

1.1 The basic economic problem

Learning objective – What do you notice about the description of the learning objectives?

- define the nature of the economic problem (finite resources and unlimited wants)
- define the factors of production (land, labour, capital, enterprise)
- define opportunity cost and analyse particular circumstances to illustrate the concept
- demonstrate how production possibility curves can be used to illustrate choice and resource allocation
- evaluate the implications of particular courses of action in terms of opportunity cost.

Survival activity – this activity will help to introduce the key concepts of this unit.

You and your team have been shipwrecked on an island.

Follow the instructions on the handout - H1 Survival

What resources do you need to survive?

What problems do you think you will face?



Findings from your activity

What resources did you have to help you survive?

What was the basic problem that you had?

Did you have to make any choices or sacrifices?

We are going to add a little theory now.....

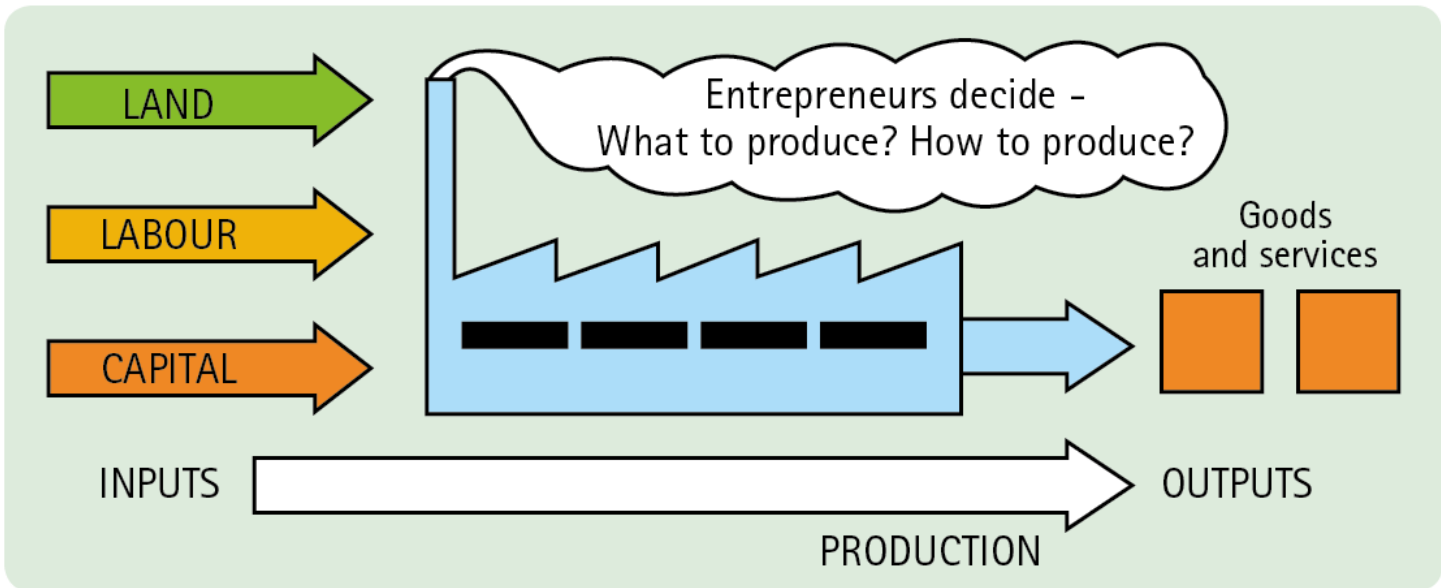
Factors of production

- Natural resources = land
- Man-made resources = capital
- Human skills and effort = labour
- Business know-how = enterprise



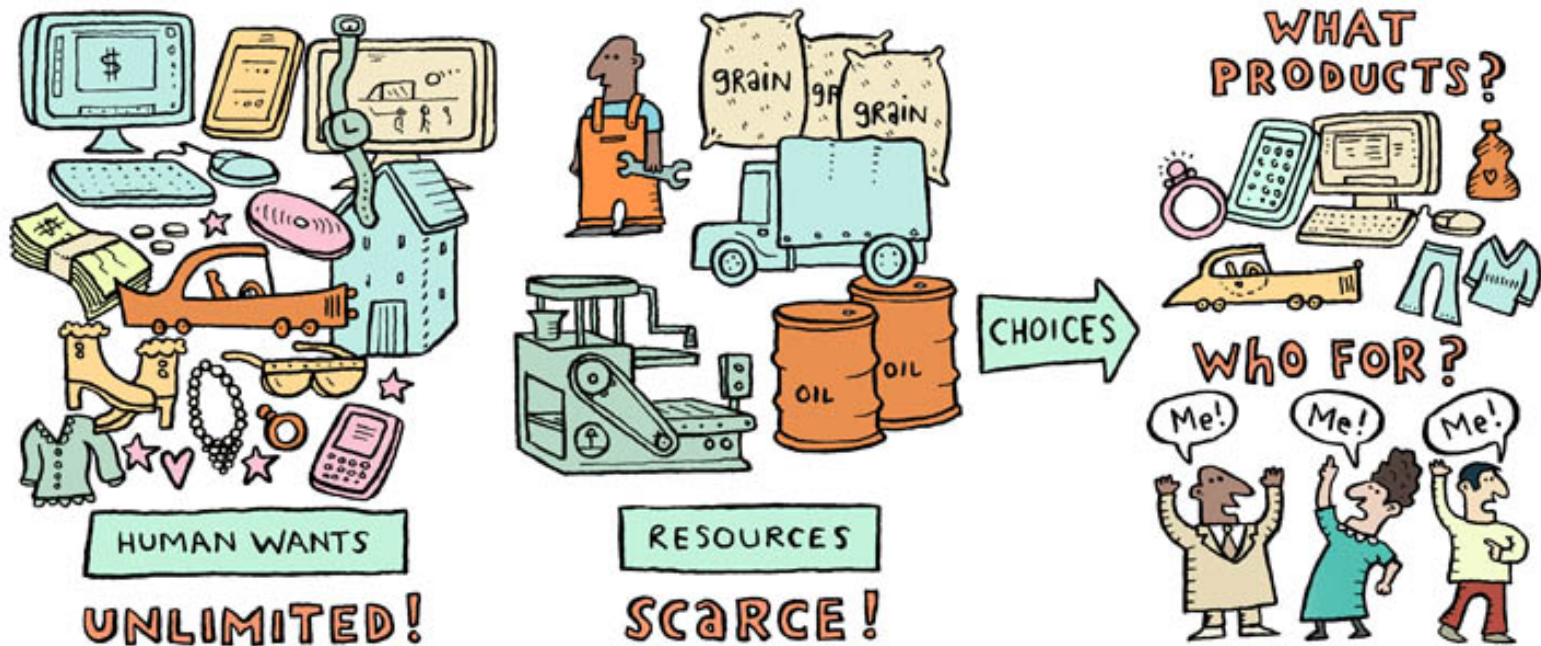
Production

Using inputs (resources) to make outputs (goods and services) to satisfy the needs and wants of consumers



The basic economic problem

Human wants are unlimited but resources are scarce



Consumption

Using up goods and services (products) to satisfy consumers' needs and wants



So, we all have to make choices

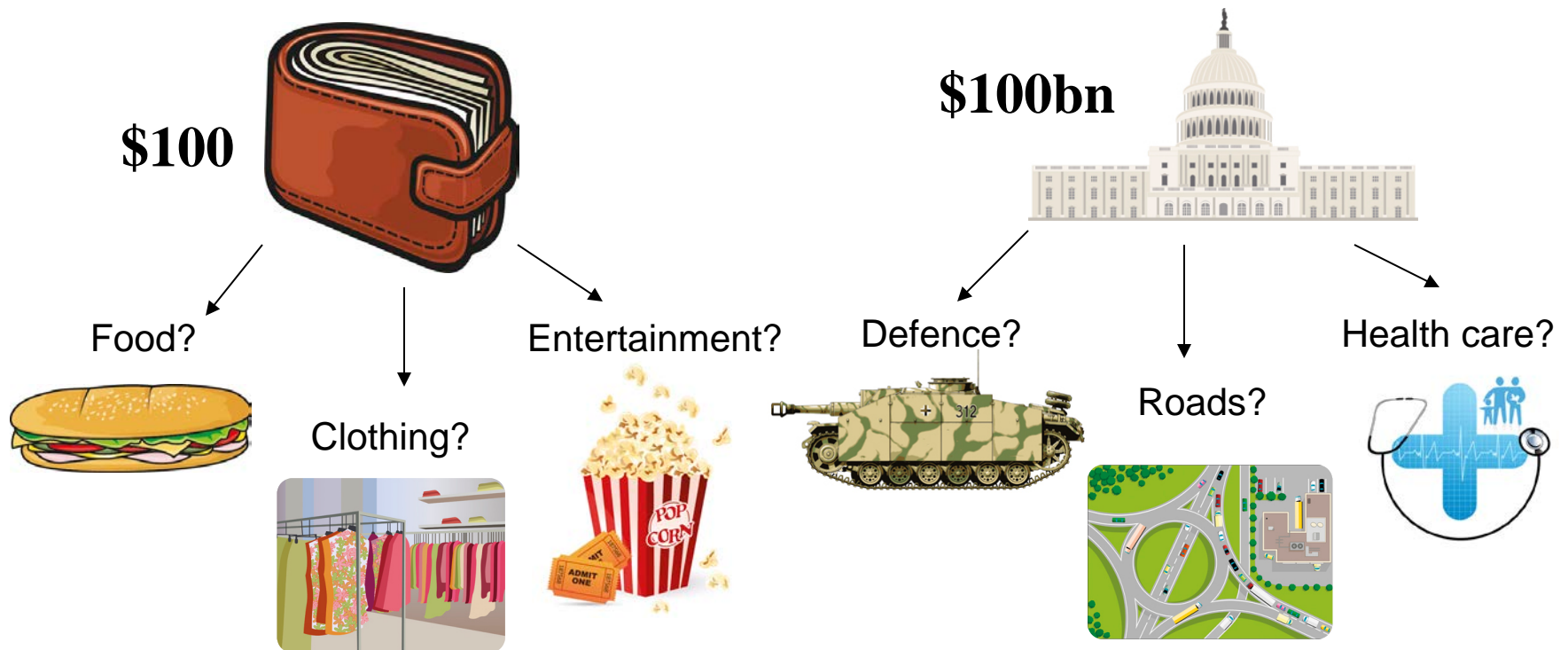
There is a limited amount of resources such as raw materials, machines, factories and skilled workers. But there are a number of different ways in which they can be used.



Resource allocation therefore involves deciding how best to use scarce resources to satisfy as many needs and wants as possible

Choice

Similarly, people and governments only have a limited amount of money but have many needs and wants to satisfy



Opportunity cost

Opportunity cost is the cost of choice

- What would you buy with US\$10?
- How should the government spend US\$250 million?
(Or, should the government cut taxes by US\$250 million?)
- What occupation will you choose when you finish your studies?
- How should a new business invest US\$20 million?
- Should we conserve more natural resources?

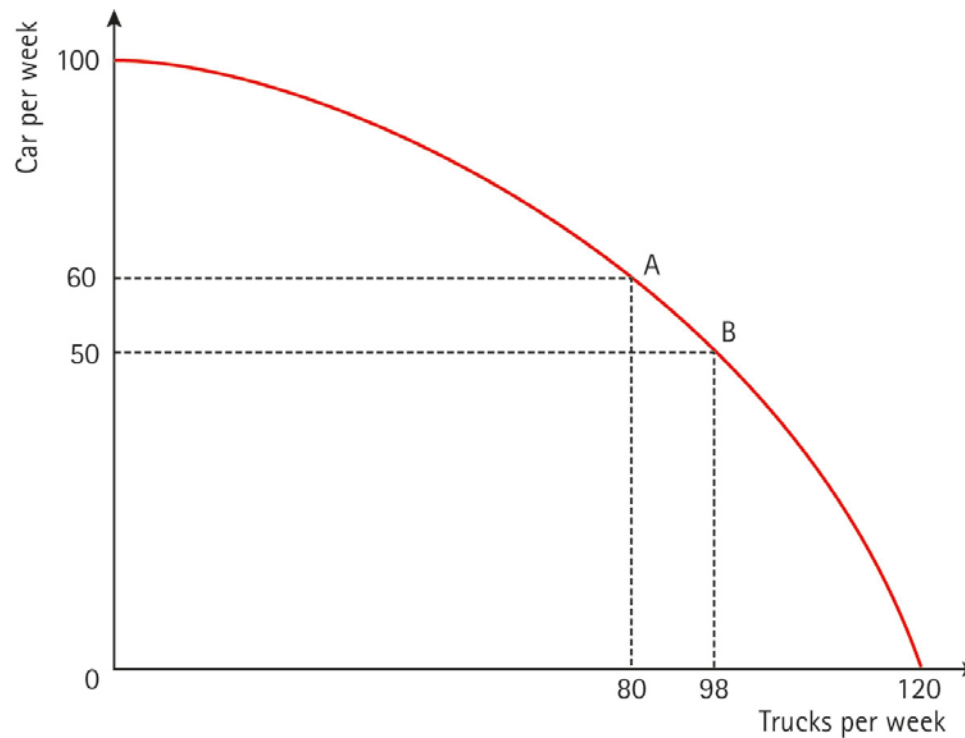
... and what are the next best alternatives foregone?

Now we have discussed these choices complete the Opportunity cost worksheet

Production possibility curves

A firm producing cars and trucks

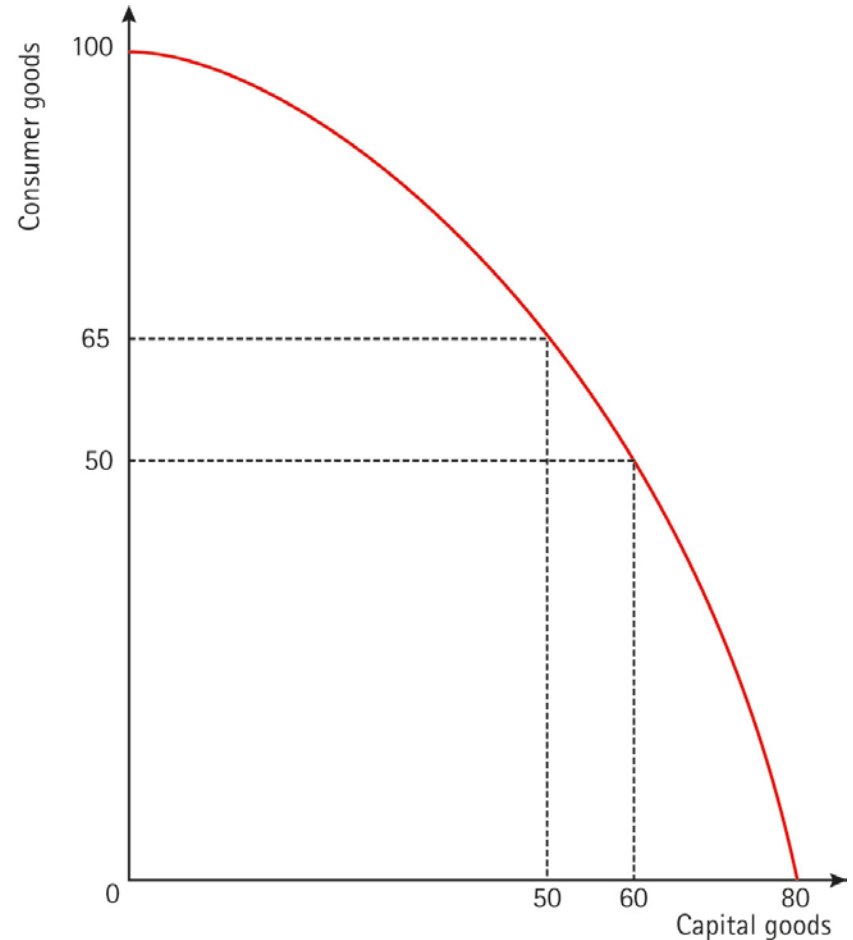
What is the opportunity cost of producing 20 more trucks?



Production possibility curves

An economy producing consumer goods and capital goods

What is the opportunity cost of producing 15 more tonnes of consumer goods?



Production possibility curves

- Production possibility curves (PPCs) show the maximum combined output of two or more products a firm or an entire economy can produce with its available resources
- Resources are being used **efficiently** if they are producing their maximum output
- But, because resources are limited, producing more of one product means producing less of another
- PPCs are therefore a useful way of showing the opportunity cost of producing more of one product in terms of how much of another must be given up