



Oxford Resources
for Cambridge

Cambridge IGCSE® & O Level
Complete
Economics

Fourth edition

Brian Titley
Sir Dan Moynihan

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1.1	The nature of the basic economic problem
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Assessment	Multiple choice Structured questions

There are just not enough resources in the world available to produce all the different goods and services we want. This is the basic economic problem: scarcity of resources relative to human wants.

Resources are the inputs to productive activity, and products (goods and services) are the outputs from productive activity. However, because there are not enough resources to produce everything we want, we must all make choices about what goods and services to produce, how to produce them and who to produce them for. For example, if we choose to use up scarce resources in the production of cars for people with enough money to buy them, we cannot use those same resources to produce bicycles instead – this opportunity is foregone.

Making a choice between alternative uses of factors of production always involves a cost in terms of what we need to give up or go without in return. When one use is selected over another, the value or benefit of the alternative use is foregone. This is the opportunity cost of that decision.

Economists group together different scarce productive resources into four broad categories called factors of production: land (natural resources), labour (human effort), capital (human-made resources) and enterprise (the knowledge and skills people need to organize production in firms). An increase in the amount and quality of factors of production over time creates the possibility of expanding the amount of goods and services that can be produced.

The study of economics therefore involves examining and informing decisions about how best to combine, use and increase the quantity and quality of factors of production to satisfy as many of human wants as possible to maximize economic welfare.

Unit 1.1 The nature of the basic economic problem

Unit 1.2 Factors of production



In this unit:

1.1.1	Finite resources and unlimited wants	<ul style="list-style-type: none">• The concept of scarcity• Definition of the basic economic problem and examples of how it affects consumers, workers, producers and governments
1.1.2	Resource allocation decisions	<ul style="list-style-type: none">• The three basic economic questions that determine resource allocation: What to produce? How to produce? Who to produce for?
1.1.3	Economic goods and free goods	<ul style="list-style-type: none">• The difference between economic goods and free goods
1.2.1	Factors of production and their rewards	<ul style="list-style-type: none">• Definitions of factors of production: land, labour, capital and enterprise• Rewards to factors of production: rent, wages, interest and profit
1.2.2	Quantity and quality of the factors of production	<ul style="list-style-type: none">• The causes of changes in the quantity and quality of the various factors of production

Section 1.1.1 Finite resources and unlimited wants

Section 1.1.2 Resource allocation decisions

The concept of scarcity

World News


Tuesday, 24 May 2127

OIL RUNS OUT

Today the world's oil supply has dried up. A crisis meeting of world leaders took place in Washington last night.

Yesterday the top oil-producing companies of the world declared that the world's supply of oil was now exhausted. The last barrel of oil has been filled, and the oil rigs will drill no more. The world now faces an energy crisis. No more oil will mean no more petrol for transport or machinery. There can be no more plastic for components in many household products like televisions, smartphones, cars and solar panels.

Energy ministers from around the world are meeting today in Switzerland to discuss the crisis and try to find a solution. Coal deposits are low and nuclear power stations are already overworked to meet the demand for electricity.



Problem Resources are finite

The newspaper article above paints a gloomy picture of what could happen in the future. It is hard to imagine a world without oil but even now there is only a limited amount of oil left in the ground. In other words, it is **finite** or limited in supply. As more and more oil is used up there will come a time when no oil remains. The world's oil took many millions of years to form but we may use it all up in a few hundred years.

However, it is not just oil that is finite. Some forecasters suggest if we continue to consume goods and services in the future at the same rate as we do today many natural resources, such as aluminium, copper, lead, tin, zinc and timber from the last remaining rainforests, will all be used up within the next 50 years. Even the land we farm or build on, and the clean air and drinking water we need are all finite or limited in supply.

If you imagine the world as a round ball, then it is possible to see that only a limited amount of these **resources** can be squeezed from it.

Problem Resources are used up in the production of goods and services

Resources are important because they are used to make **goods** such as bread, televisions, cars, fruit and vegetables – and to provide **services** including banking, insurance, transport, healthcare, policing and cleaning.

Production therefore involves using resources to make and sell different goods and services. Resources – such as natural materials, land, machinery and workers – are the inputs to productive activities and goods and services are their products or **outputs**. ► 3.6.3

Any activity that fails to satisfy a human need or want is not a productive activity according to economists. So, for example, if resources are used to make clothes nobody wants to wear, televisions that fail to display moving images, clocks that cannot keep time or any other good or service that fails to satisfy a human need or want, then those resources have not been used productively.

The people and organizations that make and sell goods and services are known as **producers**.



▲ Resources used to produce other goods and services include natural materials, people, machinery and land

Problem Human wants are infinite

Does it matter if the resources used to produce goods and services that people need and want are limited in supply? The world is a big place, and it may take many years for many non-renewable resources like oil, coal, gas, copper and iron to run out.

We can also grow, renew or replace some resources over time such as trees for timber, corn to eat and people to work in shops, offices and factories. In fact, the population of the world is growing rapidly. A larger global workforce should be able to produce more machines, build more factories and invent new materials and better ways of producing food and other goods and services.

So does this mean having a limited supply of resources is not such a big problem? Before you agree or disagree, look at Activity 1.1.

Activity 1.1

Needs and wants

Look at the two photos A and B. Photo A represents modern city life; photo B shows a group of people living in a poor African village.

1. What needs have the two families in common?
2. Which family will not be able to satisfy all its needs?
3. What do you think are the wants of the family in picture A?
4. What do you think are the wants of the family in picture B?
5. Why can't the wants of either family be satisfied?
6. What do you think are the main differences between **needs** and **wants**?
7. If the world population continues to grow, what do you think will happen to the total of human needs and wants over time?



Problem Resources are scarce relative to human wants

The really big problem is that our **human wants** for different goods and services are infinite or without limit. Just imagine if we listed everything that every person in the world could ever want. There would be no end to the list because our wants are without limit and our wants are growing and changing all the time.

This means that resources are not just limited in supply, they are **scarce** in comparison to the unlimited wants humans have for goods and services. It is therefore impossible to produce all the different goods and services humans want with the resources available.

In some countries resources are so scarce it is difficult to even produce enough basic items to address people's needs.

What do we need and what do we want?

[illegible]

Needs	Wants	Reason
Bread	Television	Humans require food like bread to live; bread is a need Television provides entertainment, but is not essential for survival; television is a want.

You should now understand the difference between needs and wants. Write a sentence to explain what these two words mean.

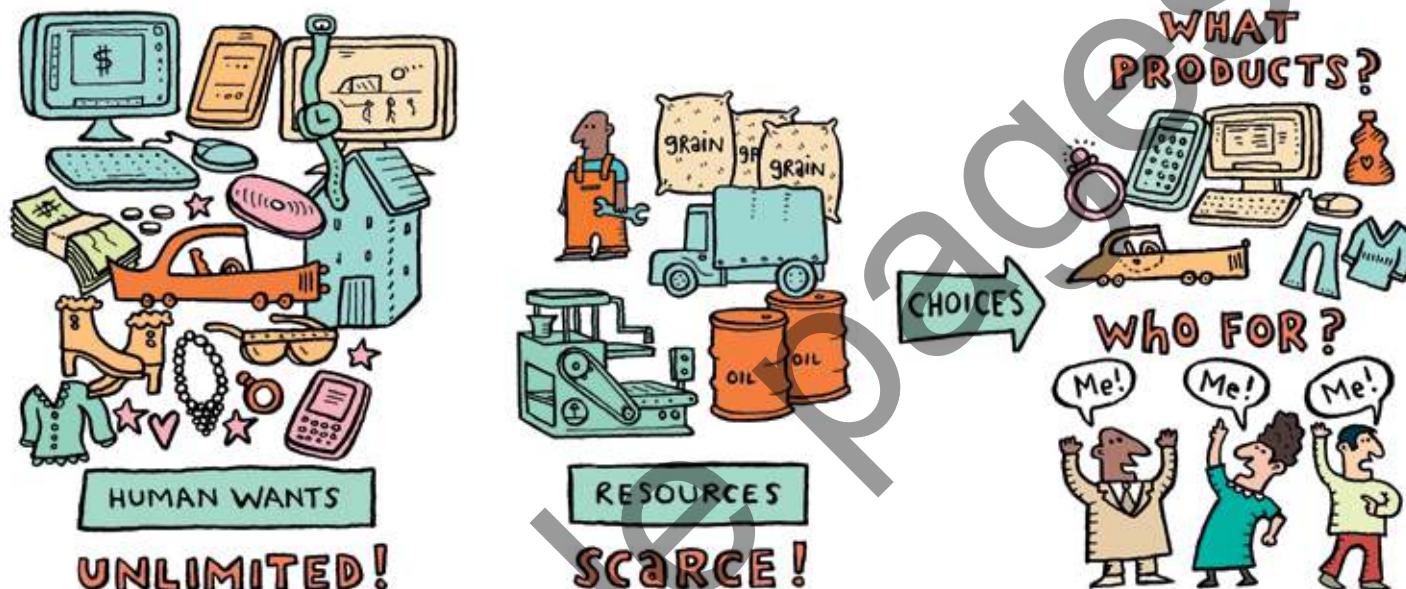
Definition of the basic economic problem

The scarcity of resources relative to infinite human wants

The central or 'basic' problem in economics arises because of the mismatch between people's unlimited wants and the limited resources available to produce what they want. As a result, we must all make choices about how to use the limited resources available.

Problem**The basic economic problem**

- Resources are finite – or limited in supply
- Resources are used up in the production of goods and services
- But human wants for goods and services are infinite – or without limit
- So it is not possible produce all the goods and services humans want
- Therefore, we must all make choices about what goods and services to produce with finite resources, how to produce them and who to produce them for?



▲ The economic problem

The three basic economic questions that determine resource allocation

Some communities and countries have access to more resources than others, but all have far less resources than they need to produce all the goods and services their populations want. All of them must choose which wants will be satisfied and how. For example, a country may choose to allocate some of its scarce resources to the production of electricity to satisfy a want for energy, but will it produce electricity from coal-fired power stations, nuclear power plants or from renewable sources such as solar panels or wind turbines?

Choosing between alternative uses for scarce resources is the problem of **resource allocation**. It therefore involves providing answers to three key questions:

What to produce?

This involves choosing what goods and services to produce with scarce resources. In countries with very limited resources, more may be allocated to the production of food, clothing and shelter than to the production of other goods and services so that every person can satisfy their basic human needs. In contrast, in countries with access

to more advanced equipment and skilled labour, choices may include whether to allocate more resources to the production of cars than to the production of clothing.

How to produce?

Once the question of what goods and services to produce has been addressed, the next problem is deciding *how* best to make them. This involves deciding what resources will be needed, when they will be needed, where they will be needed and in what combination.

For example, what tools will be required? Should more machinery or more labour be used in the production process? What skills will workers need to have? How much land is needed and where should production be located?

Who to produce for?

When the questions of what to produce and how to produce have been answered, a final issue remains. Scarcity means it is impossible to satisfy the wants of everyone. The final resource allocation problem therefore involves deciding *who* gets the goods and services that have been produced. Some people are stronger than others, while some people may work harder than others – perhaps they should receive more of the goods and services available? Others may be weak and be unable to work – perhaps they should be first to receive goods and services? Or should everybody receive an equal share of all the goods and services produced, even if some people are in greater need than others? Or should goods and services simply be allocated to those people who are willing and able to pay the most for them?

Examples of the basic economic problem

The basic economic problem of scarcity of resources affects every person and organization in the world in different ways.

Consumers

We all consume goods and services when we use them to satisfy our needs and wants. When we eat, we are consuming food. When we watch television, we are consuming electricity, the television and the services of a television broadcasting company. When we go to schools and colleges, we are consuming the services of teachers and classroom buildings. We are consuming when we enjoy reading a book, sit on a chair, sleep on a bed, keep money in a bank account, ask a policeman the time, use tools and equipment and use or enjoy any other good or service to satisfy our needs and wants.

Every person and every organization are therefore a **consumer** of goods and services – and, because of the economic problem, they all must make decisions about what goods and services they will buy with their income or savings. Some people may only be able to afford to buy basic items that will address their needs for food, clothing and shelter while others may have enough money to buy cars, jewellery and holidays to satisfy some of their wants. Some people may be so rich they can afford to buy their own private aircraft and yachts. ► 2.2.1