

The resource allocation problem

Limited resources lead to scarcity which leads that every economy has to choose what Gs&Ss to produce with their limited resources. Some economies are better off while others do not possess so many resources as they would need.

Resource allocation - is choosing what to produce and how much land, labour and capital we will need to produce certain Gs&Ss

The basic economic questions

What to produce? What Gs&Ss will be produced? In scarcity not all of them can be taken care of.

Which needs and wants will be satisfied?

How to produce? Choosing which method of production to use.

For whom to produce? Whose wants and need will be satisfied? This depends on peoples opinions or it involves a value judgement.

Economic systems

How a national economy answers the basic economic questions is called an economic system.

Market economy - questions

What to produce? Only what is desired by the consumers

How to produce? The cheapest method available.

For whom to produce? The one's with the most money.

Market economy

Firms and households in the private sector determine the allocation of resources.

There is no role for government.

All resources in the market economy are owned by people and firms - all of them make as much profit as possible.

If a product or service is selling well firms increase the price they charge for higher profit as they know that people will still buy it.

Price mechanism

High prices indicate the desired products by people.

Low prices indicate the firms should change the allocation of their resources.

Advantages of the market system

The free market responds quickly to people's wants Private firms adapt quicker to make more profit.

Wide variety of Gs&Ss They want to meet consumer's wants.

Encouraging new and better methods and machines to produce Gs&Ss

The market system relies on producers to decide the basic questions There is no need to employ people to make decisions.

Disadvantages of the market system

Factors of production will be employ only if they are needed People will become unemployed.

Free market can fail to provide some Gs&Ss Public goods - street lighting or flood barriers, etc.

Disadvantages of the market system (cont)

The free market encourages consumption of harmful Gs No regulations by government.

The social effect of production may be ignored No pollution regulations by government.

The free market allocates more Gs&Ss to consumers who have more money than others Wealthier people can have better financial freedom.

These are the reasons why mixed economy is needed.

The mixed economy - questions

What to produce? Based on regulations by the government.

How to produce? Coping with regulations but still the cheapest way.

For whom to produce? For those who want to buy it.

The mixed economy

Ownership and decision making over the scarce resources are split between private and public sector.

Mixed economy combines market system with and interference of government.

Still the aim is to make as much profit as possible.

Government also owns some scarce resource which they think their country needs and wants.

The benefits of mixed economy

The government can provide public Gs Such as defence, street lightning or merit goods like healthcare or education.

They get money for this by taxing people.

Government also owns some scarce resources In case of need government can provide.

Reducing unemployment Creating job spots in public companies.

Decrease the consumption of harmful Gs They make them illegal.

Prevent pollutions Places fines and restrictions on pollution done by firms.

Planned/Central economy - question

What to produce? government decides

How to produce? government decides

For whom to produce? for everyone

Planned/Central economy

An extreme opposite of a market economic system.

Almost all decisions are taken by organizations owned or accountable to government.

Individual consumers, firms and households have little control over the allocation of resources.

The government provides information to firms what exactly they should produce and where people should work.

Firms have no motivation to do better and the quality of goods was poor or there was a shortage.

Developed and less developed economies

Developed economies Countries with a high level of economic development.

High average income, good quality housing, legal and education systems, modern infrastructure and wide range of industries.

Less-developed economies Developing countries with a low level of economic development and well-being.

Overpopulation An economic condition when there are too many people and too few resources.

Reasons for the underdevelopment of an economy

High population growth Available Gs&Ss have to be shared among more people.

Dependence on the production and sale of agricultural products Developed countries buy resources at low prices and proceed to make Gs&Ss that they sell to less developed countries at high prices.

Poor infrastructure Poor transport and communication networks.

Reasons for the underdevelopment of an economy (cont)

Lack of capital LDC's have to spend their tight budget on food for their enormous population there is no more money for them to spend elsewhere.

Low quality of education Low levels of skills and qualification.

Possible solutions or cures for underdevelopment

Self-help Some countries believe, that LCD's should not rely on help provided by other states.

Foreign aid **Food aid** - necessary but if free food is given to LCD's their local products will not be sold - urbanizations to find work in the cities

Financial aid - giving money to developing countries on condition that they spend it on a particular project e. g. an airport. Usually providing countries depend on buying the material needed for this from them at high prices. LCD's have no say to decide how to spend this financial aid.

Possible solutions or cures for underdevelopment (cont)

Technological aid - developed countries sometimes provide LCD's with machinery and technology. The problem is that there are very few people who can work with it.

Borrowing LCD's may be unable to repay it.

Trade Producing and selling Gs&Ss to developed countries would help LCD's out but developed countries are not willing to buy them because they fear unemployment. Once LCD's become richer, they may buy Gs&Ss also from developed countries.

Population control More people in poor countries means less resources per person. Better education on family planning would help to reduce population growth and to improve standards of living.



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Page 3 of 3.

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