Edexcel (B) Economics A-level

Theme 1: Markets, Consumers and Firms

1.1 Scarcity, Choice and Potential Conflicts

1.1.1 The economic problem

Notes

The problem of scarcity

- The basic economic problem is scarcity. Wants are unlimited and resources are finite, so choices have to be made. Resources have to be used and distributed optimally.

- Scarcity refers to the shortage of resources in relation to the quantity of human wants.

- For example, if you only have £1 and you go to a shop, you can buy either the chocolate bar or the packet of crisps. The scarcity of the resource (the money) means a choice has to be made between the chocolate and the crisps.

Choices and potential trade-offs

- The problem of scarcity gives rise to **opportunity cost**. The opportunity cost of a choice is the value of the next best alternative forgone. In the above example, the opportunity cost of choosing the crisps is the chocolate bar.

- If a car was bought for £15,000 and after 5 years the value depreciates by £5,000, the opportunity cost of keeping the car is £5,000 (which could have been gained by selling the car), regardless of the starting price.

- Opportunity cost is important to economic agents, such as consumers, producers and governments. For example, producers might have to choose between hiring extra staff and investing in a new machine. The government might have to choose between spending more on the NHS and spending more on education. They cannot do both because of finite resources, so a choice has to be made for where resources are best spent.

- When producing goods, the economy has to consider the following questions:
    - **What to produce:** determined by what the consumer prefers. Consumers tell producers what they prefer by demanding goods and using their 'spending votes' and demanding certain goods.
    - **How to produce it:** producers seek profits and aim to minimise production costs.

- **For whom to produce it:** whoever has the greatest purchasing power in the economy, and is therefore able to buy the good.