1.1.3 The economic problem

a) The problem of scarcity – where there are unlimited wants and finite resources
b) The distinction between renewable and non-renewable resources
c) The importance of opportunity costs to economic agents (consumers, producers and government)

- Economic agents: a decision maker in a model of some aspect of the economy.
  - Rational consumer: they want to maximise their satisfaction or utility from consumption by correctly choosing how to spend their limited income
  - Firms: they want to maximise profit, by producing at the lowest cost the goods and services that are desired by consumers. Profit= total revenue- total costs
  - Government: they want to improve the economic and social welfare of citizens
- The basic economic problem: How can the available scarce resource be used to satisfy people's infinite needs and wants as effectively as possible
- Capital goods are goods that are used in producing other goods, rather than being bought by consumers.
- Opportunity cost: The next best alternative that is forgone when a choice is made. It is a real cost measured in terms of something foregone.
- Economic problem:
  - What to produce and how much to produce?
  - How should the goods and services be produced
  - How should the goods produced be allocated?
- Free goods are not scarce therefore consumption by one persons doesn't limit consumption from other's so people won' buy them while economic goods are scarce so can be traded
- Rationality: making decisions based on evidence
- Factors of production are the inputs available to supply goods and services in an economy
  - Land
  - Labour
  - Enterprise
  - Capital
- A sum of money paid regularly (typically annually) by a company to its shareholders out of its profits (or reserves).
- Rationing is a way of allocating scarce goods and services when market demand out-weighs the available supply and it is determined by:
  - By market price
  - By consumer income
  - By assessment of need
  - By household postcode
  - By education level
  - By age
  - By gender

    - By nationality
- The price mechanism describes the means by which millions of decisions taken by consumers and businesses interact to determine the allocation of scarce resources between competing uses. Prices serve to ration scarce resources when demand in a market outstrips supply. When there is a shortage, the price is bid up – leaving only those with the willingness and ability to pay to purchase the product.
- Capital goods:
    - Goods that are used to make other goods and services e.g. machinery and factories
- Consumer goods:
    - Goods and services that satisfy our needs and wants directly
        - Consumer durables: products that provide a steady flow of satisfaction (utility) e.g. a smartphone or dishwasher
        - Consumer non-durables: products which are used up in the act of consumption e.g. food
        - Consumer services
- Opportunity cost: it measures the cost of a choice made in terms of the next best alternative foregone
    1. Work-leisure choices
    2. Government spending priorities
    3. Investing today for consumption tomorrow- i.e. in capital goods
    4. Use of scarce farmland
- The problem of scarcity: resources are finite but our needs are infinite therefore choices must be made
- LAND: As well as the actual 'territory', it includes the Earth's natural resources which are nearly always scarce because there aren't enough to satisfy the demands of everyone.
- AIR :
    1. It is not scarce because there's enough for everyone
    2. Air isn't equally good though as it polluted
    3. Therefore, the environment is considered by some people as a scarce resource
- LABOUR: Work done by people and includes all human effort both physical and mental.
- Human capital: The economic value of a person's skill
- Unemployment: The amount people who are capable of working and who are old enough, but don't have a job.
- Some unemployment is acceptable as there are some unemployed who still provide things people want such as homemakers
- Human capital is different because different people have different levels of education, experience or training
- Labour force: The population who are available to work
- CAPITAL: The equipment, factories and schools to help produce goods and services. Most of an economy's capital is paid for by the government e.g. roads.
- Capital is different to land as capital has to be made first so you can use the land

- ENTERPRISE: The people who take risks and create things
- Functions of enterprise:
    1. Bringing together other factors of production so that goods and services can be produced
    2. Taking the risk involved in production which can lead to large losses but the rewards for risk taking is profit
- Free goods are not scarce therefore consumption by one persons doesn't limit consumption from others so people won't buy them while economic goods are scarce so can be traded
- A sustainable resource is consumed slower than they are replenished
- Renewable resources are those whose stock levels can be maintained at a certain level
- Non-renewable resources are those which will eventually be completely depleted
- Economic activity involves combining the factors of production to create outputs (goods and services) that people can consume to increase people's economic welfare by creating outputs that satisfy their needs and wants.
- Consumption is an economic activity as when you consume something, you're trying to satisfy a need or want.
- Economic agents (participants):
    1. Producers
    2. Consumers
    3. Governments
- Producers decide what to make, and how much they're willing to sell it for
- Consumers have to decide what they want to buy, and how much they're willing to pay for it. So in effect consumers decide what is to be produced.
- Governments have to decide how much to intervene in the way producers and consumers act
- The assumption made in a free-market economy is that all economic agents are assumed to be maximising their welfare when they make decisions
- For consumers when somebody buys a product the opportunity cost is that of buying another product
- A firm may have to choose between different priorities to allocate their resources therefore the opportunity cost is that of investing in other priorities
- Governments have to choose where to allocate taxes therefore the opportunity cost is that of using them for other sectors of the economy