

The Basic Economic Problem: Scarcity

The basic economic problem is **scarcity**.

Scarcity exists because there are **finite resources** available to satisfy **unlimited human wants and needs**. These scarce resources are known as the **factors of production**.

As it is impossible to satisfy every want, consumers, producers and governments must make choices about how scarce resources should be allocated.

Scarcity creates three key questions:

- **What to produce?** Should resources be used to produce cars or trains?
- **How to produce?** Should production use more workers or more machinery?
- **Who to produce for?** Should goods and services go to those willing and able to pay the most, or those most in need?

Scarcity and Prices

In a free market, scarcity can influence prices.

Generally, the **scarcer a resource is relative to demand, the higher its price is likely to be**.

Renewable and Non-Renewable Resources

Resources can be classified as either **renewable** or **non-renewable**.

Renewable Resources

Renewable resources can be **naturally replenished** and therefore used repeatedly over time.

For example, **wind energy** is renewable because wind is naturally replenished.

Non-Renewable Resources

Non-renewable resources **cannot be naturally replenished at a rate fast enough to keep up with their consumption**.

Examples include:

- Oil
- Coal
- Natural gas

Continued consumption of non-renewable resources will therefore reduce the amount available for future use.

Opportunity Cost

Opportunity cost is the value of the next best alternative forgone when an economic decision is made.

Opportunity cost exists because scarcity forces economic agents to make choices. Choosing one option means giving up the benefits that could have been gained from the **next best alternative**.

Opportunity cost therefore applies whenever **scarce resources have alternative uses**. Every resource allocation decision involves sacrificing the next best alternative.