SATPREP

The Basic Economic Problem

Basic Economic Problem: How to allocate scarce resources to satisfy unlimited needs and wants and this leads to opportunity cost.

Economic Good: It is one which is limited in supply. Eg. oil, cotton, wheat, housing and cars.

Free Goods: They are unlimited in supply. Eg. Air, sea, rain, water, sunlight and public domain web pages.

Economic Agents/ Decision Makers:

1. Individuals or households
2. Firms (businesses that operate in the private sector of the economy)
3. The government.

Production of goods and services:

1. Firms and Individuals by Private Sectors
2. Government by Public Sectors. Eg. Education or health care services

Goods: Physical Items Eg. Table, clothing

Services: Non-physical Items. Eg. Telephone calls, Internet

Needs: Essential goods and services required for human survival. Eg. Nutitional food, clean water, shelter, protection, clothing, health care and education.

Wants: They are goods and services which are not necessary for survival. Individual's wants are unlimited and most people are not satisfied and always strive for more.

Factors of Production (or Resources): They are sources to produce goods and services. They are land, labour, capital and Enterprise.

	Land	Labour	Capital	Enterprise
Explanation	Natural resources used in production process.	Human resources required in the production process (skilled and unskilled labour)	Goods used to produce other goods and services.	Enterprise refers to the skills a business person requires to combine and manage successfully all factors of production and can take risks.

Examples:	Oil, water, metal ores, agriculture products.	Performing administrative tasks or people to work on production line.	Machinery, tools, a factory building and trucks to transport	Skills necessary to organize production process and to motivate workers.

Combining factors of production:

Labour Intensive	Capital Intensive
1. Firms use more labour and spends more on lab proportionately than other factors of production.	1. A firm uses more and spends more on capital costs than other factors of production. 2. High costs of capital, barriers to entry. 3. Mass production 4. Economies of scale (unit cost of production will be lower).

Economy is divided into three sectors:

	Primary Sector	Secondary Sector	Tertiary Sector
Definitions	Firms that extract raw materials.	Firms that- 1. Manufacture goods and changes raw materials into finished goods. 2. Construct buildings, roads and bridges.	Firms that provide services to the general public and other firms.
Examples	Farming, Fishing and Mining	Tablets, Mineral Water bottles, Books etc.	Health care, Postal, Schools, Advertising
Points to remember	1. Primary, secondary and tertiary sectors are interdependent on each other. 2. Three sectors are linked together in Chain of Production.		

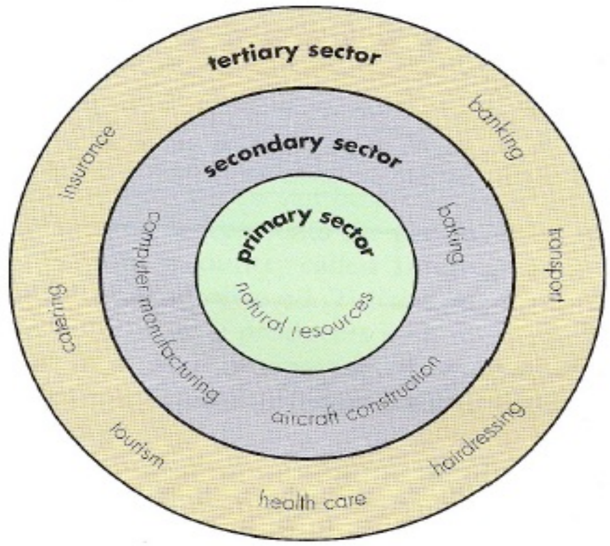
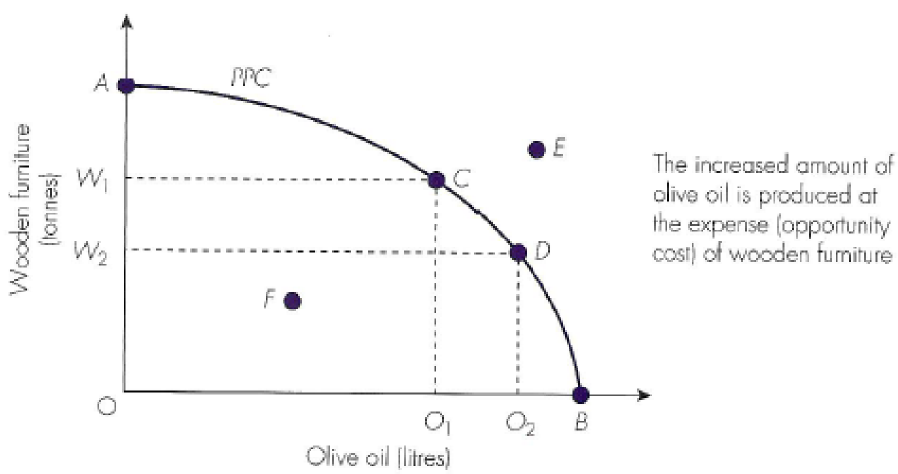


Figure 1.2 The three sectors of industry

Opportunity Cost: The benefit sacrificed for not choosing the next best alternative.

Production Possibility Curve: It represents the maximum amount of goods and services which can be produced in an economy, if all resources are used efficiently.

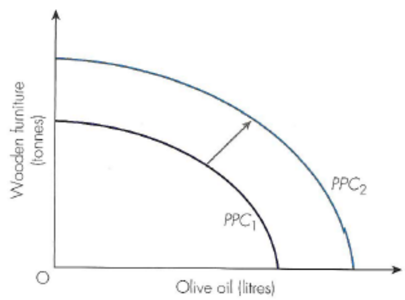
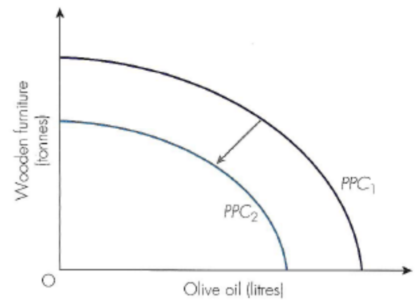


Key:

A – All resources dedicated to the production of wooden furniture
B – All resources dedicated to the production of olive oil
C – W_1 tonnes of wooden furniture are produced alongside O_1 litres of olive oil
D – W_2 tonnes of wooden furniture and O_2 are litres of olive oil are produced
E – This point is beyond the production possibility curve and lies outside the productive capacity of the economy, so it is unattainable
F – This point is within the productive capacity of the economy and production of both olive oil and wooden furniture can increase without any opportunity cost as some factors of production are not being used

Figure 1.4 The production possibility curve (PPC) of Tullassa

Changes in Productive Capacity

Increase in productive capacity	Decrease in productive capacity
Makers has increased yields of commodities  **Figure 1.5** An outward shift of the PPC	Makers has decreased yields of commodities  **Figure 1.6** An inward shift of the PPC