

# The Economic Problem: Scarcity and Choice

## The Economic Problem

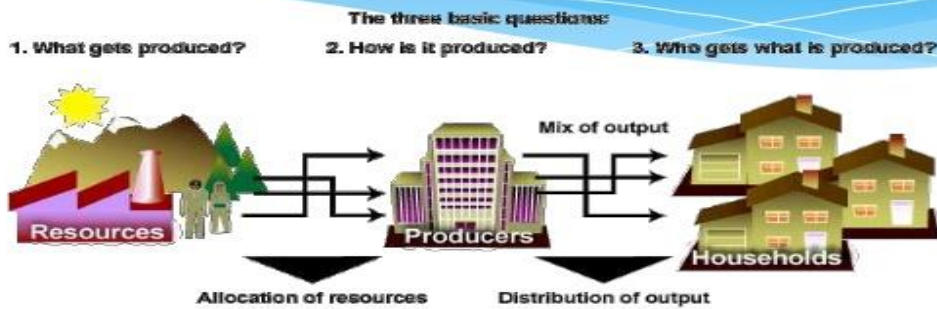
- \* *Needs* – the essentials of life, such as food and shelter
- \* *Wants* – desires for non-essential items
- \* *Economic Problem* – the problem of having unlimited wants, but limited resources to satisfy them
- \* *Scarcity* – the limited nature of resources, which underlies the basic economic problem
- \* *Economic Resources* – basic items that are used in all types of production, including natural, capital, and human resources

- \* *Natural Resources* – the resources from nature that are used in production, including land, raw materials, and natural process
- \* *Capital Resources* – the processed materials, equipment, and buildings used in production; also known as capital
- \* *Human Resources* – the efforts of people involved in production, including labour and entrepreneurship

## Scarcity, Choice, and Opportunity Cost

- \* *Human wants are unlimited, but resources are not.*
- \* Three basic questions must be answered in order to understand an economic system:
  - \* What gets produced?
  - \* How is it produced?
  - \* Who gets what is produced?

# Scarcity, Choice, and Opportunity Cost



- \* Every society has some system or mechanism that transforms that society's scarce resources into useful goods and services.

# Scarcity, Choice, and Opportunity Cost

- \* **Capital** refers to the things that are themselves produced and then used to produce other goods and services.
- \* The basic resources that are available to a society are **factors of production**:
  - \* **Land**
  - \* **Labor**
  - \* **Capital**

## Scarcity, Choice, and Opportunity Cost

- \* **Production** is the process that transforms scarce resources into useful goods and services.
- \* Resources or factors of production are the **inputs** into the process of production; goods and services of value to households are the **outputs** of the process of production.

## Scarcity and Choice in a One-Person Economy

- \* Nearly all the basic decisions that characterize complex economies must also be made in a single-person economy.
- \* *Constrained choice* and *scarcity* are the basic concepts that apply to every society.



## Scarcity and Choice in a One-Person Economy

- \* **Opportunity cost** is that which we give up or forgo, when we make a decision or a choice.

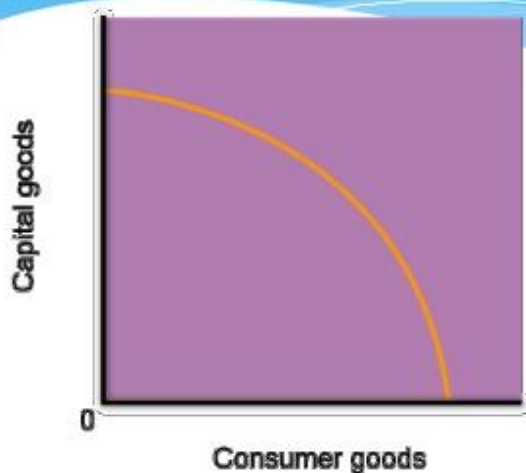
## Capital Goods and Consumer Goods

- \* **Capital goods** are goods used to produce other goods and services.
- \* **Consumer goods** are goods produced for present consumption.

## Capital Goods and Consumer Goods

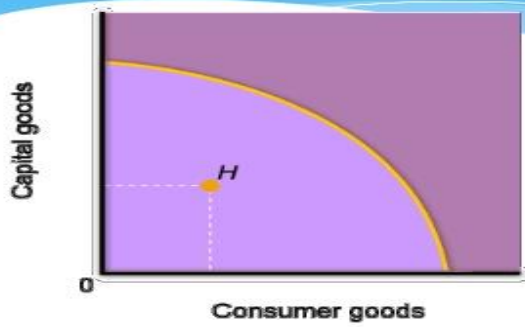
- \* **Investment** is the process of using resources to produce new capital. Capital is the accumulation of previous investment.
- \* The opportunity cost of every investment in capital is forgone present consumption.

## The Production Possibility Frontier



- \* The production possibility frontier curve has a negative slope, which indicates a trade-off between producing one good or another.

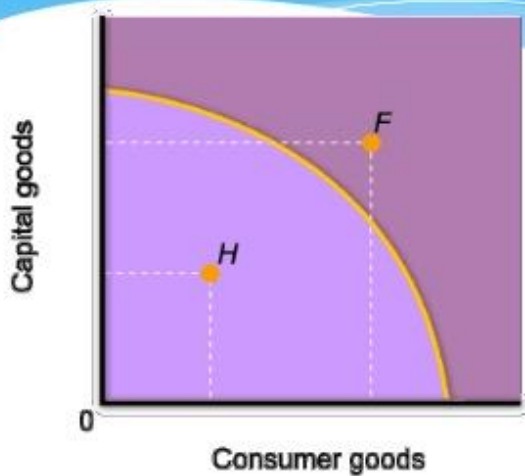
## The Production Possibility Frontier



\* Points inside of the curve are inefficient.

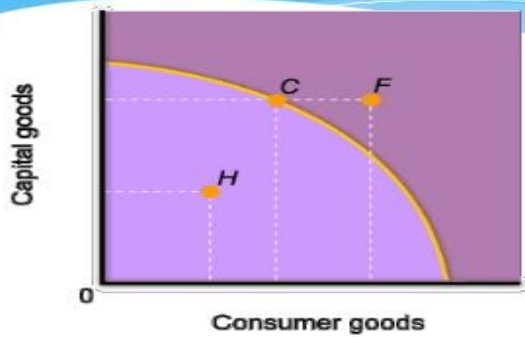
- At point *H*, resources are either unemployed, or are used inefficiently.

## The Production Possibility Frontier



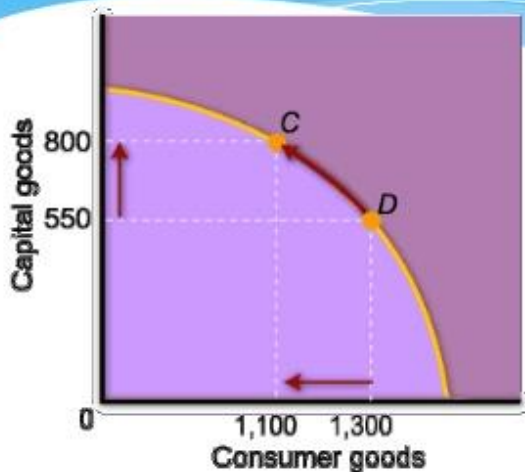
\* Point *F* is desirable because it yields more of both goods, but it is not attainable given the amount of resources available in the economy.

## The Production Possibility Frontier



- \* Point C is one of the possible combinations of goods produced when resources are fully and efficiently employed.

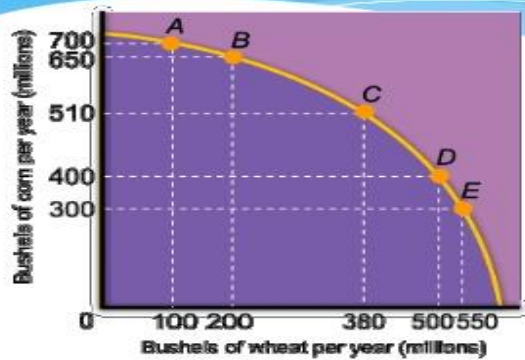
## The Production Possibility Frontier



- \* A move along the curve illustrates the concept of opportunity cost.
- \* From point D, an increase the production of capital goods requires a decrease in the amount of consumer goods.



# The Law of Increasing Opportunity Cost



- \* The slope of the ppf curve is also called the **marginal rate of transformation (MRT)**.
- \* The negative slope of the ppf curve reflects the *law of increasing opportunity cost*. As we increase the production of one good, we sacrifice progressively more of the other.