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WHAT IS ECONOMICS?

A simple definition of Economics is;

THE MANAGEMENT OF MONEY OR RESOURCES

This management can vary from small amounts of money or resources to the management of vast sums. Resources are the things we rely on and include;

Electricity

Water

Gas Supplies

Minerals In The Earth

Food Supplies

We all have skills in economics, whether it is in managing pocket money or a large budget. The basic principles are the same;

HOW TO USE THE RESOURCES AT OUR DISPOSAL IN THE BEST WAY.

The 'best way' depends on the priorities we have. Priority means to think about the things which are important and then to decide which of these are the most important. There are some basic priorities which are important to humans. These are;

Food

Shelter

Warmth

The basic use of resources therefore is to have enough food to eat, to have a roof over our heads, and have enough power to keep us warm. Translating these into how we would spend our money would be;

Food Shopping And Some Stocking

Paying Rent/mortgage On Our Home

Paying The Gas And Electricity Bills

SIMPLE ECONOMICS

We have seen that there are some basic needs which **HAVE** to be met. After we have secured food shelter and warmth, priorities over which we have little choice because they are crucial, we then come to economics which are a little bit more complicated.

In most budgets there are resources left over after we have satisfied the basic needs. Economics then is employed to decide what to do with these resources. Among factors which determine what we will do are;

SHORT TERM PLANNING

MEDIUM TERM PLANNING

LONG TERM PLANNING

Short term planning may mean that we save some money to go towards the mortgage or rent payment next month. Medium term planning might include plans to save some money to buy a new television in six months time or so. Long term planning might be to pay money into a pension so that there will be some security in later life.

Besides these factors there are also other decisions to be made. We need to allocate resources in areas which are not essential but are desirable, and our pastimes, hobbies and general enjoyment.

Basic economics and the economics applied by large companies or the government are all similar in principle. What varies is that large resource economics are more complicated because there are more factors to consider and larger amounts at risk if bad decisions are taken.

EXERCISES

If you were in charge of your family's budget, how would you decide to spend the money? Make a list of priorities of the things which have to be supported, and what you would do with any money left over.

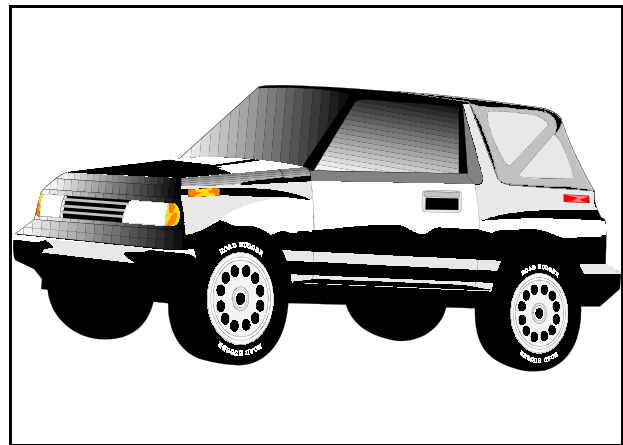
How does the management of resources of a household vary from the management of the resources of a nation?

SCARCITY

Scarcity in economic terms does not mean that something is rare. Scarcity refers to those items which are in greater demand than there is supply of them. The desires of people are many and varied whilst the supply of goods does not always reflect the needs of the people. In this way there is often a shortage of the things that people want. Many demands are created quickly, whilst the supply of these items can take a long time.

EXAMPLE.

A new car is launched by a leading manufacturer. Lots of people want to buy it. The problem for the manufacturer is that the demand is likely to be very great only for the first year or so and after that the steady demand can be met from its normal production. It is not viable for the company to have a second production plant turning out the car because the increased production is only required for a short time. This means that there is a scarcity problem for the product.



EXERCISE

Can you make a list of other items which are prone to scarcity? These could be things which are scarce only for a short time or ones which are scarce periodically. Things are often scarce because the resources required to make them are not available or are used to make something else. Fill in the exercise box below.

ITEM	WHY IS IT SCARCE?	WHICH RESOURCES ARE NEEDED TO SOLVE THIS SCARCITY?

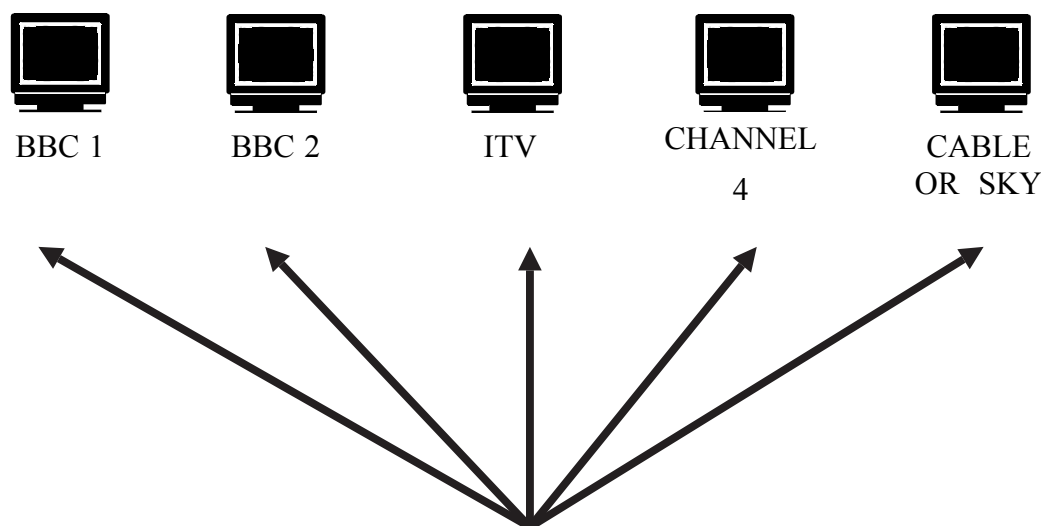
CHOICE

Due to a lack of resources and scarcity of goods, people are always making **choices** of what to produce and how much of it to make. We have to make decisions all the time about what to buy or do because we do not have unlimited money supplies. For example, you may decide not to go out so much so that you can save up for something special like a new mountain bike or Hi-fi.

In economics, choice plays a very important part.

EXERCISE

Consider your television watching habits. You have a choice of watching several channels



You make a choice every time you watch television because you can only watch one channel at a time. This choice making happens in many parts of your everyday life, and the life of the country.

The television station also makes choices about which programmes to show in order to attract the viewer.

EXERCISE

How Do You Choose What To Watch?

How Does The Television Station Choose What To Show?

Make a list of the type of programmes you watch. How do the television channels make their money? How does their choice of programming affect your choices? What other things do you choose NOT to do when you decide to watch television?

TYPES OF ECONOMIES

SUMMARY

The main problem in economics is that the desires of people are varied and great whilst the resources to produce these items are scarce and limited. Governments have to find a way in which to best meet the needs of the people whilst at the same time bearing in mind other things which are for the benefit of all or which are required as essentials.

There are three main types of economic system which can be used to try to achieve the best balance and results. These are;

THE FREE MARKET ECONOMY

THE CENTRALLY PLANNED ECONOMY

THE MIXED ECONOMY

These are discussed in greater detail on the following pages but in summary they have the following features:

FREE MARKET ECONOMY

All production is undertaken for profit.

There is complete freedom of choice in what a person decides to buy or which services to use.

There is no government involvement.

Everything is owned privately.

Prices are fixed according to the demand and supply situation

CENTRALLY PLANNED ECONOMY

All production takes place according to a plan decided centrally by government.

Profit is never the main motive.

All means of production are centrally owned.

There is no private property.

Prices are fixed according to the plan laid down by the government and do not have to reflect the price of production.

MIXED ECONOMY

Some production is carried out for profit whilst other production is planned.

Profit is the motive in many cases but not all.

Government is involved in some areas.

Some property is privately owned whilst some is not.

FREE MARKET ECONOMIES

The **Free Market Economy** does not exist in real life. It is a model which is used to illustrate what would happen if we had a totally 'free' market. The main features of the free market are;

All Production Is Conducted For Profit

There Is Complete Freedom Of Choice

There Is No Government Involvement

Everything Is Owned Privately

Prices Are Fixed Solely According To Supply And Demand

The advantages of a free market is that consumers are all important. If they want more of an item it will be reflected in buying power and so lead suppliers to produce more of that item. Similarly if there is no demand for a particular product it will not be manufactured.

The pricing mechanism works automatically and needs no control. Put simply, this means that supply and demand are directly linked where the price will be set by the amount of demand compared to supply. If there is too much of a product the price will fall, but if there is great demand for a product its price will go up.

The disadvantages of the free market is that there is likely to be a great divide between the rich and poor. The people who own the means of production would most likely become super rich whilst people who were workers would have to compete with other workers for who would work for least. In times of economic slump the unemployed would be without any support at all and if someone fell ill they would have to pay for treatment.

EXERCISE

Write about what life would be like in a free market economy if you were;

A WORKER

A FACTORY OWNER

OLD

DISABLED

CENTRALLY PLANNED ECONOMIES

There is no country in the world which is wholly centrally controlled and this type of economy is studied as a model of how life would be in such an economy. The **Centrally Planned**, or command economy, has the following features;

All Production Is Undertaken According To A Central Government Plan

Profit Is Never The Main Motive

All Means Of Production Are Centrally Owned

There Is No Private Property

Prices Are Fixed According To Need And Not According Supply And Demand

The advantages of the centrally planned economy are that there are plenty of the goods that are deemed necessary, and there is less difference between the wealth of rich and poor. There is much more stability in the economy because everything is planned and not left to market forces. There is also less of a chance that many products will be out of the reach of ordinary people.

The disadvantages are mainly that production can be very inefficient because there is no need to compete for prices. Planners can make the wrong decisions and then the products which are required most may never be produced. There is likely to be less choice as well.

EXERCISE

Write about what life would be like in a centrally planned economy if you were;

A WORKER

ONE OF THE PLANNERS

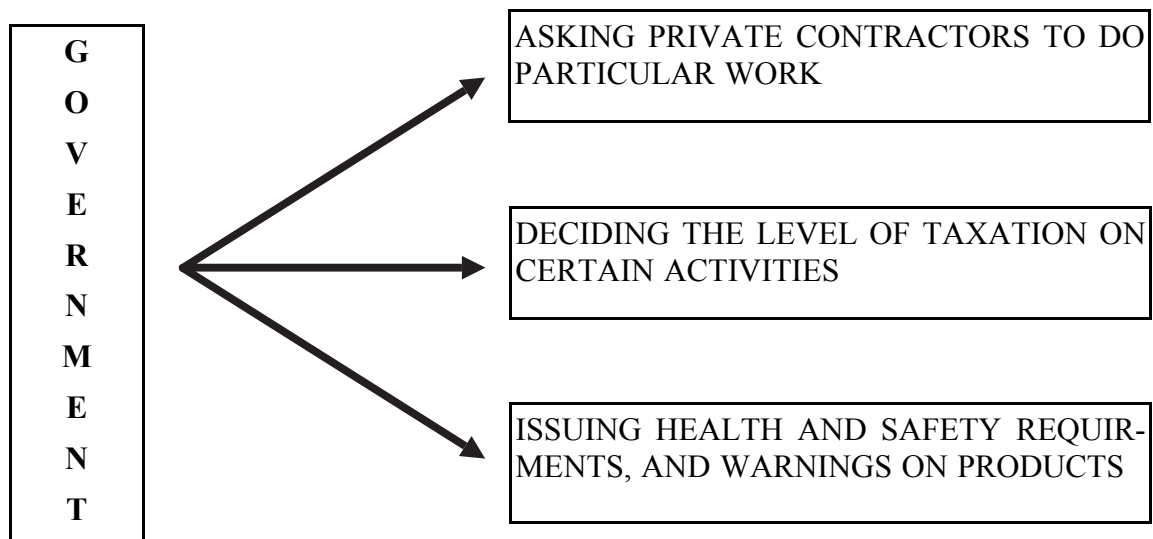
OLD

DISABLED

MIXED ECONOMIES

In the real world all economies are mixed to a greater or lesser extent. Even in the most planned economies there is some free market activity. Since 1990 there has been a trend for centrally planned economies to become more liberalised and have developed free market tendencies.

In a **Mixed Economy** the government allows free market activity in many things whilst controlling others. An example of this may be the road building programme where the government pays for private companies to build roads. The government also controls free market activity through taxation. In some areas where the government wants activity to develop it may offer cheaper taxes and rental options. Similarly in other areas of industry the government may levy high taxes which depresses activity. The government influences free market activity in three main ways;



EXERCISES

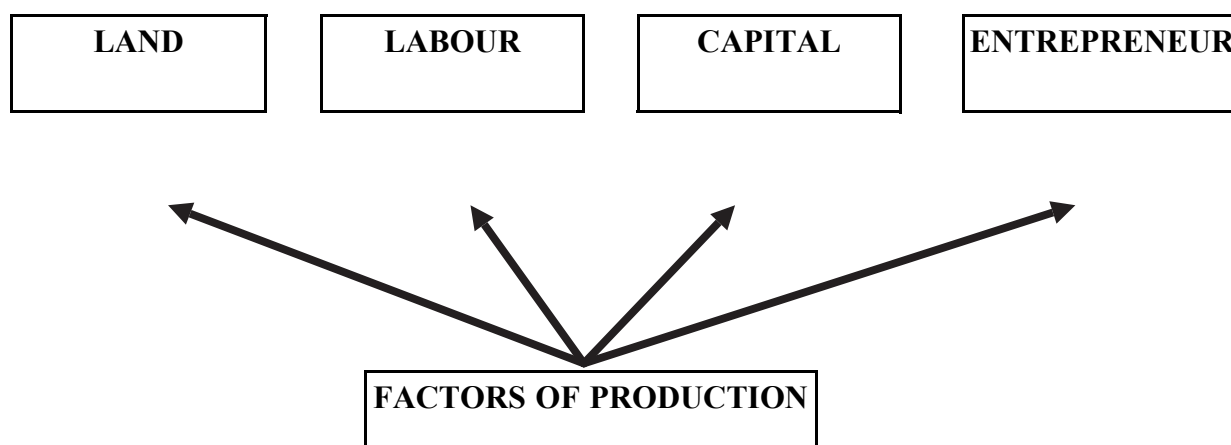
Can you think of practical examples of how the mixed UK economy balances the central control of government with the free market impulses of business?

Find out about a country with a more centrally controlled economy than the UK, and a country with a less centrally controlled economy than the UK. What factors led these economies to be the way they are?

What does the UK government's privatisation policy between 1990 and 1996 tell us about the direction in which the U.K. economy has been going?

FACTORS OF PRODUCTION

The **Factors Of Production** is another way of referring to resources. The factors of production can be defined as four main features;



Land is defined as that which is 'given free by nature'. These things include the rivers, sea, mountains, fields and natural deposits. Used in its natural state land has no cost of production, but does incur a cost if it is manipulated. An example of this is peat bags which gardeners buy. The peat is natural but there is a cost in collecting, bagging, and moving it to the garden centres.

Labour is the human effort which is expended in the production process. The cost of this is the wages paid to people who work. The availability of labour is also important and depends on things like the size of the population, the average age of the working population, and the sex structure of the population.

Capital is divided into two categories; **Fixed Capital** and **Working Capital**. Fixed capital includes the buildings which make up a factory, and machines. Working capital is mainly the stocks of raw materials, money, and finished goods.

The **Entrepreneur** is the person or people who manage the above three factors. The entrepreneur also risks his or her own investment if the product is not popular or if a misjudgement leads to collapse.

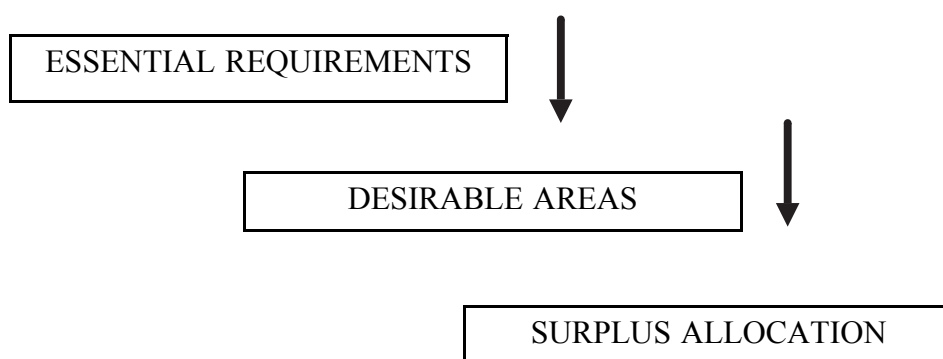
EXERCISE

Choose a local company and make a list of the resources it uses. Use the above classification of resources to list your findings.

ALLOCATION OF RESOURCES

The **Allocation Of Resources** varies depending on what the **Priorities** are. Resources are limited and almost always less than the demand which exists. It is necessary to target the resources available effectively in order to meet the demands of the nation.

We all make decisions about the allocation of resources. From pocket money to government we must all make choices. It can be said that there are three areas of priority when allocating resources.



Essential resource allocation would include ensuring that enough food, power, and homes are available for the population. Desirable features might include that there are private cars and electrical goods available for purchase. Surplus allocation might be improving existing provision or developing services which are not essential but which will improve the wellbeing of the people.

EXERCISE

Make a list of what the essential requirements of your school are, what the desirable areas for development might be and how any surplus resources might be spent.

ESSENTIAL REQUIREMENTS	DESIRABLE AREAS	SURPLUS RESOURCES

DIVISION OF LABOUR

The **Division Of Labour** refers to the very specific jobs which people do. In the past it was possible for one person to oversee the production of a simple product from the beginning of the process to its completion. Today it is virtually impossible to find a job in which the same worker will start with the raw materials and end up with the finished product. Specialization can be seen in most industries.

EXAMPLE.

In a biscuit factory there are people who sort out the sacks of raw materials, others who mix the ingredients, others who will produce the shape and consistency of the mixture, still others who will work in the baking process, and others who will pick, pack and load the finished product onto vans and trucks for delivery.

The advantage of the division of labour is that there is far greater output because a worker can become skilled at a fairly simple task and then repeat it over and over again and become very fast. In some cases machines can be built to do each simple task. When there are a series of simple task machines working together they may be able to produce a very complicated product. It is also easier to skill workers to do a simple operation than it would be to train someone in all aspects of the job.

The disadvantage of this is that the jobs are very boring and repetitive. Workers feel no commitment to the product because they do not see the product being developed. It is also possible for workers to disable a company in a strike. If the workers who perform a particular task on a production line went on strike it would bring all other operations to a halt as well.

EXERCISES

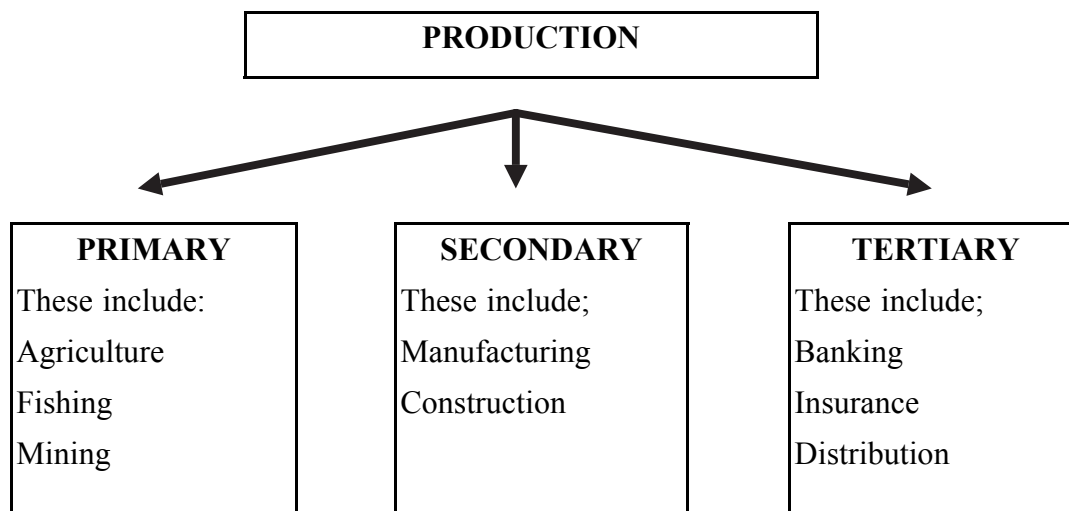
Make a list of industries which rely most on workers doing very specific tasks.

Which industries do not use the division of labour to a great extent to improve their productivity?

If you were a worker on a production line, how would you feel about doing the same job day after day?

TYPES OF PRODUCTION

There are three **Types Of Production** which can be listed as;



The important thing to remember about these classifications is that they are a guide only. Some types of production sit comfortably in one or two of the sections defined. Can you think of any which do not fit neatly into the categories above?

In the West there is a tendency away from the first two areas and increasingly the tertiary or **Service** industries are growing fastest. One of the reasons for this is that the price of labour in some Third World countries is cheaper than in the West which means that in these areas of industry they can compete better than the West.

EXERCISES

Make a longer list of industries which fit into the three categories outlined above.

What do we mean by the **West**? Is it fair to keep talking about the **Third World** when some of these nations have a greater manufacturing output than the UK?

Why are **Service** industries growing in the west? Why is manufacturing decreasing?

DEMAND

Demand in an economics context means the desire of people to acquire an item and includes their ability to purchase it. Most people may want to own a computer but only some people can afford it. In this sense only those who can afford to buy a computer are seen as making up a demand. Another way economists often describe this distinction is by talking about '**effective demand**'.

There are many factors which affect demand including;

The Price Of The Product

Seasonal Factors

The Availability Of Other Similar Products

A Change In Tastes

Crisis In Confidence

Demand for a product can vary greatly depending on how many people want the product. There may often be a waiting list for some products whilst others will sit on shelves for many months without anyone showing any interest. Demand for products can vary depending on the item in question. In the middle of Summer childrens plastic paddling pools are often sold out in shops, but there will be no demand for them in Winter. If the product is priced cheaply there will be more people who can afford it and demand will rise. If other similar products are available demand might decrease as people make a choice between the products. If there is a crisis in confidence then a product may become less popular. A good example of this is the Beef Crisis in the UK which led to people losing confidence in British beef and led to a change in preference to other meats like pork or chicken.

EXERCISES

Can you think of any products which have increased demand due to seasonal factors?

How important is price when considering the demand for a product?

Can you think of other factors which affect demand?

SUPPLY

Supply means the ability of the producer to make available the goods which are demanded. As with demand there may be a desire for the supplier to make more goods available but economists are only interested in the actual ability to do so. A computer supplier may dream of every home in the U.K. having a computer, but that is of little use if the output of the suppliers cannot match the number of homes in the UK.

There is a direct relationship between supply and demand. If the demand increases then the supplier will try to increase the supply to meet it.. If demand decreases then the supplier would reduce production of that product.

Factors which affect supply include;

The rise in price of a similar product. This means that if a farmer who plants potatoes finds that the price of sugar beet is better, he or she is more likely to plant sugar beet next time.

The rise in price of a complement product. An example of this is if a farmer finds the price of straw going up he is more likely to plant wheat because the part of the wheat which is not required is straw which can be sold for animal bedding or feed. In this way the farmer gets two products out of one activity.

A reduction in the cost of production means that the supplier can make the same product for less money and hopefully make a bigger profit when the product is sold.

Taxes and financial penalties or **tax holidays** will influence the supplier because depending on how the government treats the Suppliers profits, the supplier will be more or less active.

EXERCISE

Choosing one industry write about how different circumstances would affect its performance and its future. Consider the following factors:

**There Is Great Demand For The Product,
Similar Products Are Being Imported Which Are Much Cheaper,
The Government Is Offering Subsidies For This Type Of Production**

COSTS AND PROFITS

There are two main types of costs which need consideration. **Direct Costs** are ones which vary with output. If it costs £20 to produce one table, it will cost £40 to produce two. This in simple terms is the direct cost. The more units that are produced means that more raw materials have to be purchased. This is sometimes called variable cost because it varies with increase or decrease in production.

Indirect Costs are the costs which usually remain the same. These might be the cost of rent on the factory. This will be the same whether one unit or a thousand units are produced. These are sometimes also known as fixed costs.

All businesses incur both direct and indirect costs. The amount of costs have to be limited to a useful minimum otherwise the profits would be less. The minimum in this case refers to the amount of resources required to function as planned. If the company does not have enough raw materials then the amount of units produced would be fewer than required but if the company had massive stocks then the money is 'tied up' and cannot be used for other purposes.

Profit is the amount of money which the company makes after it has paid its costs. If the total income was £40,000 and the costs were £30,000 then the total profits would be £10,000. This amount is called **Gross Profit**. The company has to pay taxes and incurs other costs. The money left over after paying all taxes is called the **Net Profit**.

Businesses sometimes reinvest some of the profits in order to improve machinery or the ability to produce more. Often the real profit which goes into the pockets of the owners can be very much lower than the Gross Profit and in some cases the company can even end up in the **Red**. This means that the company has spent more money than it has made.

EXERCISES

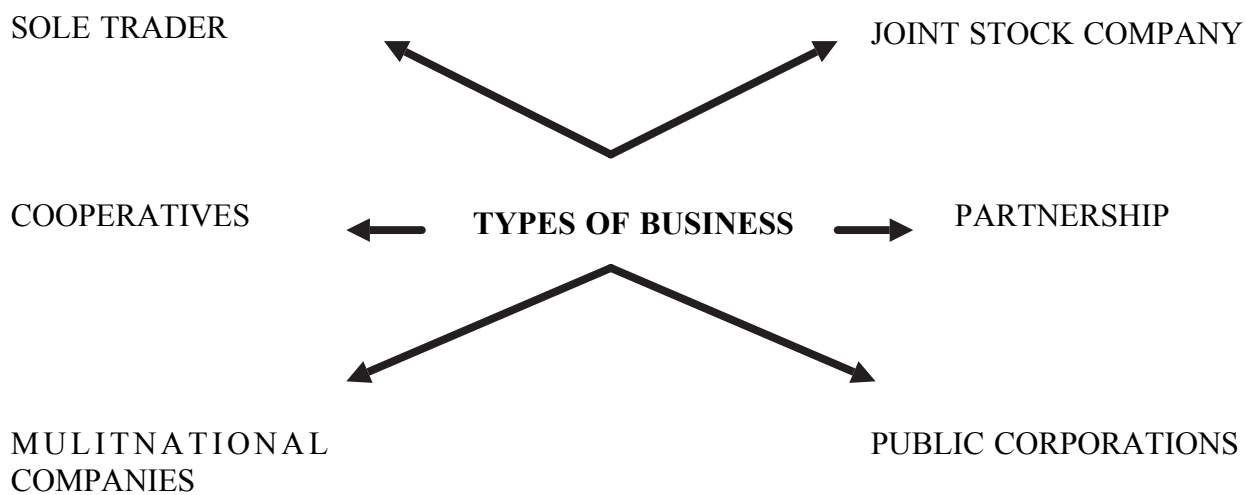
How do businesses work out how much to charge for their products in order to ensure that they make profit but also that their products are not too expensive?

What can happen to a company which goes into the red?

TYPES OF BUSINESS

SUMMARY

Businesses are organised in many ways, but mainly there are six types. These are;



As well as categorising businesses as being in the Primary, Secondary and Tertiary sectors, it is sometimes useful to categorise them according to the type of ownership as illustrated above. There is also another distinction to recognise. This is between to **Privately** owned Business and the **Publicly** owned Business. On the following pages you will find descriptions of some of these businesses.

EXERCISES

When should businesses be categorised in terms of their ownership rather than the sector of production in which they operate?

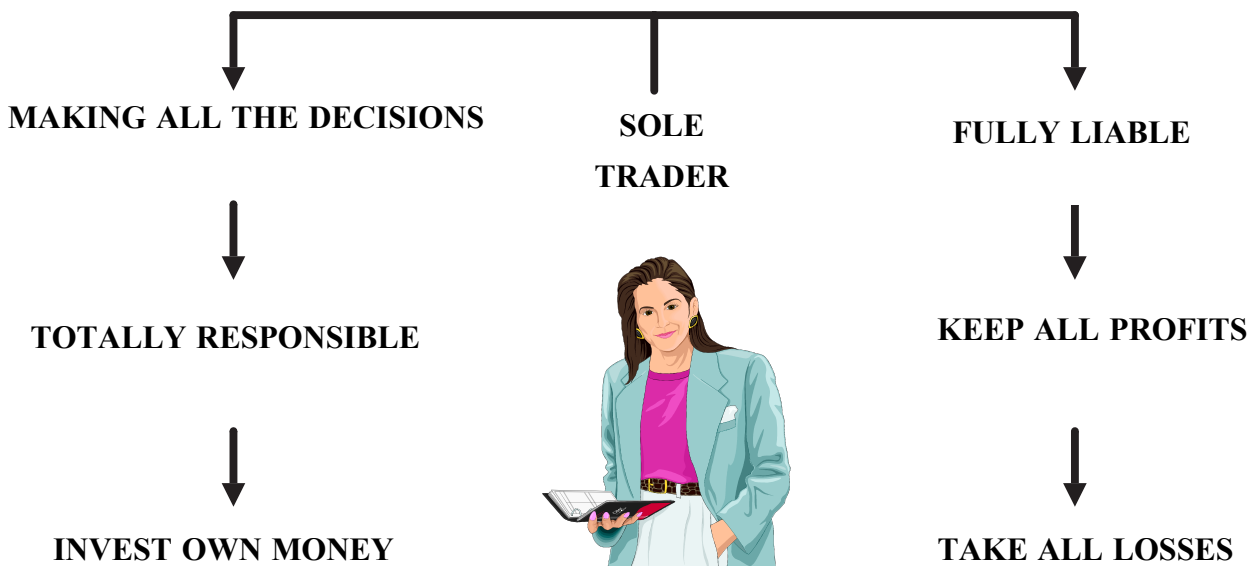
What is the difference between privately owned and publicly owned businesses?

SOLE TRADER

The **Sole Trader** type of business is the most common form of business in the UK. Put simply the sole trader is a single person owned business. This single person makes all the decisions of the business and is fully responsible for all activity. Being a sole trader does not mean that no one else works in the business. The business is owned by only one person but he or she may employ many people to work for him or her.

The advantages of being a sole trader is mainly that the person is very motivated because the profits made are all for him or her. The harder the sole trader works the more money he or she can make. The amount of money made by increased effort directly benefits the trader. Other advantages of the sole trader setup is that decisions can be made very quickly because the trader has only himself or herself to consult, and there is generally more flexibility in the operations of the business.

The disadvantages of this type of business is that there are limits to what one person can do. This matters in terms of raising money for expansion, being responsible for every decision, and the problems which can arise if the person is unable to work due to illness. The sole trader often also has unlimited liability and could end up losing home and possessions if the business fails and debts remain outstanding.

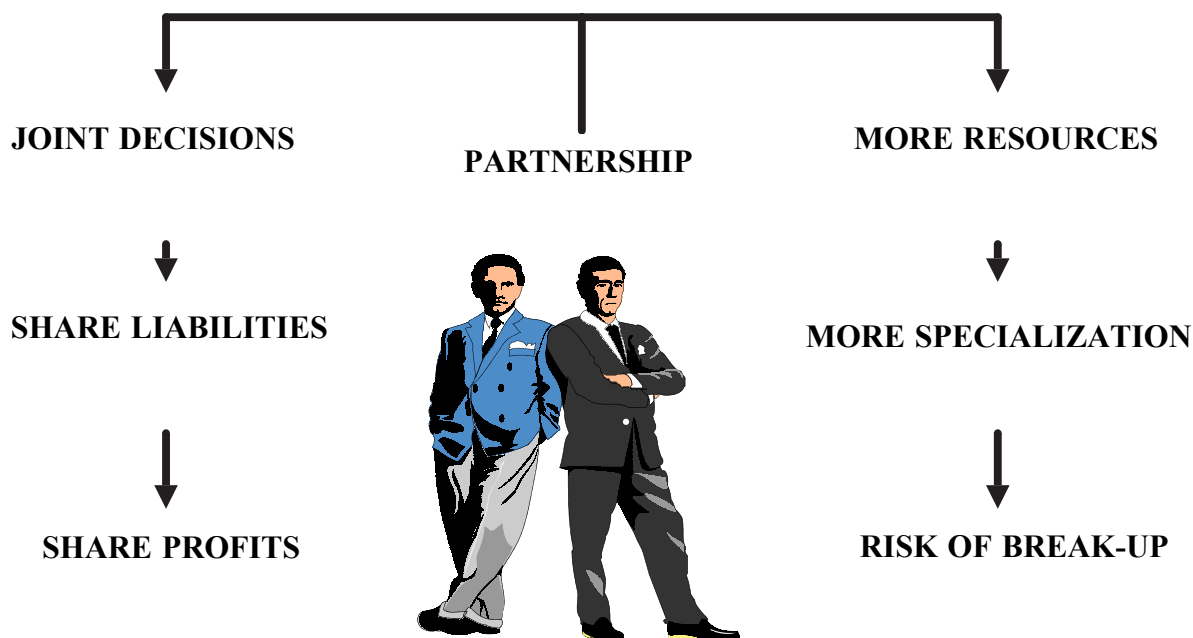


PARTNERSHIP

Often the way in which a sole trader expands is to become a **Partnership**. Other partnerships are formed at the very beginning of a business venture. A partnership can be two or more people and as the word suggests many of these give equal responsibility and liability to each partner. There can of course be partnerships where there is a major partner and one or more junior partners.

The advantages of a partnership can be that '**two heads are better than one**'. Where there is more than one person making decisions then often by pooling ideas and comparing strategies there is less chance of making expensive mistakes. In partnerships there is also scope for specialization. In a partnership responsibilities can be shared so that, for instance, one partner who is good at figures can concentrate on that side of the business and is likely to be more efficient than the other less mathematically minded partners. There is also likely to be more money and resources available to partners as each of them will contribute to the setting up and running of the business.

The disadvantages of a partnership are mainly that the independence which the sole trader enjoys is missing. All partners can reasonably expect to be consulted on decisions which means that there is less flexibility and speed in decision making. There is also the common problem of partners ending the relationship because of disagreements, illness or death of one partner.



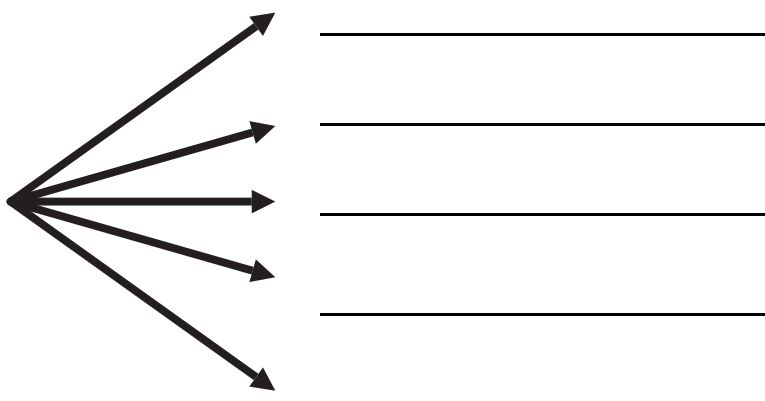
JOINT STOCK COMPANIES

Write a short description of what a Joint Stock Company is.

What are the advantages of a Joint Stock Company?

What are the disadvantages of a Joint Stock Company?

THE FIVE MAIN FEATURES OF
A JOINT STOCK COMPANY ARE:



MULTI - NATIONALS

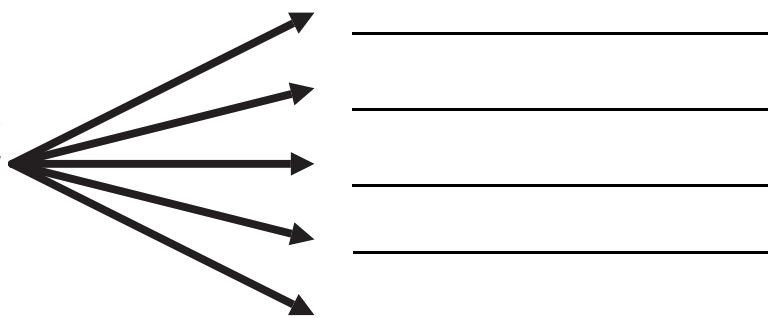
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Write a short description of what a Multi-National Company is.

What are the advantages of a Multi-National Company?

What are the disadvantages of a Multi-National Company?

THE FIVE MAIN FEATURES
OF A MULTI-NATIONAL
ARE;



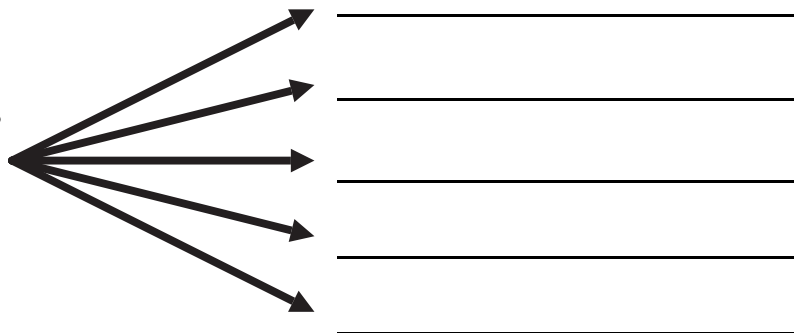
COOPERATIVES

Write a short description of what a Cooperative is.

What are the advantages of a Cooperative?

What are the disadvantages of a Cooperative

THE FIVE MAIN FEATURES
OF A COOPERATIVE ARE;



PUBLIC CORPORATIONS

Write a short description of what a Public Corporation is.

What are the advantages of a Public Corporation?

What are the disadvantages of a Public Corporation?

THE FIVE MAIN FEATURES OF
A PUBLIC CORPORATION ARE;

