing a service and also meeting the needs of consumers.

We can become efficient by using fewer raw materials, fewer workers, replacing high cost labour with low cost technology, lowering waste etc.

OPPORTUNITY COST

It is the value of the second best alternative forgone.

It is the benefit that is lost in making a choice between two competing uses of scarce resources.

Who is making the choice?	What they choose	The opportunity cost (what they could have had)
BUSINESS	<input type="checkbox"/> New computers <input type="checkbox"/> New workers <input type="checkbox"/> Office party	<input type="checkbox"/> New fax <input type="checkbox"/> Delivery van <input type="checkbox"/> Pay for boss!
GOVERNMENT	<input type="checkbox"/> Unemployment benefit <input type="checkbox"/> Weapons	<input type="checkbox"/> New roads <input type="checkbox"/> More hospital beds
INDIVIDUALS	<input type="checkbox"/> Mars bar <input type="checkbox"/> T-shirt <input type="checkbox"/> Beach holiday	<input type="checkbox"/> Twix bar <input type="checkbox"/> DVD <input type="checkbox"/> Fixing the roof

Everything has an opportunity cost.

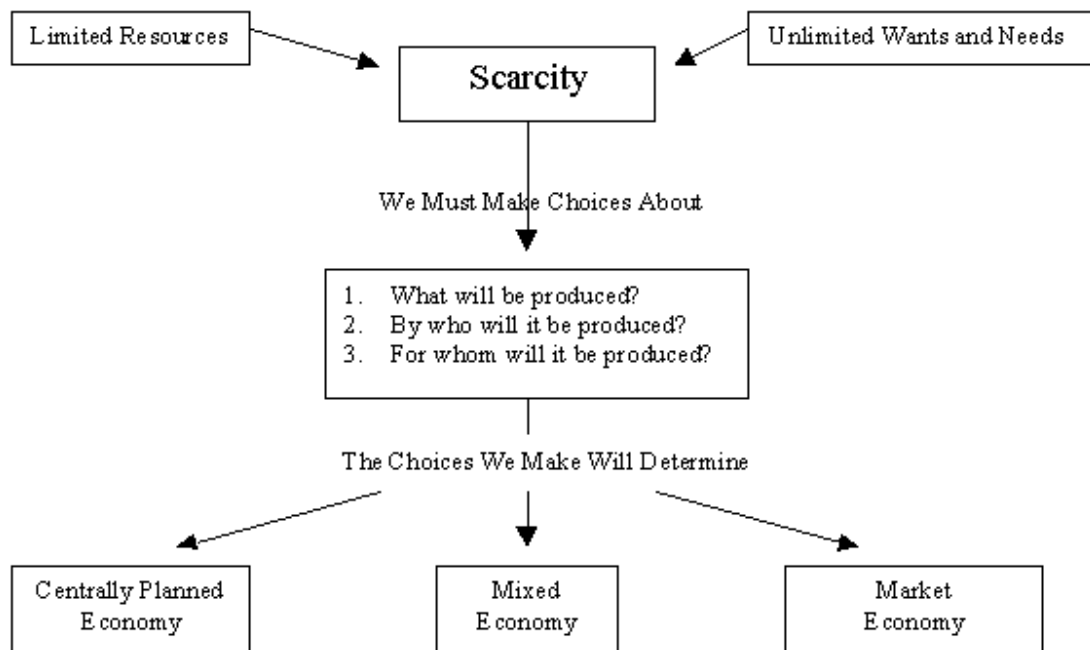


ALLOCATION OF RESOURCES

This is about how resources are allocated between competing uses.

Any individual, organization or nation has to make three fundamental types of choices about how to allocate the scarce resources available to it. It has to decide:

1. **WHAT TO PRODUCE** – food or industrial machinery, books or newspapers, and so on
2. **HOW TO PRODUCE** – how many workers will be used, with what machinery...
3. **FOR WHOM TO PRODUCE** – will some people get a bigger share of resources than other? Will some people get so few resources that they cannot survive, while other live in luxury?



ECONOMIC SYSTEMS

1. Centrally Planned Economy

Also called **COMMAND ECONOMY** is one where all economic decisions are made by the government.

The government decides what to produce, how it is to be produced and how it is to be allocated to consumers. This involves a great deal of planning. Planned economies tend to be run by governments who, in theory at least, want to see greater economic equality between consumers. By state planning, goods and services can be produced to satisfy the needs of all the citizens of a country, not just those who have the money to pay for goods.

2. Market Economy

Also called **FREE-MARKET ECONOMY** is one where decisions are made through the market mechanism. The forces of demand and supply, without any government interference, determine how resources are allocated.

What to produce is decided upon by the level of profitability for a particular product. Buyers cast their spending votes in the market place.

How production should be organized is equally determined by what is most profitable. Firms are encouraged through the market mechanism to adopt the most efficient methods of production.

For whom production should take place, production is allocated to those who can afford to pay. Consumers with no money cannot afford to buy anything.

3. Mixed Economy

It is one where some goods and services are produced in the free-market sector of the economy, but others are produced by the state – i.e. it is mixture of a pure free-enterprise market economy and a pure command economy. Some resources are allocated via the market mechanism and some via the state.

4. Traditional or Subsistence Economies

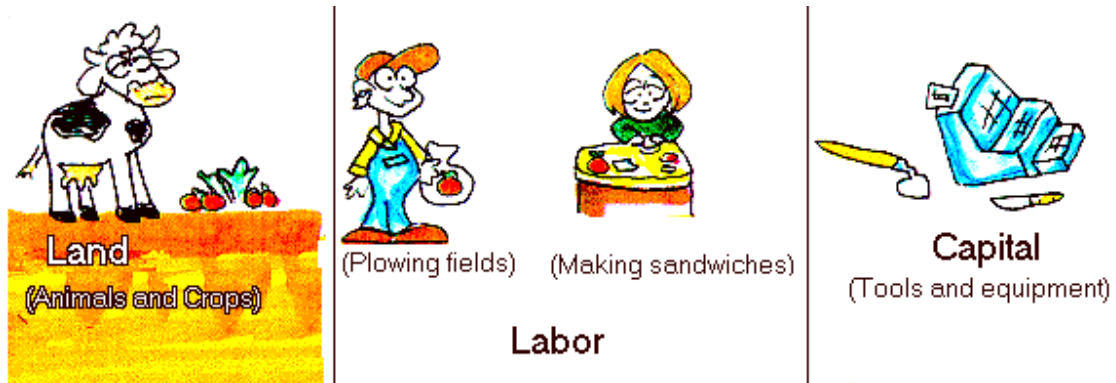
It is one where there is little specialization and little trade. People tend to live in family groups, and these families grow most of their own food, make their own houses, gather their own fuel and provide their own leisure activities i.e. to a great extent they are self-sufficient. It is a traditional economy because it is the type of economy that has existed all over the world since man began being economically active. What, how and for whom to produce are decisions that are answered by looking to the past. If a society has managed to survive for some time, then what was done in the past must have been successful. No two traditional economies are the same, so it is impossible to describe typical economic mechanisms by which resources are allocated.

FACTORS OF PRODUCTION

1. **LAND** is the natural resources on the planet. It includes space on the ground, hills, seas and oceans, air etc.
2. **LABOUR** is the human input (workers, managers etc) into the production process.

Each individual has a different level of skills, qualities and qualifications. This is known as the **human capital**.

3. **CAPITAL** – man made physical goods used to produce other goods and services



4. **ENTERPRISE**

The entrepreneur provides the initial ideas. They risk their own resources in business ventures. They also organize the other 3 factors of production.

An entrepreneur puts them together and you get a business.



SOURCES:

1. www.tutor2u.net
2. Dan Moynihan, Brian Titley - ECONOMICS, A Complete Course, Oxford University Press 2000
3. Alain Anderton – ECONOMICS FOR GCSE, second edition, Collins 2002