

Scarcity and Choice

The [Economist's Dictionary of Economics](#) defines economics as

"The study of the production, distribution and consumption of wealth in human society"

Another definition of the subject comes from economist **Lionel Robbins**, who said in 1935 that

"Economics is a social science that studies human behaviour as a relationship between ends and scarce means which have alternative uses. That is, economics is the study of the trade-offs involved when choosing between alternate sets of decisions."

The purpose of economic activity

It is often said that the central purpose of economic activity is the production of goods and services to satisfy our changing needs and wants.

The **basic economic problem** is about **scarcity** and **choice**. Every society has to decide:

- (i) **What goods and services to produce:** Does the economy use its resources to operate more hospitals or hotels? Do we make more iPhones and iPads or double-espressos? Does the National Health Service provide free IVF treatment for childless couples?
- (ii) **How best to produce goods and services:** What is the best use of our scarce resources? Should school playing fields be sold off to provide more land for affordable housing? Should coal be produced in the UK or is it best imported from other countries?
- (iii) **Who is to receive goods and services:** Who will get expensive hospital treatment - and who not? Should there be a minimum wage? If so, at what level should it be set?

Scarcity

We are continually **uncovering of new wants and needs** - which producers attempt to supply by employing factors of production. For a perspective on the achievements of countries in meeting people's **basic needs**, the [Human Development Index](#) produced by the United Nations is worth reading. The economist [Amartya Sen](#) (Winner of the 1998 Nobel Prize for Economics) has written extensively on this issue.

Making choices

Because of scarcity, **choices** have to be made by all consumers, businesses and governments. For example, over six million people travel into London each day and they make choices about when to travel, whether to use the bus, the tube, to walk or cycle – or whether to work from home. Millions of decisions are being taken, many of them are habitual – but somehow on most days, people get to work on time and they get home too! This is a remarkable achievement, and for it to happen, our economy must provide the resources and the options for it to happen.

Road space is becoming increasingly scarce as the demand for motor transport increases each year – what do you think are the best solutions to reducing the problem of congestion on our roads?



Trade-offs when making choices

Making a **choice** made normally involves a **trade-off** – this means that choosing more of one thing can only be achieved by giving up something in exchange.

1. **Housing:** Choices about whether to rent or buy a home – there are costs and benefits to renting a property or in choosing to buy a home with a mortgage. Both decisions involve **risk**. People have to weigh up the **costs** and **benefits** of the decision.
2. **Working:** Do you work full-time or part-time? Is it worth your while studying for a degree? How have these choices been affected by the introduction of university tuition fees?
3. **Transport and travel:** The choice between using Euro-Tunnel, a low-cost ferry or an airline when travelling to Western Europe.

The cost benefit principle

In many of these decisions, people consider the **costs** and **benefits** of their actions – economists make use of the ‘**marginal**’ **idea**, for example what are the benefits of consuming a little extra of a product and what are the costs.

Economic theory states that rational decision makers weigh the marginal benefit one receives from an option with its marginal cost, including the opportunity cost.

This **cost benefit principle** well applied will get you a long way in Economics!

Consumer welfare and rationality

What makes people happy? Why despite several decades of rising living standards, surveys of happiness suggest that people are not noticeably happier than previous generations?

Typically we tend to assume that, when making decisions people aim to **maximise their welfare**. They have a **limited income** and they seek to allocate their money in a way that improves their **standard of living**.

Of course in reality consumers rarely behave in a well informed and rational way. Often decisions by people are based on **imperfect or incomplete information** which can lead to a loss of welfare not only for people themselves but which affect others and our society as a whole. As consumers we have all made **poor choices** about which products to buy. Behavioural economics is an exciting strand of the subject that looks at whether we are rational in our everyday decisions. One of the best people to read on behavioural economics is Dan Ariely.

Opportunity Cost

There is a well known saying in economics that “there is no such thing as a free lunch!” Even if we are not asked to pay a price for something, **scarce resources** are used up in the production of it and there is an opportunity cost involved.

Opportunity cost measures the cost of any choice in terms of the **next best alternative foregone**.

- **Work-leisure choices:** The opportunity cost of deciding not to work an extra ten hours a week is the lost wages foregone. If you are being paid £6 per hour to work at the local supermarket, if you take a day off from work you might lose £48 of income.



- **Government spending priorities:** The opportunity cost of the government spending nearly £10 billion on investment in National Health Service might be that £10 billion less is available for spending on education or the transport network.
- **Investing today for consumption tomorrow:** The opportunity cost of an economy investing resources in capital goods is the production of consumer goods given up.
- **Making use of scarce farming land:** The opportunity cost of using farmland to grow wheat for bio-fuel means that there is less wheat available for food production

Economic Systems



An economic system is a **network of organisations** used by a society to resolve the basic problem of **what, how much, how** and **for whom** to produce.

1. **Traditional economy:** Where decisions about what, how and for whom to produce are based on custom and tradition. Land is typically held in common i.e. private property is not well defined. This BBC news article looks at the [traditional economy of Vanuatu](#).
2. **Free market economy:** Where households own resources and markets allocate resources through the workings of the **price mechanism**. An increase in demand raises price and encourages businesses to switch additional resources into the production of that good or service. The amount of products consumed by people depends on their income and household income depends on the market value of an individual's work. In a free market economy there is a limited role for the government. Indeed in a pure free market system, the government limits itself to protecting the **property rights** of people and businesses using the legal system and it also seeks to protect the value of money or the value of a currency.
3. **Planned or command economy:** In a planned or command system typically associated with a socialist or communist system, scarce resources are owned by the government. The state allocates resources, and sets production targets and growth rates according to its own view of people's wants. In such a system, market prices play little or no part in informing resource allocation decisions and queuing rations scarce goods.
4. **Mixed economy:** In a mixed economy, some resources are owned by the public sector (government) and some resources are owned by the private sector. The public (or state) sector typically supplies public, quasi-public and merit goods and intervenes in markets to correct perceived [market failure](#).

Life inside North Korea

Sue Lloyd-Roberts has produced some remarkable reports for television over the years. Few can be as impressive as the ones available on BBC Our World and BBC Newsnight tracking her time in North Korea. She tries to gain an insight into the daily existence of people in North Korea and, despite the constant presence of government minders and security officials; she discovers private markets which for many can be the difference between a meagre life and starvation. The North Korean authorities refuse to acknowledge the existence of these markets but they are the inevitable result of the complete failure of the state planning system. She meets some North Korean defectors who are still coming to terms with the ultimate culture shock.

Here are some links to Sue Lloyd-Roberts' reports

[Glimpses of real North Korean life behind the facade](#)



Sectors of Production

Production of goods and services takes place in different sectors, when added together they give us a figure for a nation's gross domestic product (GDP). These sectors are as follows:

