BASIC ECONOMIC IDEAS RESOURCE ALLOCATION

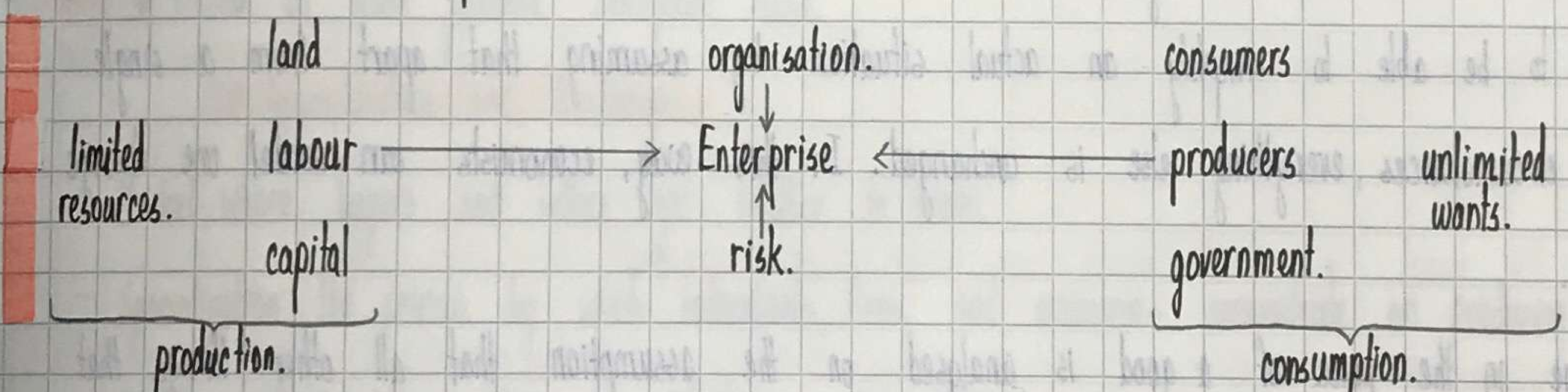
1.1. The Fundamental Economic Problem.

* One Economic Problem or Many?

- Resources: Inputs available for the production of goods and services.
- Wants: Needs that are not always realised.
- Scarcity: A situation in which wants and needs are in excess of the resources available.
- Choice: Underpins the concept that resources are scarce so choices have to be made by consumers, firms and governments.

* The Fundamental Economic Problem.

- Fundamental economic problem: scarce resources relative to unlimited wants.



↳ Figure 1.1 Elements of the fundamental economic problem.

- Production: The process of creating goods and services in an economy.
- Consumption: The process by which consumers satisfy their wants.

* Factors of Production.

- Land: Natural resources in an economy
- Labour: Human resources available in economy.
- Capital: a-man-made aid to production.
- Entrepreneur: Organises production and is willing to take risks.
- Factors of production: Anything that is useful in the production of goods and services.

* Unlimited wants.

People's choice and preferences of wants are different bcs of a complex set of influences, involving; culture, upbringing and life experiences. Wants are continually expanding, developing and changing.

* Choice and Opportunity Cost.

- Opportunity cost: The cost expressed in terms of the best alternative that is forgone.

* Basic Questions: What to produce, How and For whom?

1) What to produce? Because we cannot produce everything, we need to decide what to produce and in what quantities. Eg. food vs. weapons.

2) How to produce? This question arises since resources are scarce in relation to unlimited wants; we need to consider how we could resources are used so that the best outcome arises. We need to consider how we can get the maximum use out of the resources available to us.

↳ It should be noted, however, that other issues besides purely economic concerns should be considered when deciding how to produce. (The decision to maximise output and satisfy more wants would need to consider the full impact on the environment and any potential long-term health risks.

3) For whom to produce? Because we cannot satisfy all the wants of all the population, decision have to be taken concerning how many of each person's wants are to be satisfied.

* Meaning of the term 'Ceteris Paribus'.

- 'Ceteris paribus': Term that is used by economists to refer to a situation where 'other things remain equal'.
  - ↳ The idea is to be able to simplify an actual situation by assuming that apart from a single change of circumstances, everything else is unchanged. In this way, economists can model one change at a time.
  - ↳ E.g: a change in the price of a good is analysed on the assumption that all other things that affect the quantity demanded remain the same, ie. ceteris paribus. This is clearly a simplication, since in practice there are many things as well as price that determine how much of a good is purchased when its price falls.

$$AD = C + I + G + (X - M)$$

AD-Aggregate demand, C-Consumption, I-Investment (net), G-Government (net), X-X (export), M-M (import).

1. 2. Key Economic Concepts.

* Margin and Time.

- 'At the margin' mean that a small change in one economic variable will lead to further (small) changes in other variables. Looking at things in this marginal way is a means of being able to predict what the impact of change might be.

- Margin: It refers to anything extra. 'At the margin' means at the point where the last unit is produced or consumed. Marginal refers to the extra additional next unit of output, consumption or any other measurable quantity that can be increased or decreased by incremental amounts.

The time dimensions:

- Short run: Time period where a firm can only change some and not all factor inputs. (ΔL to ↑ or ↓ production)
- Long run: Time period when all factors of production are variable. (3 to 5 years) (all fac. of. prod or resources can change)
- Very long run: Time period when all key inputs into production are variable. (include technology, gov/regulations and social considerations.)

* Positive and Normative statements in Economics.

- Positive statement: one that is based on empirical or actual evidence.
  - ↳ If this happens this will happen. ↳ No value judgements are involved. ↳ Widely used in smthing that can be measured.
- Normative statement: one that is subjective about what should happen.
  - ↳ If this happens this will happen and this should result in this. ↳ An opinion or value judgement is being made.
  - ↳ Less certain, yet form the basis of policy-making by firms and governments operate.. in attempting to solve economic problems.
  - ↳ Based on some positive conceptual basis.

* Specialisation and Exchange.

- Market: where buyers and sellers get together to trade.
- Specialisation: The process by which individuals, firms and economies concentrate on producing those goods and services where they have an advatage over others.
  - ↳ With expansion in trade and the development of market, the benefits of regional and national specialisation became apparent. Surpluses produced by regions and countries were bought and sold, allowing world living standards to rise.
  - ↳ Yet the dangers of specialisation are: As the technology and economy develops, individual's specialist skills may become redundat. Individuals need to be multi-skilled to be able to change occupations. At regional or national level, changes in consumers' wants can create unemployment (demand and quantity Δ-ing).
  - ↳ Policies then have to be adapted.

Through specialisation and the division of labour, resources that are available can be used to increase what is being produced, so meeting more wants.

* Division of labour.

- Division of labour: Where a manufacturing process is split into a sequence of individual tasks.
  - ↳ Increases production & output. ↳ Labour is quicker and cheaper ↳ Workers can become specialised resulting in ↑ productivity and ↑ in quality of the ~~g..~~ finished product.
  - ↳ Yet creates dissatisfaction (dislikes and gets bored of the monotonous nature)

1. 3. Resource allocation in Different Economic Systems and Issues of Transition.

Used to calculate the GDP.

* Economic Structure.

- Economic structure: The way in which an economy is organised in terms of sectors.
  - Primary sector: This consist of agriculture, fishing and activities such as mining and oil extraction.
  - Secondary sector: This term is used to describe the wide range of manufacturing activities that are found in an economy. (food processing, iron and steel production).
  - Tertiary sector: This is the service sector and covers a range of diverse activities such as retailing, transport logistics, banking and education.
  - Quartery sector: A relatively new term to denote the knowledge-based part of the economy, especially the provision of information. Typical examples are scientific research and product development, computing and ICT.
    ↳ In developed country/economies, the tertiary sector tends to be the principal employer.

* Systems of Resource Allocation.

Scarcity → Requires choices to be made → Common to all economies, rich or poor.

The choices that are made which can realistically be made one. are determined by the economic system of a particular country.

- Economic system: The means by which choices are made in an economy.
  ↳ - Market economy: One where most decisions are taken through market forces.
  - Command or planned economy: One where resource allocation decisions are taken by a central body.
  - Mixed economy: One where market forces and government, private and public sectors are involved in resourse allocation decisions.

· Market Economy.

In a market economy, decisions on how resources are to be allocated are taken by households and firms.

- Market mechanism: Where desisions on price and quantity are made on the basis of demand and supply alone.

↳ Attributed to the Scottish economist Adam Smith, who is remembered for his reference to an invisible hand (price system) that brings together private and social interests in a harmonious way.

Government has a very restricted part to play in a market economy.

↳ In Smith's view it should control national defence, act against monopolies, issue money, raise taxes and so on, while protecting the rights of the private sector.

· Planned Economy.

- In this type of economy, the government has a central role in all decisions that are made and, the emphasis is on centralisation.
- Key features of a planned economy are that central government and its constituent organisations take responsibility for:
  - ↳ The Allocation of resources.
  - ↳ The determination of production targets for all sectors of the economy.
  - ↳ The redistribution of income and the determination of wages.
  - ↳ The ownership of most productive resources and property.
  - ↳ Planning the long-term growth of the economy.

One sacrificing current consumption and standards of living in order to achieve enhanced future well-being.

- There has to be limited level of market economy in it. (private ownerships) But for the more substantive businesses it will be shared between the state and the private sector. This often involves foreign investors who are keen to exploit the opportunies of an emerging market economy.
- The outcome is different from market economy's, as its objective is to reach high rate of economic growth as possible to "catch up" to the progress of more advanced mal. market economies.

· Mixed Economy.

- Involves both private and public sectors in the process of resource allocation.
- ↳ Consequently, decisions on most important economic issues involve some form of planning (by private as well as public enterprises) and interaction between government, businesses and labour through the market mechanism.
- ↳ Private ownership of productive resources operates alongside public ownership in many mixed economies, altough, increasingly, the trend is towards the privatisation of certain activities that were once in public sector hands.
- In this system government might be responsible for:
- ↳ The government at all levels is an important employer and provides basic services, such as education and various types of health care.
- ↳ Government agencies regulate and control the provision of some essential services, such as energy, telecommunications and transportations.
- ↳ Indirect support is given to various strategically important companies.

* Issues of Transition When Central Planning in an Economy is Reduced.

- **Inflation:** Prices are determined by the forces of demand and supply, so there is more price instability and possibly inflation.
- **Output:** In a planned economy, the state can support relatively inefficient firms and industries, but in a market economy, these firms and industries, if inefficient, may not survive and so there may be a fall in output.
- **Employment / Unemployment:** Private sector firms will aim to maximise profits, but this could lead them laying off some workers.
- **Industrial unrest:** Strike more possible.
- **International trade:** Possibly new international trading relationships will need to be established.
- **Welfare:** In a planned economy, the state can provide welfare support for everybody; in a mixed economy, there may be a reduction in the level of welfare provision.
- **Specialised support markets and services:** The specialised markets and services that will be required, e.g. banking and legal services, may take a long time to become sufficiently established.