OCR Economics A-level

Microeconomics

Topic 1: Introduction to Microeconomics

1.1 The Economic Problem

No

Economic and free goods

- **Economic goods** benefit society, have the problem of scarcity and have an opportunity cost. Since they are scarce, they have some value, so consumers will pay for them, and they can be traded.

- **Free goods** have no opportunity cost, because there is no scarcity of the good. For example, air and water are free goods. These goods are not traded because they are freely available.

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.

Positive and normative statements

- Positive statements are **objective**. They can be tested with factual evidence, and can consequently be rejected or accepted.
- Look for words such as 'will', 'is'.
- For example, "Raising the tax on alcohol will lead to a fall in the demand of alcohol and a fall in the profits of pub landlords" is a positive statement. "Higher temperatures will lead to an increase in the demand for sun cream" is also a positive statement.
- The key thing here is that these statements can be tested, the results can be examined and the statement can then be rejected or accepted.

- Normative statements are based on **value judgements**. These are subjective and based on opinion rather than factual evidence.

- Look for words such as 'should', and if the statement is suggesting one action is more credible than another.
- For example, "The free market is the best way to allocate resources" is a normative statement, because it is based on opinion and suggests one method of resource allocation is better than another. "The government should increase the tax on alcohol" is another normative statement.

- Value judgements can influence economic decision making and policy. Different economists may make different judgements from the same statistic. For example, the rate of inflation can give rise to different conclusions.

- People's views concerning the best option are influenced by the positive consequences of different decisions and by moral and political judgements.

Economic Agents

- Economic agents play a role in the economy.
  It is assumed that economic agents only act in their own interests.

- **Government:** Governments are assumed to act on behalf of consumers. Governments intervene in the economy to different extents. For example, some might provide healthcare and education, whilst others might leave healthcare to the free market. In the UK, healthcare is provided by the government, whilst in the US, healthcare is provided by the private sector.
- **Firms:** It is generally assumed that firms aim to maximise their profits. This is the reward entrepreneurs receive for taking risks and making investments. Some firms might have different objectives, which might involve maximising social welfare or helping the environment. Some firms might have philanthropic owners who seek to maximise the utility of others.
- **Households:** Households have to make decisions about how to spend their limited resources. Usually, consumers choose the option which maximises their utility. Workers demand wages and good working conditions. **Maximisation** for consumers is when consumers aim to generate the greatest utility possible from an economic decision.
- A consumer's utility is the total satisfaction received from consuming a good or service.

The Factors of Production

- Economic resources are the factors of production. These are land, labour, capital and enterprise.
- The factors of production (CELL):

Factor	Description	Reward/Incentive
Capital	Physical: goods which can be used in the production process Fixed: Machines; buildings Working: finished or semi-finished consumer goods	Interest from the investment
Entrepreneurship	Managerial ability. The entrepreneur is someone who takes risks, innovates, and uses the factors of production. Resources are drawn together into the production process.	Profit- an incentive to take risks
Land	Natural resources such as oil, coal, wheat, water. It can also be the physical space for fixed capital.	Rent
Labour	Human capital, which is the workforce of the economy.	Wages

Renewable and non-renewable resources

- The environment is a scarce resource. There are only a limited amount of resources on the planet. These are made up of renewable and non-renewable resources.

- Renewable resources can be replenished, so the stock level of the resources can be maintained over a period of time. For example, commodities such as oxygen, fish, or solar power are renewable assuming the rate of consumption of the resource is less than the rate of replenishment. If the resource is consumed faster than it is renewed, the stock of the resource will decline over time.

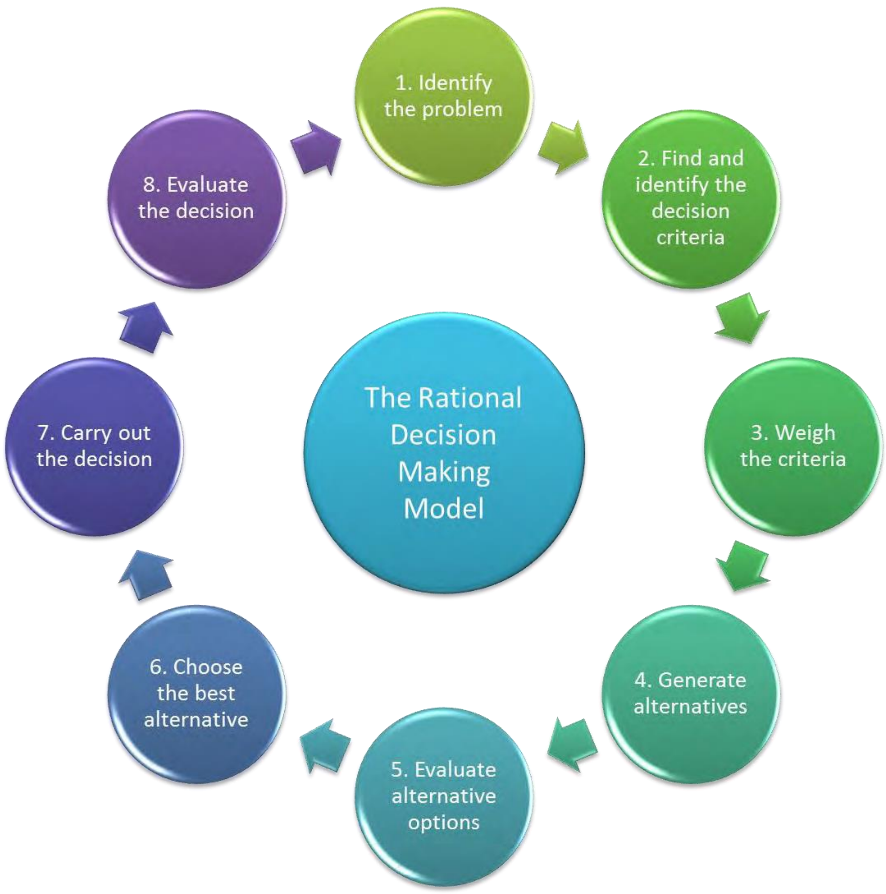
- This is important in environmental economics, and can be managed by preventing or limiting deforestation, or imposing fishing quotas. Renewable resources are **sustainable**. However, currently, resources are being consumed faster than the planet can replace them. The Worldwide Fund for Nature claims that two planets will be required to meet global demand by 2050 if this continues.

- Non-renewable resources cannot be renewed. There are only finite resources, and this scarcity means the resource is unsustainable. Choices have to be made for where these scarce resources are best used. For example, things produced from fossil fuels such as coal, oil and natural gas are non-renewable. The stock level decreases over time as it is consumed.

- Methods such as recycling and finding substitutes, such as wind farms, can reduce the rate of decline of the resource.

Rationality in economic decision making

- A firm or an individual can make decisions using intuition or rationally. Intuition uses the feelings or instincts of the consumer and does not use facts. Businesses use this when they do not have access to facts or when making the decision is difficult. A rational decision is made using several steps, and it involves analysis and facts.



1. **Identify the problem:** For a firm, this might be falling profits.
2. **Find and identify the decision criteria:** The firm might have to find information or criteria that will increase their profits. The firm's criteria might include, for example, keep a certain number of employees or to not change the price of their goods. The criteria might include how the decision will affect stakeholders (the customer and the staff, for instance), and how the quality might be affected.
3. **Weigh the criteria:** The firm will have to rank the criteria based on their relative importance. They might think keeping all of their employees is the most important, for example.
4. **Generate alternatives:** The firm might consider some alternative options. For instance, they might think that moving their premises somewhere else will reduce costs and hence increase profits. Perhaps they will consider a loyalty scheme or a promotion for the consumer. Alternatively, they might decide to reduce the size of their workforce.
5. **Evaluate alternative options:** The firm might now consider which of the alternatives meet their criteria the best, and help them increase their profits the most.
6. **Choose the best alternative:** Now the firm will choose the alternative they think meets their criteria.
7. **Carry out the decision:** The firm can now see what the consequences of the decision are.
8. **Evaluate the decision:** After seeing what effect the decision has on the firm, they can consider whether this was the best option or not.

Limitations:

- This is not always the best or most realistic way for firms to make decisions. Although it might be fairer than making an intuitive decision, it takes significantly longer to decide, which is not practical in a firm with strict time constraints.