



SECTION I

The Basic Economic Problem

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Susan Grant
Excerpt
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UNIT 1

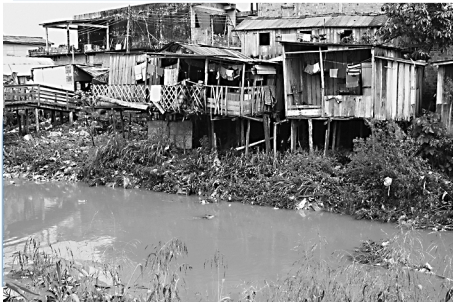
Scarcity

In this first unit you will be introduced to the basic problem facing all economies. This is the problem of scarcity.



The Nature of Scarcity

In all the countries throughout the world, people would like to have more goods and services. It was estimated that in India, in 2006, at least 6 million people were living in slums. These people would clearly like to have better quality housing. Even many of those living in the rich suburbs would like to improve the quality of their living accommodation by, for instance, adding a swimming pool. What stops people enjoying all the products they would like to have? It is a lack of resources to produce them. Resources, including workers and machinery, are scarce.



Key Point

Scarcity: a situation where there is not enough to satisfy everyone's wants.



The Continuing Nature of Scarcity

Scarcity continues to exist. More goods and services are being produced today than ever before but the growth in wants is exceeding the growth of economic resources. People still want more products than the resources available can produce. Over a period of time, wants continue to grow and change.



The Economic Problem

The economic problem arises because of scarcity. There is no limit to people's wants – they are infinite. For instance, people want more and better clothing and health care and improved transport infrastructure. The number of workers, machines, offices, factories, raw materials and land used to produce these products, however, is limited. At any given time, for example, there are only a limited number of workers and they can produce only a specified amount. This mismatch, between what people want and the maximum that can be produced, gives rise to the economic problem.



Key Point

The economic problem: unlimited wants exceed scarce resources.



Evidence of the Existence of Scarcity

The fact that people have to choose which products to buy, which subjects to study, what jobs to do and which products to produce shows that there are insufficient resources. As consumers, we cannot have everything we want. We have limited incomes. Students have to select which courses to study. It is not possible to study economics and chemistry at the same time. Some teachers may carry out other work in the evening but when they are teaching, they are not working as writers! Time is in limited supply. Farmers cannot grow rice and wheat on the same land. They have to select one crop as land is scarce.



Activity 1

Decide which of the following are scarce:

- vacancies for university degree courses
- foreign holidays
- health care.



Summary

- People's wants continue to grow.
- Resources such as workers, machines and land are limited in supply.
- The economic problem of scarcity arises because wants exceed resources.



Teacher's Tip

It is very important to learn definitions. The more you apply a term such as scarcity in your work, the more you will become familiar with it. You may also want to compile your own economics dictionary by writing down terms in alphabetical order, as you come across them.

Multiple Choice Questions

1. Why does scarcity exist?
 - a. Each year workers tend to produce less than previously.
 - b. Machines wear out with time.
 - c. There are not sufficient resources to produce all the products people want.
 - d. There is a limit to people's wants.

2. Why will scarcity continue to be a problem in the future?
 - a. Prices will rise.
 - b. The quantity of resources will decline.
 - c. Wants will continue to increase.
 - d. World population will fall.

UNIT 2

Factors of Production

This unit explores the key characteristics of the factors of production, the influences on their supply and also discusses the mobility of these factors. It also mentions the payments to factors of production. Factors of production is another term for economic resources. Unit 1 explained that economic resources are used to produce goods and services and are in limited supply.



What are the Factors of Production?

Most economists identify four factors of production. These are land, capital, labour and enterprise. Some economists, however, claim that there is really only three factors of production and that enterprise is a special form of labour.



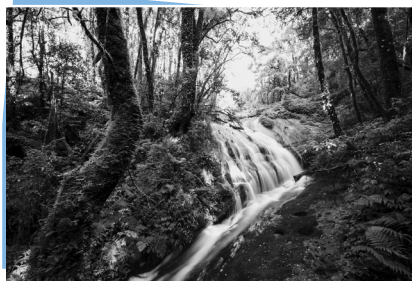
Key Point

Factors of production: the economic resources of capital, enterprise, labour and land.

Land

Land in general terms includes the earth in which crops are grown and on which offices and factories are built, but in economics it has a wider meaning. It covers any natural resource which is used in production. So besides the land itself, it also includes what is beneath the land, such as coal, what occurs naturally on the land e.g. rainforests and the sea, oceans and rivers and what is found in them, for instance fish.

To attract foreign tourists, for instance, a travel company will make use of water in its swimming pools, good climate and beaches in the holidays it provides. Equivalently, the land used by a safari park includes not only the grass on which some of the animals graze but also the animals themselves.





Key Point

Land: gifts of nature available for production.

The Supply of Land

The amount of physical land in existence does not change much with time. There is a certain degree of soil erosion which reduces the supply of arable land but also a certain amount of land reclamation which increases its supply.

Other natural resources, however, can change quite significantly. Rainforests are currently declining at a rapid rate.

Some natural resources are renewable whilst others are non-renewable. Renewable resources, for instance wind power, are replaced by nature and hence can be used again and again. In contrast, non-renewable resources, e.g. gold and oil, are reduced by use. There is a risk that renewable resources can be turned into non-renewable resources if they are over-exploited, that is used at a faster rate than they are replenished. Over-fishing and the hunting of wildlife can diminish numbers to a point where they cannot be restored.

The Mobility of Land

Most land is occupationally mobile. This means that it can be used for a number of purposes. Land which is currently being used for farming may instead be used to build houses. Trees can be used to make tables or sleepers for railway lines.

Land, in its traditional sense, is however geographically immobile. It is not possible to move a section of land from Sri Lanka to India, for instance. Some forms of land, in its wider meaning, can be moved to a certain extent. For example, the course of rivers can be diverted and wildlife can be moved.



Key Points

Occupationally mobile: capable of changing use.

Geographically immobile: incapable of moving from one location to another location.



Activity 1

Identify two forms of land that are used by a paper mill.

Capital

Capital would have to be used in the diversion of the course of a river. Capital is any human-made (manufactured) good used to produce other goods and services. It includes, for example, offices, factories, machinery, railways and tools.



Capital is also referred to as capital goods and producer goods. Economists distinguish between capital and consumer goods. Capital goods are not wanted for their own sake but for what they can produce. In contrast consumer goods, such as food, clothing and entertainment, are wanted for the satisfaction they provide to their owners.

In deciding whether a good is a capital or a consumer good, it is necessary to consider who the user is and the purpose of its use. A computer, for example, will be a capital good if it is used by an insurance company to process insurance claims – it is producing a service. If, however, it is used by a person to play games, it is a consumer good.



Key Point

Capital: human-made goods used in production.



Activity 2

Decide which of the following are capital goods and which are consumer goods:

- a chocolate bar
- a car
- a child's toy
- a farm tractor
- a dentist's drill
- a courtroom.

The Supply of Capital

The supply of capital tends to increase with time. Every year some capital goods physically wear out and some become outdated. A farm barn may fall down, for instance, and some machinery may be replaced by newer, more efficient machinery.

New capital goods, however, usually take the place of those goods, which firms are unable (or choose not) to use any more. The total value of the output of capital goods produced

is referred to as **gross investment** or sometimes just investment. Some of the capital goods being produced will be replacing those which have worn out or become obsolete. The value of replacement capital is called **depreciation** or capital consumption.

Net investment is the value of the extra capital goods made. It is equal to gross investment minus depreciation. For instance, if a country produces \$200m capital goods one year and there is depreciation of \$70m, net investment is \$130m. The country will have more capital goods. These additional capital goods will allow it to produce more goods and services.

Occasionally gross investment may be lower than depreciation. This means that some of the capital goods taken out of use, are not replaced. This is said to be *negative net investment*.



Key Point

Investment: spending on capital goods.



Activity 3

A firm is currently using 12 machines. Each machine is capable of producing 100 units of output. It anticipates that by the end of the year, 3 of its machines will wear out. If it expects to sell 1 600 units next year:

- How many machines will it buy?
- Why in the future may fewer machines be needed to produce the same output?

The Mobility of Capital

The geographical and occupational mobility of capital varies according to the type of capital goods. Some types of capital goods can be transferred from one part of the country to the other. A photocopier used by a bank in one area of a country can be sold to and then used by a bank in another area. A coal mine and a dock, however, are fixed in position and so are geographically immobile. They are also occupationally immobile since their use cannot be changed, as they have been made for a specific purpose. In contrast, a delivery van, used originally by a book publisher may be bought and employed by a toy manufacturer to distribute its products. Similarly, an office block may be used for a variety of purposes. It may house a call centre or an accountancy firm.