Economic Concepts of Scarcity & Choice

Chapter 2

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Learning Outcomes

In this chapter we will:

- explain how scarcity of economic resources relative to wants results in choices being made between competing uses of resources; predict possible consequences of these choices
- explain how individuals, firms, businesses, non-governmental organisations (NGOs) and the government interact to produce, consume and distribute economic resources
- evaluate the opportunity costs involved in economic decisions made by individuals, firms and the government at local and national levels
- discuss the role of incentives and the motivating influences for individuals, firms, the business sector and the government in economic decisions; describe conflicting incentives with reference to local, national or international examples
- differentiate between individual markets and aggregate supply and demand; explain the difference in focus between micro and macro economics
- explain the idea of specialisation & how it applies to individuals/firms seeking to increase efficiency
- analyse how a cost-benefit approach supports effective decision- making; apply a cost-benefit approach to assess who enjoys the benefits and who bears the costs

What the LC Exam Rewards in This Chapter

You must be able to do three things (not just "know definitions"):

1. **Define** key terms precisely (scarcity, opportunity cost, incentives, etc.).
2. **Use diagrams** correctly (especially PPC) and explain what they show.
3. **Apply** concepts to real-life choices and **evaluate** consequences / trade-offs.

Command words (how to score marks)

- **Explain:** what it is + why it happens
- **Evaluate:** pros/cons + judgement
- **Discuss:** balanced points + examples
- **Analyse:** break into parts + link cause/effect

Your "must-have" toolkit

- 1 solid **PPC diagram** explanation
- 2 clear **opportunity cost** examples (micro + government)
- 2 **incentives** examples (including a conflict)
- A short **CBA** template you can apply to any policy

Core Idea: Scarcity → Choice → Trade-offs

Economics is about how people and society allocate **scarce** resources with **alternative uses** to satisfy **unlimited wants**.

Key terms (LC wording)

- **Needs:** essentials for survival (food, basic shelter)
- **Wants:** non-essential desires (new phone, holidays)
- **Scarcity:** not enough resources to satisfy all wants
- **Choice:** selecting one option means giving up another

Competing uses (simple examples)

- Student time: study vs part-time work vs sport
- Land: housing vs farming vs wind farm
- Government budget: healthcare vs housing vs transport

Economic Resources: Factors of Production (and Rewards)

Factors of production

- **Land:** natural resources (land, water, minerals)
- **Labour:** human effort/skills (workers, teachers, nurses)
- **Capital:** man-made aids to production (machines, tools, buildings)
- **Enterprise:** risk-taking + organisation (entrepreneurs)

Rewards (often asked)

- Land $\rightarrow$ **Rent**
- Labour $\rightarrow$ **Wages**
- Capital $\rightarrow$ **Interest**
- Enterprise $\rightarrow$ **Profit**

LC link: Scarcity applies to **all** factors (e.g. limited skilled labour; limited housing land; limited capital funding).

Consequences of Choices (What You Must Be Able to Predict)

When we choose one use of resources over another, we create winners and losers

- **Short-run consequences:** price changes, waiting lists, shortages, overcrowding, pressure on wages
- **Long-run consequences:** skills gained/lost, productivity, economic growth, inequality, environment
- **Unintended consequences:** policies/incentives can change behaviour in unexpected ways

Exam move: always link choice $\rightarrow$ opportunity cost $\rightarrow$ consequences (economic + social + environmental where relevant).

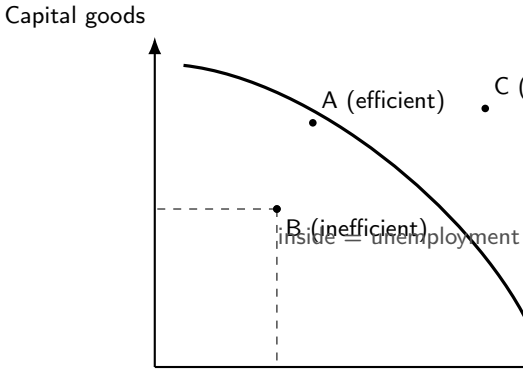
The Production Possibility Curve (PPC): Your Key Diagram

What the PPC shows

- maximum output possible with **current** resources/technology
- **trade-off** between two goods/services
- **opportunity cost** measured by the slope
- efficiency vs inefficiency

How to talk about points

- **On curve:** efficient production
- **Inside curve:** unemployed/underused resources (inefficient)
- **Outside curve:** unattainable now (unless growth)



Opportunity Cost (How to Write It for Full Marks)

Opportunity cost is the value of the **next best alternative** forgone when making a choice.

Individual (local level)

- working a shift → forgone study time / leisure
- buying a laptop → forgone holiday / savings

Firm / Government (national level)

- firm invests in machinery → less money for marketing / dividends
- government funds transport → less for health/housing (and vice versa)

Exam sentence template (steal this)

"The opportunity cost of _____ is the _____ that must be given up because resources are scarce."

Who Makes Economic Decisions? (Agents)

Main agents

- **Households:** consume, supply labour, pay taxes
- **Firms:** produce, hire labour, invest, pay wages/taxes
- **Government:** taxes, spending, regulation, public services
- **NGOs:** influence policy, provide services, advocacy

What you must be able to explain

- how decisions interact (e.g. taxes affect spending; wages affect demand)
- how resources are **produced, consumed, distributed**
- that incentives/policies change behaviour

LC link: When asked "explain how agents interact", describe flows of money, goods/services, and factors of production.

Incentives: Why People/Firms/Government Change Behaviour

Types of incentives

- **Financial:** wages, prices, profits, taxes, subsidies, fines
- **Non-financial:** reputation, convenience, rules, social pressure
- **Positive vs negative:** reward vs penalty

How to write it in an exam

- Identify the incentive
- Explain **who** responds and **how** behaviour changes
- State likely **outcome** (and any unintended effects)

One-liner: Incentives **matter** because people respond to **costs and benefits** when resources are scarce.

Conflicting Incentives (You Must Be Able to Describe These)

What "conflict" means

An incentive that **encourages one goal** can **discourage another** or harm a different group.

Local / national examples (pick 1–2 in class)

- **Carbon tax:** reduces emissions, but raises commuting/heating costs
- **Rent caps:** protects tenants short-run, may reduce supply long-run
- **Subsidies:** support a sector, but cost taxpayers / may distort choices

Exam structure (quick)

1. **Policy/incentive**
2. **Who gains? Who loses?**
3. **Short-run vs long-run effect**
4. **Judgement:** is it worth it? why?

Microeconomics vs Macroeconomics (Different Focus)

Microeconomics (individual markets)

- single market (e.g. housing, coffee, labour market)
- consumer and firm behaviour
- prices, demand, supply, competition

Macroeconomics (whole economy)

- total output/income (GDP/GNI)
- inflation (price level), unemployment
- fiscal/monetary policy, growth

LC link: **Individual markets** use demand/supply for one good; **aggregate** demand/supply looks at the overall price level and total output in the entire economy.

Specialisation: Efficiency (and Its Risks)

Why specialisation raises efficiency

- workers become more skilled through repetition
- time saved (no switching tasks)
- higher productivity $\rightarrow$ lower unit costs $\rightarrow$ potentially lower prices

Where you see it

- individuals (jobs/careers)
- firms (departments, assembly lines)
- countries/regions (industries clustering)

Costs / drawbacks (evaluation marks)

- dependence on others (supply chain risk)
- job monotony / deskilling
- economy vulnerable if one sector dominates

Exam tip: If asked to "**evaluate**", you must give **benefits AND costs**.

Cost-Benefit Analysis (CBA): The LC-Friendly Method

CBA compares the **total benefits** and **total costs** of a decision to judge if it is worthwhile.

A simple 6-step template you can apply to any policy/project

1. Define the **decision** and the **alternative options**
2. Identify **stakeholders** (who is affected?)
3. List **benefits** and **costs** (private + social)
4. Quantify where possible (money/time/health/environment)
5. Compare totals & consider **short-run vs long-run**
6. Make a **judgement** and justify it

CBA: Who Benefits and Who Pays? (Distribution Matters)

Quick stakeholder grid (exam-ready)

Group	Benefits	Costs
Local residents	e.g. jobs, services	e.g. noise, traffic
Businesses	e.g. sales, access	e.g. taxes, disruption
Government	e.g. growth, votes	e.g. spending, debt
Wider society	e.g. emissions cut	e.g. higher prices

Full-mark move:
Even if net benefits are positive, you must comment on **fairness**:
who gains vs **who loses**.

Mini example prompts

- bypass road / cycle lanes
- wind farm / data centre
- hospital expansion / new school

Exam-Style Check (Short Questions)

1) Definitions (2–3 sentences each)

Define: **scarcity**, **opportunity cost**, **incentive**, **specialisation**.

2) Diagram (PPC)

Draw a PPC for two goods. Label: **efficient point**, **inefficient point**, **unattainable point**. Explain what each means.

3) Application (CBA)

A local council is choosing between funding **more buses** or **more road building**. Use a cost-benefit approach and state **who benefits** and **who bears costs**.

Marking logic: definition + correct concept + application/example + (if asked) judgement.

Chapter 2 Summary (What You Must Be Able to Do)

If you can do these, you are on top of the learning outcomes

- Explain scarcity $\rightarrow$ choice $\rightarrow$ opportunity cost $\rightarrow$ consequences
- Use a PPC diagram to show efficiency, unemployment/underuse, growth
- Describe how households, firms, government and NGOs interact (circular flow)
- Explain incentives & give at least one **conflicting incentives** example
- Clearly differentiate micro vs macro (individual vs whole-economy focus)
- Evaluate specialisation (efficiency gains + risks)
- Apply a cost-benefit approach and identify winners/losers