Edexcel (A) Economics A-level

Theme 1: Introduction to Markets and Market Failure

1.1 Nature of Economics

1.1.3 The economic problem

Notes

- 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.

- 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.

- This 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.

- 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	Profit- an incentive to take risks

	are drawn together into the production process.	
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

- These factors of production are inputs, and they produce outputs in the form of goods and services. This forms the economy.

- **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. 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.