Factors of production

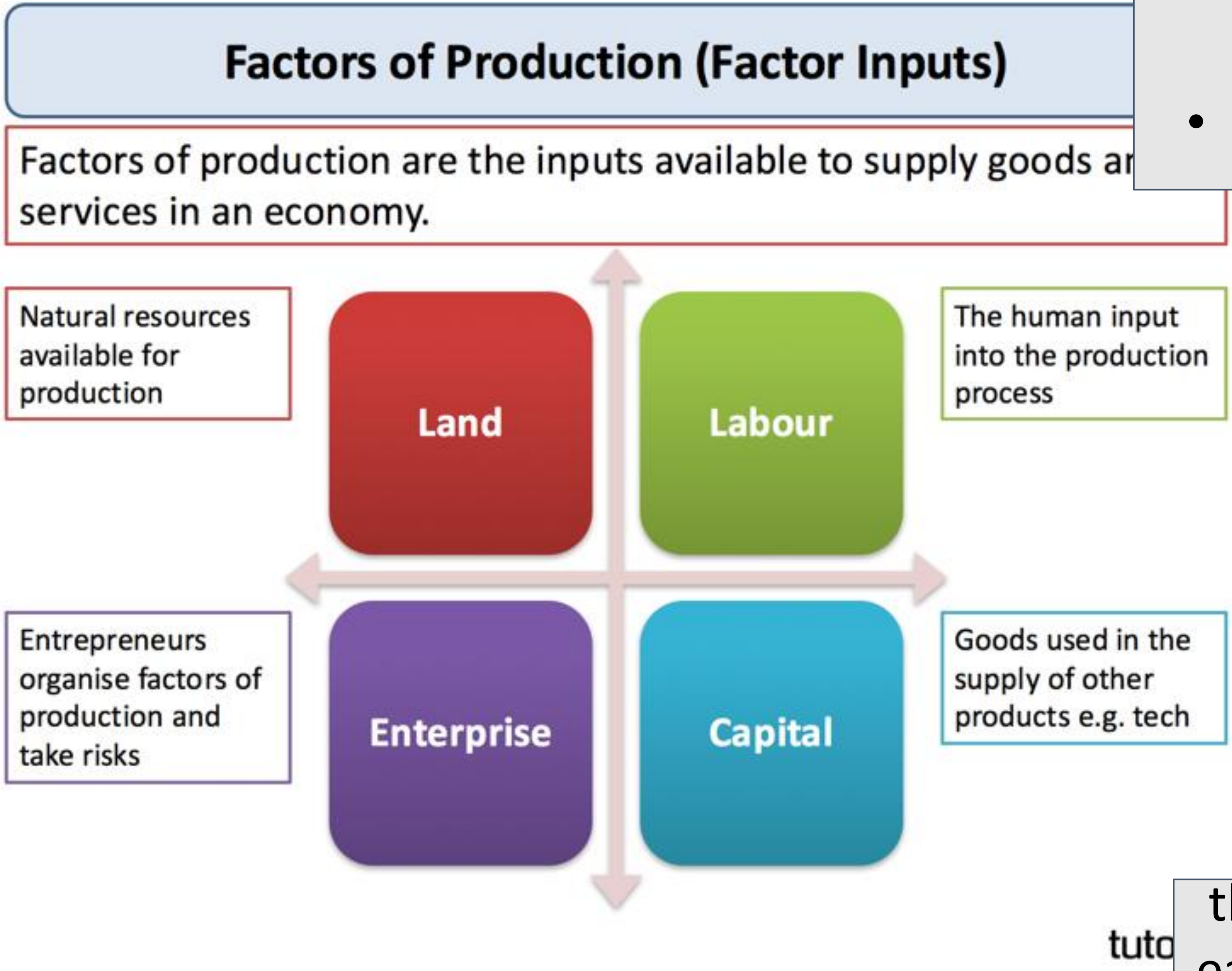
Chapter 1

Scarce resources

It also includes mineral deposits below the earth and the climate above, as well as the small area of land that makes up a farm or factory.

the income that is generated (rent)

profit



Not available

- above or below the working population age
- some choose not to work.

Wage/salary

Capital goods help land and labour produce more units of output – they improve the output from land and labour.

the rate of return that is earned (interest)

Factors of production: anything that is useful in the production of goods and services.

Land: natural resources in an economy.

Labour: human resources available in an economy.

Capital: a man-made aid to production.

Entrepreneur: organises production and is willing to take risks.

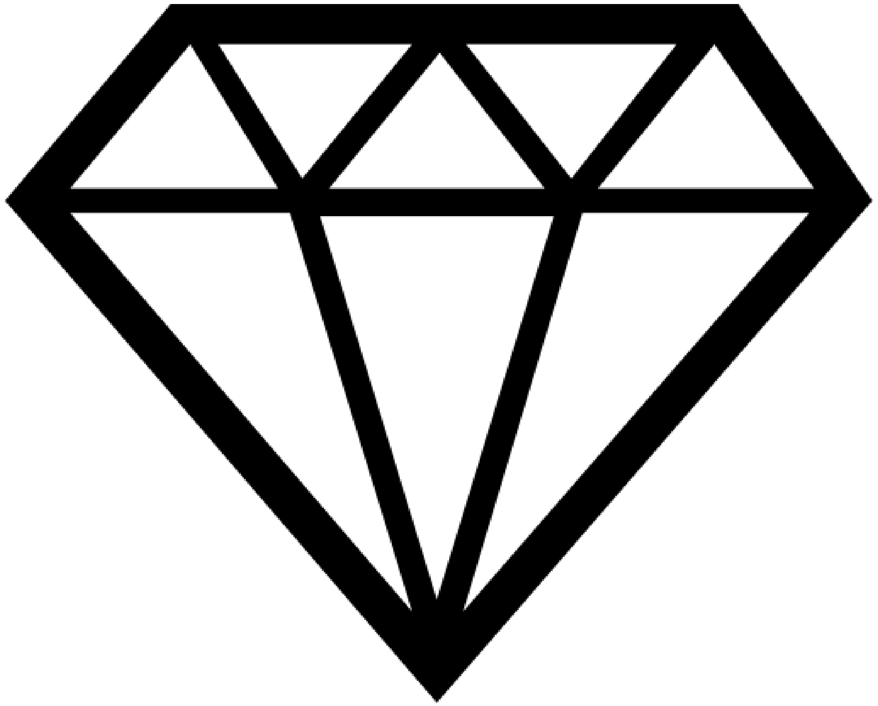
Production and consumption

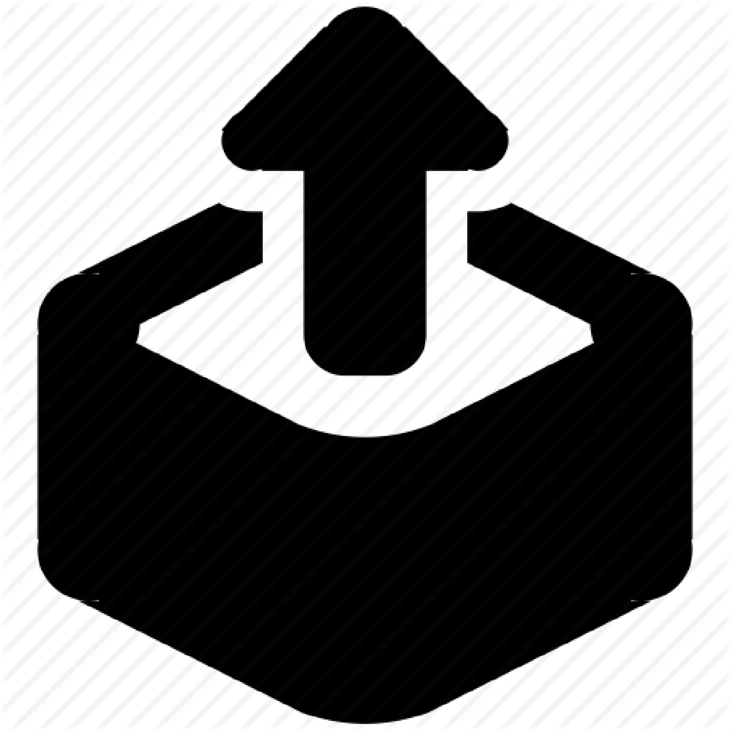
Resources are combined in the process of **production** to create goods and services. Goods and services have the capacity to satisfy wants. The process through which individuals use up goods and services to satisfy wants is known as **consumption**. Some goods, such as a chocolate bar, are quickly used up to satisfy our wants. Other things satisfy wants over a longer period. These are called **consumer durables**.

Production: the process of creating goods and services in an economy.

Consumption: the process by which consumers satisfy their wants.

Unlimited wants





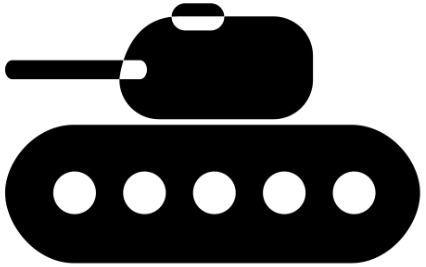
Our wants are continually expanding, developing and changing.

Basic questions: what to produce, how and for whom?

1. What to produce?

Because we cannot produce everything, we need to decide what to produce and in what quantities. We have to choose:

- Produce lots of good and services to improve our standard of living
- Produce lots of military hardware to improve our defences



2. How to produce?

This question arises since resources are scarce in relation to unlimited wants; we need to consider how resources are used so that the best outcome arises.We need to consider how we can get the maximum use out of the resources available to us. It should be noted, however, that other issues besides purely economic concerns should be considered when deciding how to produce. The decision to maximise output and satisfy more wants would need to consider the full impact on the environment and any potential long-term health risks.

3. For whom to produce?

Because we cannot satisfy all the wants of all the population, decisions have to be taken concerning how many of each person’s wants are to be satisfied.In some economies there are deliberate attempts to create a more egalitarian society through policies that redistribute wealth and income from the rich to the poor. This could be achieved through progressive taxation systems. In other economies there are no such policies and inequalities of income and wealth, often based upon inheritance, remain extreme. As an issue, it has become very significant in most emerging economies with a widening gap between rich and poor.

Meaning of the term ‘ceteris paribus’

The Latin phrase ceteris paribus is commonly translated as ‘other things remain equal’. The idea behind this is to be able to simplify an actual situation by assuming that apart from a single change of circumstances, everything else is unchanged.

The ‘margin’

Like ceteris paribus, this is another tool that is used by economists to simplify a situation. Many aspects of microeconomics involve analysing decisions ‘at the margin’. By this we mean that a small change in one economic variable will lead to further (small) changes in other variables. Looking at things in this marginal way is a means of being able to predict what the impact of change might be.

The ‘time dimension’

- The short run is a time period in which it is possible to change only some inputs. Typically it is when labour, a variable factor of production, can be increased or decreased to change output. So, with all other factors of production remaining the same (ceteris paribus), a firm taking on more workers may be able to increase its output.

- In the long run, it is possible for all factors of production or resources to change. So, in the long run, a firm may improve the quality and quantity of its capital by building a new factory to increase its output. This will usually allow it to be more efficient since the firm has had time to evaluate how best this can be done successfully and efficiently.

- The very long run is where not only are all factors of production variable, but all other key inputs are also variable. These key inputs can include technology, government regulations and social considerations.

The ‘time dimension’

Key terms

Short run: time period when a firm can only change some and not all factor inputs.

Long run: time period when all factors of production are variable.

Very long run: time period when all key inputs into production are variable.