



Cambridge (CIE) A Level Economics



Your notes

Scarcity, Choice & Opportunity Cost

Contents

- * The Basic Economic Problem
- * Basic Questions of Resource Allocation



The fundamental economic problem: scarcity

- The **fundamental economic problem** is that resources are **scarce**
 - There are **finite/limited resources** available in relation to the **infinite/unlimited wants and needs** that humans have
 - In economics, these resources are called the **factors of production**
 - Due to the problem of scarcity, **choices have to be made** by producers, consumers and governments about the best (**most efficient**) use of these resources
- **Economics is the study of scarcity and its implications for resource allocation in society**
- In a free market, **scarcity** has a direct **influence on prices**
 - The **scarcer** a resource, the **higher** the price for it will be
 - The **less scarce** a resource, the **lower** the price for it will be
- **Resources** can either be **renewable** or **non-renewable**
 - **Renewable resources** can be **used repeatedly and naturally replenished**
 - For example, wind-generated electricity
 - **Non-renewable resources cannot be naturally replenished** at a pace that keeps up with consumption
 - For example, oil and coal

Defining opportunity cost

- **Opportunity cost is the loss of the next best alternative when making a decision**
- Due to the **problem of scarcity**, **choices have to be made** about how to best **allocate limited resources** amongst competing wants and needs

Opportunity cost in decision-making

- There is an **opportunity cost** in the allocation of resources:
 - When a **consumer** chooses to purchase a **new phone**, they may be **unable to purchase new jeans**. The jeans represent the loss of the next best alternative (**the opportunity cost**)
 - When a **producer** decides to allocate all of their resources to **producing electric vehicles**, they may be **unable to produce petrol vehicles**. The petrol vehicles represent the **loss of the next best alternative** (the opportunity cost)

- When a **government** decides to **provide free school meals** to all primary students in the country, they may be **unable to fund some rural libraries**, which may have to close. The libraries represent the loss of the next best alternative (**the opportunity cost**)



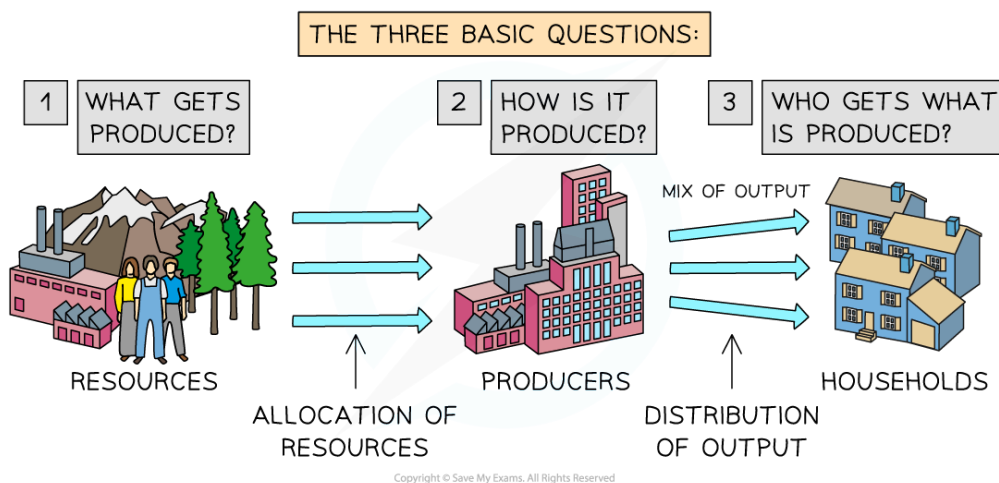
Your notes



What to produce, how to produce and for whom to produce?

- As resources are scarce, every economy faces the **fundamental economic problem**
- This forces all societies to make decisions about how limited resources should be allocated
- These decisions can be summarised by **three key economic questions**

The three fundamental economic questions



How the three questions are answered determines the economic system of a country

What to produce?

- No economy has enough resources to produce everything people want. As a result, decisions must be made about **which goods and services to produce and in what quantities**
- For example, governments and firms must choose between producing:
 - **Consumer goods and services** (such as food, clothing and transport) to raise living standards, **or**
 - **Capital and defence goods** (such as military equipment) to improve national security
- Different priorities explain why some countries devote a much larger proportion of their resources to defence spending than others
- These choices always involve **opportunity cost**, as producing more of one type of good means producing less of another

How to produce?



Your notes

- This question focuses on **how resources are combined and used** in the production process
- Firms aim to use resources as **efficiently** as possible so that output is **maximised** from the available inputs
- Decisions about production methods may involve choosing between:
 - **labour-intensive** or **capital-intensive** techniques
 - **traditional** or more **advanced technology**
- Although firms often aim to minimise costs, production decisions are not always based purely on economic efficiency.
- **Ethical** and **environmental** considerations may also influence how goods are produced. For example, **the use of very low-paid labour may reduce costs but raise moral concerns**
- In agriculture, output can be increased through more intensive farming methods or by making better use of natural resources, such as using underground water supplies to grow crops in dry regions

For whom to produce?

- This question concerns **how output is distributed** among the population
- Governments must decide whether goods and services should be shared relatively **equally** or whether **income and wealth gaps** are acceptable
- Some economies use policies such as **taxation and welfare payments** to redistribute income and reduce inequality
- Others allow **market forces** and inheritance to play a larger role, which can result in significant gaps between rich and poor
- Income and wealth inequality is a major issue in many developing and emerging economies, where economic growth has not benefited all groups equally



Examiner Tips and Tricks

You should see all three questions as connected, as they are all caused by **scarcity**

Resources are limited so every economy must decide **what** goods to produce, **how** to use resources efficiently, and **who** will receive the output