

Section I: THE BASIC ECONOMIC PROBLEM

The nature of the economic problem

Learning summary

By the end of this chapter, you should understand:

- what is meant by wants and how these differ from needs
- why resources are scarce and why this can explain the so-called 'economic problem'
- the difference between economic goods and free goods.

1.1 Needs and wants

There is a fundamental difference between needs and wants. A need is something we must have in order to survive, for example food, clothing and somewhere to live. A **want** is something we would like to have in order to make our lives more enjoyable.

TERM

Wants: desires for goods and services.

1.2 The economic problem

Each of us faces the so-called '**economic problem**' – see Figure 1.1. This is because we do not have the income to satisfy all of our wants. It leads to a situation of **scarcity**. The economic problem affects individuals, businesses and government, none of which has the **resources** to meet all of their needs.

TERMS

Economic problem: unlimited wants exceeding finite resources.

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

Resources: factors used to produce goods and services.

TIP

Make sure you know the difference between something that is a need and something that is a want.

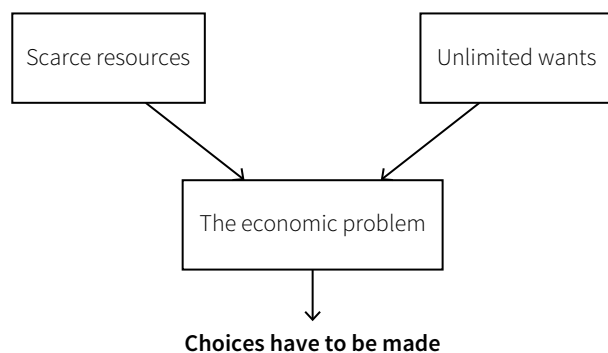


Figure 1.1 The economic problem

Sample question

Refer to Figure 1.1. Describe how the economic problem affects each of the following in a country that you have studied:

- i a typical family
- ii the owner of a takeaway food stall
- iii the government.

Sample answer:

- i A family's needs have to be satisfied from the income of family members – this can include benefits that are provided in kind or in monetary terms by the government. Wants are likely to be greater – a person might like a more up-to-date mobile phone, a new bicycle or to be able to

watch a top football game. The economic problem is that a family may not have sufficient income to be able to do all of these.

- ii The food stall owner might like to have some new cooking equipment or use some savings to purchase a second food stall. If unlimited resources were available it would be fine, but as this is unlikely the owner has to choose which of the options to pursue.
- iii A government's income mainly comes from taxation which is then used to fund services such as hospitals and schools, to construct new roads or upgrade railway lines. Government revenue is limited – not all wants can be satisfied so, inevitably, choices have to be made.

SKILLS FOCUS

In each case, wants are unlimited, yet resources are limited whether family income, savings or a government's income from taxation. The point about unlimited wants and limited resources is fundamental when answering the sample question.

1.3 Economic goods and free goods

Almost everything that is provided is an **economic good**. This is because resources are required to produce such goods – these resources include raw materials, labour and business know-how. **Free goods** are different – no resources are required to produce such goods.

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.

Progress check

Answer the following questions to check your understanding:

- 1 What is the difference between a need and a want?
- 2 What is the economic problem?
- 3 Give an example of a free good and an economic good.

Sample question

Describe whether each of these is an economic good or a free good:

- i a mobile phone
- ii rain water used to irrigate food crops
- iii free medicines for the elderly.

Sample answer:

- i A mobile phone is an economic good. This is because all sorts of resources, human and physical, are required in its production and sale to customers.

- ii Rain water could be either a free good or an economic good. The rain water itself is a free good when it falls directly onto crops. If a man-made irrigation system is required to make use of the rain water, then it becomes an economic good.
- iii Although elderly people are not charged for medicines, they are an economic good. This is because many resources and scientific expertise are required to manufacture the medicines before they are distributed to the elderly.

SKILLS FOCUS

The key point in each case is that an economic good requires resources to produce it.

Revision checklist

You should know:

- The fact that needs are essential while wants are not, means that we cannot always have everything we would like.
- Resources are required to produce economic goods, even though a charge may not be made for them.
- This underpins the economic problem of unlimited wants in relation to scarce resources.

STRUCTURED SKILLS PRACTICE

- 1 Explain how the economic problem might apply to a small clothing manufacturer in Bangladesh.
- 2 The Indian government provides 2.5 million farmers with free power to irrigation pumps. Explain why free power is an economic good.

TIP

This question could mislead. Think about whether any resources are being used.

Exam-style multiple choice questions

- 1 Why does the economic problem occur?
 - A resources are limited; wants are limited
 - B resources are limited; wants are unlimited
 - C resources are unlimited; wants are limited
 - D resources are unlimited; wants are unlimited
- 2 Which is **not** an economic good?
 - A a free sample of a new type of soap
 - B a local bus service
 - C medical care provided free to young children
 - D sunlight that helps crops to grow

Factors of production

Learning summary

By the end of this chapter, you should understand:

- what is meant by factors of production
- the nature of land, labour, capital and enterprise, and be able to give examples of each
- what influences the mobility of factors of production
- the causes of changes in the quantity and quality of factors of production.

2.1 Factors of production

The term **factors of production** is used in economics to describe the resources that are needed to produce the many goods and services that are made in all types of economy. They are limited in supply.

Most economists identify four main factors of production, as shown in Figure 2.1.

TERM

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

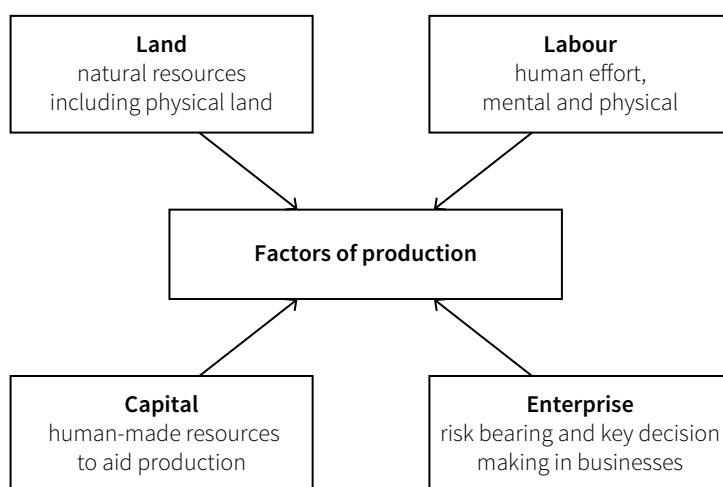


Figure 2.1 The four factors of production

Land covers any natural resource which is used in production. So besides the land itself, it also includes what is beneath the land (e.g. coal), what occurs naturally on the land (e.g. rainforests) and the seas, oceans and rivers, and what is found in them (e.g. fish).

Labour covers all human effort. This includes both the mental and the physical effort involved in producing goods and services.

Capital is any human-made (manufactured) good used to produce other goods and services. It includes, for example, offices, factories, machinery, railways and tools.

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.

TERM

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

TIP

Remember:

- Land is more than just a physical resource.
- Labour is more than simply the number of workers.
- Capital should not be confused with money used in the production process.
- Enterprise involves risk and uncertainty.

Sample question

Mauritius, an island in the Indian Ocean, has an economy which is heavily dependent on international tourism. Identify **two** examples for each of the four factors of production that are likely to have been responsible for the development of an international tourism business in Mauritius.

Sample answer:

Mauritius has sandy beaches and sunny weather (land) and an abundant supply of skilled and unskilled labour. Capital includes an international airport and hotels. In terms of enterprise, international companies are prepared to invest and take risks to develop the international tourism business, as well as local entrepreneurs who are increasing the scale of their businesses.

SKILLS FOCUS

There are other possibilities in each case. Note that land as a factor of production is best remembered as 'a natural resource'.

2.2 Mobility of the factors of production

Mobility refers to the extent to which it is possible to change how or where a factor of production can be used. The extent of mobility varies for each factor of production.

TERMS

Occupationally mobile: capable of changing use.

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

Figure 2.2 compares the extent of **occupational and geographical mobility** of the factors of production.

<p>IMMOBILE</p> <p>MOBILE</p>	<p>Mobility of land</p> <ul style="list-style-type: none"> • Geographically immobile, although a piece of land can be used to support various activities such as a factory or an office block
	<p>Mobility of labour</p> <ul style="list-style-type: none"> • Some geographical and occupational mobility is possible, e.g. migration of workers to countries such as the UK, Singapore and Dubai • May also be immobile for occupational reasons (e.g. a dentist could become a labourer on a construction site, but you would not want an unqualified labourer to be your dentist) and for personal or family reasons
	<p>Mobility of capital</p> <ul style="list-style-type: none"> • Can be very mobile, e.g. the globalisation of manufacturing and service sector activity • Mobility depends on the type of capital, because some capital resources cannot be moved
	<p>Mobility of enterprise</p> <ul style="list-style-type: none"> • Very geographically and occupationally mobile because entrepreneurs have the skills to organise different types of business in almost any location anywhere in the world

Figure 2.2 Mobility of factors of production

2.3 Quantity and quality of the factors of production

The quantity and quality of an economy’s factors of production are important enablers in allowing it to grow and develop. For many less developed economies, the lack of adequate factors of production can be a reason why development is restricted.

- ‘Quantity’ refers to the *volume of resources* available through an economy’s factors of production.
- ‘Quality’ means *how useful or productive* its factors of production are. This is particularly relevant in the case of an economy’s **labour force** and capital.

TIP

Be careful not to confuse **productivity** with production, which is defined as the output arising from the use of factors of production.

TERMS

Labour force: people in work and those actively seeking work.

Productivity: the output per factor of production in an hour.

Table 2.1 summarises how quantity and quality can apply to the factors of production.

Table 2.1 How quantity and quality apply to the factors of production

Factor of production	Quantity	Quality
Land	Fixed in general terms – subject to depletion through over-use	Has modest scope for improvement
Labour	Dependent on the size of population and other determinants of the labour force	Dependent on the education, training, experience and health of the labour force
Capital	Influenced by investment	Affected by technological advances which produce higher-quality output
Enterprise	Influenced by favourable economic conditions which develop entrepreneurs	Dependent on experience but also willingness to bear risks

Progress check

Answer the following questions to check your understanding:

- 1 Give an example of each factor of production for a food stall trader in a local market.
- 2 Why might an agricultural worker be occupationally and geographically immobile?
- 3 Give examples of how the quality of labour in an economy might be improved.

Sample question

As the size of the global population continues to grow, there is an ever-increasing need to increase food production. Explain how the quantity and quality of the factors of production can be used to expand production.

Sample answer:

The factors of production – land, labour, capital, enterprise – are the resources required to produce goods and services. There are many possibilities to improve their quantity and quality which will lead to an increase in food production.

Land can be reclaimed for agriculture. The fertility of land can be improved and land pollution can be reduced.

In the case of labour, more workers can be employed to increase food production and the skill level of the agricultural workforce can be improved by training.

Capital can be used to purchase more machinery in order to increase crop yields and older machinery can be replaced with modern, more efficient equipment.

Entrepreneurs (enterprise) can be encouraged to invest in agriculture and more can be done to enhance awareness of business opportunities.

SKILLS FOCUS

Note how an example of quantity and quality is given for each factor of production, as required by the question. This is good examination technique and shows that both aspects of the question have been considered.

Revision checklist

You should know:

- There are four factors of production – land, labour, capital and enterprise.
- These are the key resources that are required to produce goods and services in any type of economy.
- The factors of production vary in terms of their mobility.
- Changes in the quantity and quality of factors of production lead to changes in the ways in which goods and services are produced.

STRUCTURED SKILLS PRACTICE

- I Explain why Japanese car manufacturers have moved their production and assembly of vehicles to other Asian locations.

TIP

Refer to the factors of production in your answer. A good starting point is to recognise that other Asian locations are likely to have lower labour costs and lower costs of setting up a production plant.