### **Basic Economic Problem**

**AS Economics Presentation 2005** 

#### **Positive Statements**

#### Positive Statements

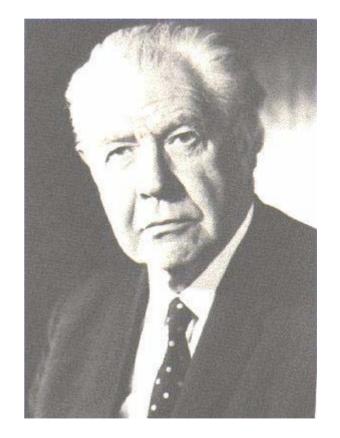
- A positive statement is a statement about what is and that contains no indication of approval or disapproval
- Notice that a positive statement can be wrong
- The tools of positive economics are reason, logic and empiricism

#### Normative statements

- A normative statement expresses a value judgment about whether a situation is desirable or undesirable
- "Monetary Policy in the UK would be more effective if Geoff Riley was Governor of the Bank"
  - There is no way of disproving this statement
- Another example: "The government should allocate more resources to state education"
- Statements that include indicator words such as: should, ought, or prefer are likely to be normative rather than positive

### The Nature of Economics

- Lionel Robbins on Economics
  - "Economics is a science which studies human behaviour as a relationship between ends and scarce means which have alternative uses."
- A general definition of the subject would be as follows:
  - Economics studies how individual consumers, businesses and governments choose to use scarce resources in attempting to satisfy their unlimited needs and wants



#### **Needs and Wants**

- What are our basic needs?
- How do needs differ from wants?
- To what extent are wants insatiable?
- What are your main wants (a) this month (b) this year?
- What are your main objectives as a consumer?
- What are the main constraints on your ability to consume goods and services?





### Objectives of Consumers and Producers

#### Consumers

- To simplify analysis, economics assumes that consumers are rational decision makers and act in a way that maximizes their satisfaction
- This means consumers use their limited income to buy that combination of goods and services that yield the highest possible level of satisfaction

#### **Producers**

- Economics assumes that producers are rational decision makers and act in a way that maximizes their welfare
- This means producers use their limited resources to produce goods or services that yield the highest possible level of profits
- In reality many businesses pursue objectives different from pure profit maximisation

# Scarcity and Choice – The Economic Problem

- Because of the problem of scarcity choices have to be made on a daily basis at all levels
- Making a choice made normally involves a trade-off
- In simple terms, choosing more of one thing means giving up something in exchange

### Fundamental Economic Questions

- What goods and services to produce: does the economy uses its resources to operate hospitals or hotels?
- How best to produce goods and services: what is the best use of scare resources of land labour and capital?
- Who is to receive goods and services: what is the best method of distributing (sharing) products to ensure the highest level of wants and needs are met? Who will get expensive hospital treatment - and who not?

# Factors of Production (Factor Inputs)

- Economics resources are
  - Goods and services (output)
  - Factors of production (inputs):
- Goods and services are those products that are directly consumed by individuals to satisfy their desires
- The factors of production are those elements required to produce the desired output

#### Land

Land is the natural resources available for production

#### Labour

Labour is our human input into the production process



#### Capital

- Capital means investment in goods that are used to produce other goods in the future
- Fixed capital includes machinery, plant and equipment, new technology, factories and buildings
- An example of physical capital would be the drilling equipment used on a North Sea Oil rig or the smelting equipment used in a steel plant



- Entrepreneurship / Enterprise
  - –An entrepreneur is an individual who seeks to supply products to a market for a rate of return (i.e. a profit)
  - -Entrepreneurs will usually invest their own financial capital in a business and take on the risks associated with a business investment



**Labour Input** 



Land



Capital

### Are all factor inputs scarce?

- Free goods are goods which are not used up in consumption – i.e. there is no opportunity cost and the marginal cost of supplying one more unit is close to zero
- Fresh air?
- Airwayes?
- The oceans?
- But what of the long term damage to our eco system?
- Economists specialising in sustainable development focus on the impact of economic growth on our natural environmental resources





### Depletion of Natural Resources



Collapse in the size of many fish stocks worldwide including the North Sea



**Deforestation** 

### Sectors of Production in the Economy

#### Primary sector:

 This involves extraction of natural resources e.g. agriculture, forestry, fishing, quarrying, and mining

#### Secondary sector:

 This involves the production of goods in the economy, i.e. transforming materials produced by the primary sector e.g. manufacturing and the construction industry

#### Tertiary sector:

 The tertiary sector provided services such as banking, finance, insurance, retail, education and travel and tourism

#### Quaternary sector:

 The quaternary sector is involved with information processing e.g. education, research and development