

SECTION 1

The basic economic problem



Chapter 1

The nature of the economic problem

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Learning objectives

By the end of this chapter you will be able to:

- define and give examples of the economic problem
- explain the difference between economic goods and free goods

Introducing the topic

Do you have everything you would like to have? Some unfortunate people clearly need more goods and services. These are the people who lack the goods and services needed for survival. If our needs for sufficient food, clothing and housing are met, we will still want other products. Indeed, our **wants** are unlimited. The richer we get, the more, and the better, quality products we would like. Many of us would like, for instance, more foreign holidays and a new laptop. This chapter will look at why we cannot have everything we would like.



KEY TERM

Wants: desires for goods and services.

1.1 Finite resources and unlimited wants

What stops people enjoying all the products they would like to have is a lack of **resources** to produce them. Resources, including workers and machinery, are scarce. This means that they are limited in supply. **The economic problem** of not being able to satisfy everyone's wants arises because of this **scarcity**.

There is no limit to people's wants – they are infinite. For instance, people want more and better clothing, healthcare and improved transport infrastructure. The number of workers, machines, offices, factories, raw materials and land used to produce these goods and services, however, is finite. At any given time, for example, there are only a limited number of workers and they can produce only a specified amount. This mismatch, between what people want and the maximum that can be produced, gives rise to the economic problem. Choices have to be made about how resources are to be used.

The continuing nature of the economic problem

Scarcity continues to exist. More goods and services are being produced today than ever before, but the growth in wants is exceeding the growth of economic resources. People still want more products than the resources available can produce. Over a period of time, wants continue to grow and change.

The economic problem in different contexts

The fact that people have to choose which products to buy, which subjects to study, what jobs to do and which products to produce shows that there are insufficient resources. As consumers, we cannot have everything we want. We have limited incomes. Students have to select which courses to study. It is not possible to study economics and chemistry at the same time. Workers have to make choices about what jobs they do. Some teachers may carry out other work in the evening, but when they are teaching they are not working as writers! Time is in limited supply. Producers have to decide what to make. Farmers cannot grow rice and wheat on the same land. They have to select one crop as land is scarce. The government has to decide how to spend tax revenue. Deciding to build a new hospital may mean that it cannot build a new school.



TIP

It is very important to learn definitions. The more you apply a term such as scarcity in your work, the more you will become familiar with it. You may also want to compile your own economics dictionary by writing down terms in alphabetical order, as you come across them.

GROUP ACTIVITY 1

In your group, discuss and decide which of the following are scarce:

- a** vacancies for university degree courses
- b** foreign holidays
- c** healthcare.



KEY TERMS

Resources: factors used to produce goods and services.

The economic problem: unlimited wants exceeding finite resources.

Scarcity: a situation where there is not enough to satisfy everyone's wants.

1.2 Economic goods and free goods

The vast majority of goods and services are economic goods. This means that it takes resources to produce them and so they are limited in supply. For example, a carpet is an **economic good**. The material and labour used to produce it could have been used to make

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Chapter 3.2 Influence of opportunity cost on decision making (Economic goods and free goods)



TIP

Remember that in economics what determines whether a product is a free good is not whether people have to pay for it, but whether it takes resources to produce it.



KEY TERMS

Economic good: a product which requires resources to produce it and therefore has an opportunity cost.

Free good: a product which does not require any resources to make it and so does not have an opportunity cost.

another good (or goods). It is easy to find examples of economic goods. Almost every good and service you can think of is an economic good. Your education is an economic good, since your teachers and the other resources used to provide it could have been employed for making other products.

Free goods are much rarer. When most people talk about free goods, they mean products they do not have to pay for. These are not usually free goods in the economic sense since resources have been used to produce them. Economists define a free good as one that takes no resources to make it. It is hard to think of examples of free goods. Sunshine is one such example, so is water in a river. However, as soon as this water is processed for drinking, or used for irrigation of fields, it becomes an economic good.



Water in a river is a free good

GROUP ACTIVITY 2

In your group, discuss and decide whether each of the following is an economic or a free good:

- a** air
- b** education
- c** newspapers
- d** public libraries
- e** state education.

Summary***You should know:***

- People's wants continue to grow.
- Resources such as workers, machines and land are limited in supply.
- The economic problem is that unlimited wants exceed finite resources.
- Economic goods take resources to produce them.
- Free goods exist without the use of resources.

Multiple choice questions

- 1** Why does scarcity exist?
 - A** Each year workers tend to produce less than previously
 - B** Machines wear out with time
 - C** There are not sufficient resources to produce all the products people want
 - D** There is a limit to people's wants

- 2** Why will scarcity continue to be a problem in the future?
 - A** Prices will rise
 - B** The quantity of resources will decline
 - C** Wants will continue to increase
 - D** World population will fall

- 3** Which of the following is a free good?
 - A** Inoculation provided without charge by the state
 - B** Products given away by a supermarket to attract customers
 - C** Recycled paper
 - D** Wind coming in from the sea

Four-part question

- a** What is meant by the economic problem? **(2)**
- b** Explain why a car is an economic good. **(4)**



Chapter 2

Factors of production

6

Learning objectives

By the end of this chapter you will be able to:

- define and give examples of land, labour, capital and enterprise
- explain the nature of each factor of production
- analyse the *influences* on the mobility of factors of production
- discuss the causes of changes in the quantity and quality of the factors of production
- identify the payments to the factors of production

Introducing the topic

We are living longer. In 1960 the average life expectancy in Bangladesh was 46 years. By 2015 it had risen to 72 years. The increase in Malaysia was even more dramatic – from 37 years to 77 years and the Japanese could expect to live until 83 in 2015. Figure 2.1 shows how the global average life expectancy has increased over the same period.

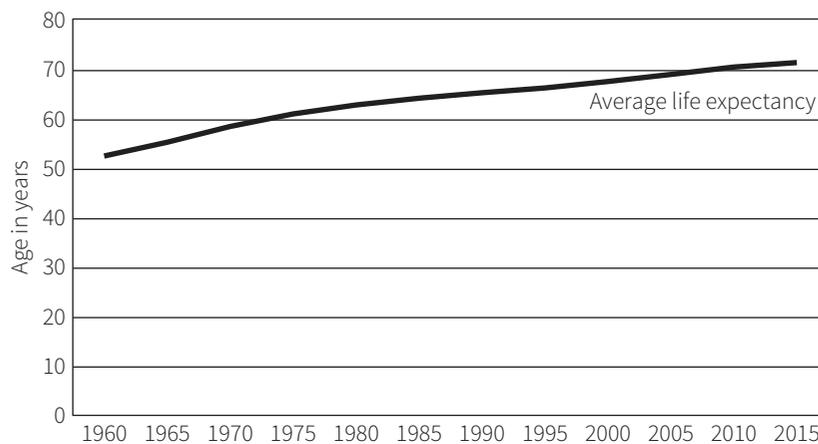


Fig. 2.1: Global average life expectancy, 1960–2015. Why can we expect to enjoy a longer lifespan?

2.1 The importance of factors of production

People are living longer because healthcare, education, housing, sanitation and nutrition have improved. This, in turn, is because of increases in the quantity and quality of **factors of production**. Factors of production is another term for economic resources. Chapter 1 explained that economic resources are used to produce goods and services, and that they are in limited supply.

Most economists identify four factors of production:

- land
- labour
- capital
- enterprise.

Some economists, however, claim that there are really only three factors of production and that enterprise is a special form of labour.

Land

Land in general terms includes the earth in which crops are grown, and on which offices and factories are built, but in economics it has a wider meaning. It covers any natural resource which is used in production. So besides the land itself, it also includes what is beneath the land, such as coal, what occurs naturally on the land, for example rainforests, and the sea, oceans and rivers and what is found in them, for example fish.

To attract foreign tourists, for example, a travel company will make use of water in its swimming pools, good climate and beaches in the holidays it provides. Similarly, the land used by a safari park includes not only the grass on which some of the animals graze, but also the animals themselves.



KEY TERMS

Factors of production: the economic resources of land, labour, capital and enterprise.

Land: gifts of nature available for production.

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Labour

Labour covers all human effort. This includes both the mental and the physical effort, involved in producing goods and services. A road sweeper, a steel worker and a bank manager all contribute their labour.

Confusingly, we sometimes also refer to human capital. This means the education, training and experience that workers have gained. The more human capital workers have, the more they should be capable of producing.

Capital

Capital would have to be used in the diversion of the course of a river. Capital is any human-made (manufactured) good used to produce other goods and services. It includes, for example, offices, factories, machinery, railways and tools.

Capital is also referred to as **capital goods** and producer goods. Economists distinguish between capital and consumer goods. Capital goods are not wanted for their own sake, but for what they can produce. In contrast **consumer goods**, such as food, clothing and entertainment, are wanted for the satisfaction they provide to their owners.

In deciding whether a good is a capital or a consumer good, it is necessary to consider who the user is and the purpose of its use. A computer, for example, will be a capital good if it is used by an insurance company to process insurance claims – it is producing a service. If, however, it is used by a person to play games, it is a consumer good.



KEY TERMS

Labour: human effort used in producing goods and services.

Capital/capital goods: human-made goods used in production.

Consumer goods: goods and services purchased by households for their own satisfaction.

Enterprise: risk bearing and key decision making in business.

GROUP ACTIVITY 1

In your group, discuss and decide which of the following are capital goods and which are consumer goods:

- a** a chocolate bar
- b** a car
- c** a child's toy
- d** a farm tractor
- e** a dentist's drill
- f** a courtroom.

Enterprise

Enterprise is the willingness and ability to bear uncertain risks and to make decisions in a business. Entrepreneurs are the people who organise the other factors of production and who crucially bear the risk of losing their money if their business fails. Entrepreneurs decide what to produce by taking into account consumer demand and how to produce it. Some of the risks faced by any business can be insured against, for example fire, flood and theft. Other risks, however, have to be borne by entrepreneurs. This is because some events are not anticipated, based on past events, and so cannot be insured against. These include the uninsurable risks of other firms bringing out rival products and the rising costs of production.

The two key tasks of an entrepreneur can be carried out by different people. In large companies, it is the shareholders who run the risk of losing their money if the companies go out of business, whilst the managing director takes production decisions and organises the factors of production.

2.2 Mobility of the factors of production

The mobility of land

Most land is **occupationally mobile**. This means that it can be used for a number of purposes. Land which is currently being used for farming may be used instead to build houses. Trees can be used to make tables or sleepers for railway lines.

Land, in its traditional sense, is **geographically immobile**. It is not possible to move a section of land from Sri Lanka to India, for example. Some forms of land, in its wider meaning, can be moved to a certain extent. For example, the course of rivers can be diverted and wildlife can be moved.



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Chapter 14.8 Immobility of resources

INDIVIDUAL ACTIVITY 1

Identify two forms of land that are used by a paper mill.

The mobility of labour

The **mobility of labour** varies. Some workers may find it difficult to move from one area of the country to another, or from one country to another (geographical immobility), and some may find it difficult to switch from one type of job to another type (occupational immobility). The causes of geographical immobility include:

- **Differences in the price and availability of housing in different areas and countries.** Workers who lose their jobs in poor areas may not be able to take up jobs in rich areas because they cannot afford or find housing there.
- **Family ties.** People may be reluctant to leave the country they are currently living in because they do not want to move away from friends and relatives.
- **Differences in educational systems in different areas and countries.** People may not be willing to move to a job elsewhere if it disrupts their children's education.
- **Lack of information.** People without jobs, or those in poorly paid jobs, may stay where they are because they are unaware of job opportunities elsewhere.
- **Restrictions on the movement of workers.** It is often necessary to obtain a work visa to work in another country and these can be limited in supply.

There are also a number of causes of occupational immobility. Again there may be a lack of information about vacancies in other types of jobs. The main cause, however, is a lack of appropriate skills and qualifications. A shortage of doctors cannot be solved by hiring bus drivers!

The mobility of capital

The geographical and occupational **mobility of capital** varies according to the type of capital goods. Some types of capital goods can be transferred from one part of the country to another. A photocopier used by a bank in one area of a country can be sold to, and then used by, a bank in another area. A coal mine and a dock, however, are fixed in position and



KEY TERMS

Occupationally mobile: capable of changing use.

Geographically immobile: incapable of moving from one location to another location.

Mobility of labour: the ability of labour to change where it works or in which occupation.

Mobility of capital: the ability to change where capital is used or in which occupation.

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so are geographically immobile. They are also occupationally immobile since their use cannot be changed, as they have been made for a specific purpose. In contrast, a delivery van used originally by a book publisher may be bought and employed by a toy manufacturer to distribute its products. Similarly, an office block may be used for a variety of purposes. It may house a call centre or an accountancy firm.

GROUP ACTIVITY 2

In your group, identify three capital goods used in your school that are geographically mobile.



KEY TERMS

Mobility of enterprise: the ability to change where enterprise is used or in which occupation.

Entrepreneur: a person who bears the risks and makes the key decisions in a business.

The mobility of enterprise

Enterprise moves when the people who carry out the functions move. These people are called entrepreneurs. The **mobility of enterprise** depends on the mobility of **entrepreneurs**.

Enterprise is the most mobile factor of production. The skills involved in being an entrepreneur can be applied in every industry. Someone who has borne uncertain risks and organised factors of production in the car industry should be able to do this in, for example, the textile industry too. Apart from being occupationally mobile, enterprise is also geographically mobile. Someone who has been successful in starting up and running a business in one country is likely to be successful in another country also.



TIP

Immobility is the opposite of mobility, so if you know the causes of an increase in immobility of a factor of production, it is easy to work out the causes of an increase in mobility of that factor. For example, if a reduction in training will cause an increase in occupational immobility of labour, an increase in training will increase the mobility of labour.

INDIVIDUAL ACTIVITY 2

The following is a list of economic resources. In each case, decide whether the resource is an example of land, labour, capital or enterprise:

- a chemical fertiliser
- b a school
- c a lake
- d the work of a nurse
- e the initiative needed to set up and run a bicycle repair shop.

2.3 Quantity and quality of the factors of production

The quantity of land

The amount of physical land in existence does not change much with time. There is a certain degree of soil erosion which reduces the supply of agricultural land, but also a certain amount of land reclamation which increases its supply. Other natural resources, however, can change quite significantly. Rainforests are currently declining at a rapid rate.