Unit 1 The basic economic problem – choice and the allocation of resources

Assessment: model answers

1  Because resources are scarce compared to human needs and wants, all societies must choose how best to allocate their resources to the production of different goods and services. Making a choice between alternative uses of scarce resources therefore always involves a cost in terms of what we have to give up in return. The benefit of the next best alternative foregone is the opportunity cost of that decision. Therefore, when a government increases spending on police and the armed forces there is an opportunity cost in terms of what the same amount of money could be spent on instead and the benefits it could create. For example, the same government could have increased spending on education, health care or infrastructure instead. The potential benefits of increased education, health care or infrastructure to society and the economy are foregone. Alternatively, governments could lower taxes on people and firms instead of increasing spending.

2  Resources such as rural land are scarce relative to our wants and there are competing demands for their use. Making a choice between alternative uses of scarce resources like land therefore always involves a cost in terms of what is sacrificed or given up in return. The benefit of the next best alternative foregone is the opportunity cost of that decision. Therefore, when rural land is developed other uses for the land are given up. For example, the benefit of the land as open space many people can enjoy for recreation is foregone. Similarly, the land could have been used for farming and therefore the benefit of the food it could have produced has also been given up.

3  Factors of production are used to produce goods and services. Economists classify factors of production as land (natural resources), labour (human effort), capital (man-made resources) and enterprise (business skills).

In the example of the RSPB, the organization has purchased land near the coast to provide a sanctuary for rare birds. It will also have used capital, such as construction equipment and machinery, and labour, to build the special visitor centres. In addition, labour and capital, such as computer equipment, will be needed to run the centres. Senior members with enterprise skills in the RSPB have combined and organized these resources to operate the organization.