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Economics Revision

AS Economics

The Nature of Economics

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Scarcity

An economy is made up of inputs (resources/factors of production) and outputs (goods/services).

Factor	Description	Reward
Land	Natural resources – physical space for fixed capital and raw materials, e.g. oil, coal, fertile soil, water.	**Rent**
Labour	Human capital – workforce of the economy.	**Wages**
Capital	(Investment in) physical capital – goods which can be used in the production process. Fixed capital – machinery, buildings etc. Working capital – stocks of finished (to be consumed soon) or semi-finished consumer goods.	**Interest**
Entrepreneurship	Drawing together of resources into production process – managerial ability.	**Profit**

→ These resources are scarce – there is a fixed amount at any point in time. An economy might increase resource stock but this will always be outstripped by the wants/needs of the population.
→ Wants and needs are unlimited – can always find something else that we want to consume – always left unsatisfied.
→ The basic economic problem is that resources are finite but wants are infinite – we have to choose what to produce, how to do so and who for.

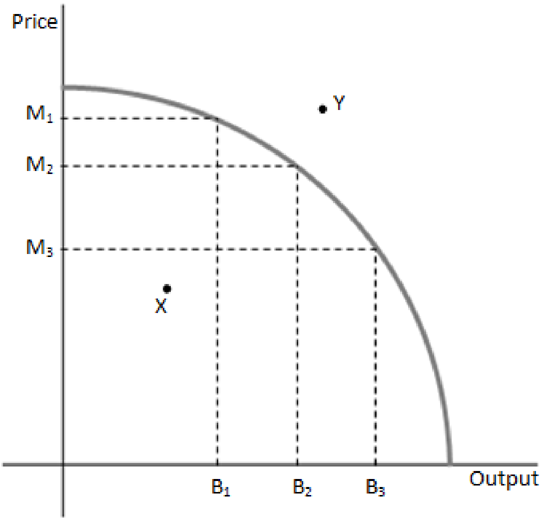
Renewable resources:

- Stock level can be maintained over a period of time.
- May decline over time if they are consumed faster than they are replenished.
- Careful management → prevention of deforestation, soil erosion etc.

Non renewable resources:

- Stock level decreases over time as it is consumed.
- Can reduce the rate of decline by recycling/developing substitutes.

Production Possibility Frontiers (PPFs)



Opportunity cost is the value of the next best alternative which is foregone. This can be illustrated on a PPF.

The PPF in figure 1 shows the different possible maximum combinations of two goods – milk and butter – for a fixed number of assets.

M_1 to M_2 < M_2 to M_3 because factors of production now used to make butter would be better used to make milk.
The firm is now less productive – output rises less rapidly than input.

B_1 to B_2 has an opportunity cost of M_1 to M_2.
B_2 to B_3 has an opportunity cost of M_2 to M_3.

At point X resources are either unemployed or being used inefficiently.
To attain point Y, an economy would need more resources or increased productivity.

- The production potential of a firm can increase due to increased quality or quantity of resources. In this circumstance the PPF would shift outwards.
- The production potential of a firm can decrease due to decreased quality or quantity of resources. In this circumstance the PPF would shift inward.

Specialisation and the Division of Labour

Specialisation is when production is concentrated on particular goods and services. It has led to increased standards of living. Countries which are specialised can trade their goods/services with those of other countries.

The Division of Labour is a type of specialisation in which the production of a good is broken up into tasks carried out by different workers.

Advantages:

- → Workers become highly skilled at their particular task – increased efficiency.
- → No time is wasted moving from one job to another.
- → Capital machinery can be used continuously throughout the production process (e.g. production line) – greater mechanisation.
- → Less time spent training workers for specific tasks.
- → More choice – workers can specialise in a job they are most suited to.
- → Higher output/increased quality – increased variety.
- → Saving of equipment – each worker doesn't need a full set of tools.

Disadvantages:

- → Repetition creates monotony/boredom – decreased motivation and efficiency.
- → High turnover of staff – recruitment/selection costs.
- → Easier to replace workers with machines – increased structural unemployment.
- → Interdependence – if one sector collapses it could affect an entire industry.
- → Less flexibility – difficult for workers to switch to performing other tasks when there is a need to cover for other workers or when demand changes.
- → Loss of skills – tasks are simple and mechanised.
- → Increased risk of unemployment – workers have limited skills – change in demand could mean that their skills aren't needed → unemployment.

Free Market and Mixed Economies

Private | UK – 60% | Public

Free market | Mixed Economy | Centrally Planned Economy

Free Market:

- → Controlled by price mechanism.
- → Resources privately owned.
- → No government intervention.
- → None exist in the world.

Mixed Economy:

- → Controlled partly by the government, partly by the private sector.
- → Most developed economies are mixed.
- → Aim – advantages of the free market with all disadvantages prevented by the government.

Centrally Planned Economy:

- → Or 'control' economy.
- → Government has complete control – economic decision is centralised.
- → No price mechanism.

Positive and Normative Economics

Positive Economics – concerned with facts – value free. Positive statements are *objective* and can be tested as true or false.

Normative Economics – concerned with opinions. Normative statements are *subjective*, i.e. they are opinions or *value judgements*.