

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 scarce 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

Factor Inputs

- Land
 - Land is the natural resources available for production
- Labour
 - Labour is our human input into the production process



Factor Inputs

- 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



Factor Inputs

- 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

Factor Inputs



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?
- Airwaves?
- 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