

Unit 1 Resource allocation and making choices

Economic choices

Economics is all about choices. People are faced with choices every day. Should we walk to school or take the bus? What should we eat for lunch? Similarly, businesses also need to make choices, such as what products or services they will provide, while governments need to decide how to spend taxpayers' money. When investigating each of these choices the potential consequences that will affect society need to be addressed. Whatever choice people, businesses or governments take, they will miss out on the alternatives they did not choose. As economists, we look at how to choose the alternative that will bring the greatest benefits as well as the consequences of the actions we choose to make.



chapter 17

Source 1 A food market is an example of the economic choice made by a fruit and vegetable business choosing to sell their products to consumers, and buyers making the choice to purchase the products that will benefit them.

17A

How do individuals and businesses make economic choices?

- 1 If someone gave you \$50, what would you spend it on? Why?
- 2 What is the main goal of a business?

17B

Why is there a relationship between consumers and producers in the market?

- 1 What would you do if your favourite drink doubled in price? Would you still buy it?
- 2 Why do you think businesses have sales, where they lower the prices of their products?

17.1 Making rational decisions

As economists, we look at how to make the right choices in a logical and thought-out way. While going with our gut feeling can be a more exciting way of doing things, a more carefully considered approach can help us make informed decisions. This means that we need to consider all of the factors involved. Although individuals and businesses should both take the same logical approach to making decisions, they have different motives and will have to consider a different range of factors.

The needs and wants of individuals

Making economic choices is quite tricky when it comes to individuals. This is because individuals have a wide range of **needs** and **wants**. Generally speaking, a rational person aims to make choices that will fulfil their basic needs for survival, such as food, water and shelter. They also consider what will bring them the most satisfaction, such as owning a new smartphone. These desires that are not necessary for survival are called wants (see Source 1). While this may seem rather simple, distinguishing between the two can be a very important part of making economic decisions.

Distinguishing needs from wants

While you may feel like you need a mobile phone, it is not something that is necessary for your survival. In our society, there are many pressures that make people feel that items they want are actually items they need.

This kind of pressure can come from businesses. The goal of a business is to make a **profit** for its owners. Businesses will find clever ways of persuading you that you need to buy their products. They develop flashy advertisements to display on billboards, TV and radio. They also pay celebrities to promote their

products in movies and magazines. The average Australian sees thousands of advertisements a day without even realising it, all of which are trying to influence them to buy a product.

Sometimes we feel pressure from our peers to buy a product. If everybody else has the latest smartphone and we don't, we might feel like a **social outcast**. Without these pressures, we would be less likely to buy the product. This would allow us to consider spending our money on something else that may bring us more satisfaction. For example, we could have saved our money for a rainy day, or even donated it to those in need. Whatever you decide to do with your money, make sure that it is a rational decision that is most likely to give you the greatest satisfaction in the long run.



Source 1 While many people feel that they need a smartphone or tablet, in economic terms, a smartphone or tablet is considered a want.



Source 2 Our unlimited wants not only use up the world's limited natural resources, they often damage the environment through pollution and waste.

Relative scarcity

Another problem caused by our wants is known as **relative scarcity**. Relative scarcity happens because our wants are unlimited, but the **resources** required to fulfil them are limited. This causes damage to the natural environment, which is certainly essential to our survival.

Our wants are unlimited in the sense that as soon as one want is satisfied, another appears. For example, a person who has already acquired a house, food, water, basic clothing, and has money left over will buy an item that will make their life easier, such as a car. That person may later decide to buy a phone, a bag, designer jeans, a new car, a new smartphone and the list goes on. People's wants can never be completely satisfied because as soon as we buy one of these items, we desire another. Before you know it, you have just spent \$35 million on a 1962 Ferrari 250 GTO race car.

Here are some other wants:

- diamond-covered smartphone: \$9.4 million
- private yacht: \$590 million
- bottle of wine: \$160 000
- slippers covered with diamonds and rubies: \$3 million
- a 27-storey skyscraper for a couple and their three children to call home: \$2 billion
- a diamond watch: \$25 million
- a dog house for a pet Chihuahua: \$325 000.



Source 3 Luxury items such as this private yacht are products that we use to satisfy our wants.

Check your learning 17.1

Remember and understand

- 1 What is the difference between a 'need' and a 'want'?
- 2 What is the goal of a business?
- 3 Describe two things that make us feel as if we need things that are actually just wants.
- 4 What is the problem of relative scarcity?

Apply and analyse

- 5 Identify each of the following items as a need or want:
 - a car
 - hairdryer
 - clean drinking water
 - pens and pencils
 - designer jeans
 - computer
 - house
 - mansion
 - basic food
 - ice cream
 - basic clothes
 - mobile phone
- 6 Why do you think it is important to be able to recognise the difference between needs and wants?

17.2 Opportunity cost

What makes choosing difficult is that we know that we will miss out on what we don't choose. The benefit we miss out on when choosing another option is called **opportunity cost**. When we have more than two options available, our opportunity cost is what we miss out on from the next best option (not all of the options combined). Considering opportunity cost is very important for both individuals and businesses, as it helps us understand the consequences of our decisions. If we do not consider opportunity cost, we risk making a choice that will not be as beneficial and may cause unexpected problems. Let's look at opportunity cost more closely through some examples.

Individuals

Imagine you have \$1 to buy one piece of fruit. You can choose from a banana, apple, mango, orange, kiwi or pear, each of which costs \$1. Knowing that you only have enough to buy one, you decide to rank them in order from favourite to least favourite until you come up with an answer.



Source 1 The opportunity cost of selecting your first choice is the next best option, your second choice.

Naturally, you pick the pear as it is the tastiest and most desirable option. In this situation your opportunity cost is the banana as it is the next best option that you missed out on.



Source 2 Choosing between different options can be difficult, knowing that we miss out on the other alternatives.



Source 3 Businesses make decisions about what to produce based on what is most profitable.

Businesses

Opportunity cost works in the same way for businesses. A business tries to choose the alternatives that will earn the greatest profit. For example, a clothing factory would have to decide on whether to produce shirts or pants. It will work out the costs of producing both shirts and pants, as well as the selling price of each. Its profit can be calculated by taking away the cost from the selling price.

PROFIT = SELLING PRICE – COST TO PRODUCE

	Selling price	Cost to produce	Profit
Shirts	20	10	10
Pants	30	25	5

Source 4 Opportunity cost for a business

Even though the pants sell for a higher price, they cost more to produce. The clothing factory will choose to produce shirts, meaning that their opportunity cost will be the lost production of pants. Businesses must analyse the costs and benefits of each option in this way when making an important decision. If they do not, they run the risk of making a bad decision that will cost the business money.

Understanding opportunity cost helps us put things into perspective. It makes us carefully consider what we miss out on as well as what we gain.

Check your learning 17.2

Remember and understand

- 1 What is 'opportunity cost'?
- 2 How does a business calculate its profit on an item it produces?
- 3 Why is it important to understand opportunity cost?

Apply and analyse

- 4 Look at the business example from source 4. Explain one reason why the pants might be more expensive to produce.
- 5 Describe another situation where a business would have to analyse the costs and benefits of each alternative to make a decision.
- 6 Consider the following scenario:
The manager of a clothing factory has received a phone call from their supplier. The supplier has advised that the material they would normally sell to the clothing factory for the shirts has run out. As a substitute, the supplier offers material for dresses. The clothing company must now choose whether to produce dresses or pants. Using the table below, calculate the profit. Which product is the opportunity cost?

	Selling price	Cost to produce	Profit
Dresses	25	25	
Pants	30	25	5

17A rich task

An everyday dilemma

Every day we are faced with countless choices. While some of these choices can be quite easy to make, others require a lot more thought. In situations where the answer is not so obvious we might be tempted to go with our instincts or even flip a coin, but as economists we know better. Economists analyse the costs and benefits that each option has to offer before deciding on what to do. One way of doing this is by writing up a list of pros and cons.



Source 1 A dilemma is a situation where a difficult decision has to be made.

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Creating a list of pros and cons

The purpose of a pros and cons list is to help us make a rational decision. The pros represent the benefits of the choice we are considering, while the cons represent the negatives of that same choice. You can refer to source 2 to see what a finished pros and cons list might look like.

- Step 1** Come up with a choice that you will consider the pros and cons for and write it as the main heading of your list.
- Step 2** Rule up a T-chart with the heading 'pros' on the left, and 'cons' on the right.
- Step 3** Carefully consider all of the benefits of choosing the option you are considering and list them under the 'pros' section of the T-chart.
- Step 4** Carefully consider all of the negatives of choosing the option you are considering and list them under the 'cons' section of the T-chart. Be sure to include in this section all of the things that you miss out on from the next best option (the opportunity cost).
- Step 5** Some pros and cons are more important than others so we need to give them weighting. Although this can be tricky, find the least important factor out of all of the pros and cons you have listed and write the number 1 next to it.
- Step 6** Compared to the least important factor, how much more important are all of the other factors? Write a number that shows how much more important they are to you next to each pro and con.
- Step 7** Add up the numbers in each column to show a total for pros and a total for cons. If the pros outweigh the cons then the choice is likely to be a good one. If the cons add up to a higher number than the pros, then the other option seems to be more appealing.

Apply the skill

- 1 Consider the following scenario:
You get home from school and after having a quick snack, you open your books to start studying for an economics test you have the following day. Five minutes into your study, your phone rings. All your friends from school are going to the park to play

Whether or not to create a Facebook account

Pros		Cons	
Get to speak to friends that I don't see regularly.	2	Facebook can be really addictive and time consuming, which takes away from my time to study and play sport.	4
Get to share my photos with friends.	1	People sometimes bully other people on Facebook	2
Can read peoples posts when I'm bored.	1	I don't really know who has access to the information I put on Facebook.	1
I feel like I am missing out if I don't have one.	2		
TOTAL PROS	6	TOTAL CONS	7

Although it was a tough decision, I decided not to make a Facebook account for the time being. Maybe when I'm a little older I might view the pros and cons differently.

Source 2 Pros and cons of creating a Facebook account

soccer. You absolutely love soccer and hate studying, but you know your parents will be disappointed if you do poorly on the test. They always say, 'If you want to go to university, you have to get better results in school!' Make a list of the pros and cons of playing soccer versus studying to help you decide what to do.

Extend your understanding

- 1 Compare your pros and cons list to the person next to you; discuss why your answers might be different.
- 2 Create a pros and cons list for another tough decision that you have had to make, or will have to make in the future.

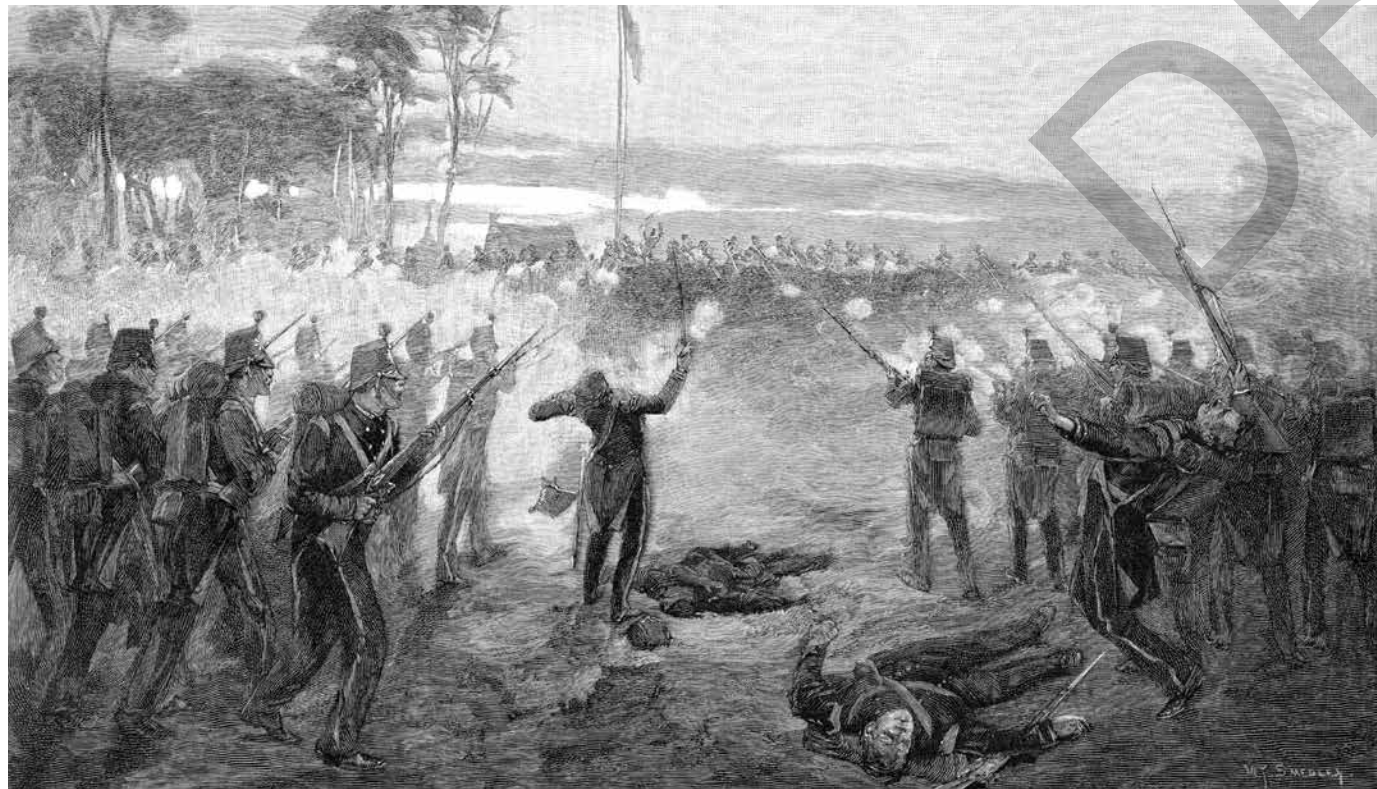


Source 3 Making a quick pros and cons list can save time that we would otherwise spend indecisively thinking about both options.

17.3 Markets

We have already looked at how individuals and businesses make decisions. While individuals try to reach the highest level of satisfaction, businesses aim to make as much profit as they can. When we need or want something, we generally go and buy it. This is what makes us **consumers** (buyers). In order for this to be possible, **producers** (sellers) have to make and sell these things, which they are happy to do for a profit. A **market** is where buyers and sellers interact with one another to exchange things of value. Usually, consumers will pay money to producers in return for **goods** and **services**.

You may have seen a market with rows of stalls selling fruit, vegetables and other goods directly to consumers. In economic terms, markets do not necessarily have a physical location like the fruit and vegetable market. The housing market, for example, doesn't physically exist; buyers can view houses listed for sale on the internet or in the newspaper and contact the seller with an offer to buy the house. An economic market exists for anything that can be bought and sold. Let's take a closer look at two of them.



The labour market

The labour market is where workers sell their skills, knowledge and effort to **employers**. In return for their **labour**, the employer will pay the workers a **wage**. This is how most people in our society earn an income. In Australia, wages for most professions are higher than in other parts of the world. This is a large reason why so many people consider Australia to be the 'lucky country'.

Because work is such an important part of people's lives, there are laws that aim to stop the unfair treatment of workers by their employers. There are also laws that require employers to maintain safe working environments for their **employees**. One of the government's goals is to improve the lives of ordinary Australians by creating jobs that will provide them with an adequate income.

Source 1 In 1854, workers at the Ballarat gold mines were so outraged by working conditions and license fees imposed on them by the government that they started an armed rebellion. This became known as the Eureka Stockade.



Source 2 Most people pay a real estate agent to help them sell their house.

The housing market

The housing market is where houses are bought and sold. Houses satisfy the basic need for shelter, and so most Australians desire the security of owning their own home. For those who can afford it, it is possible to own multiple houses which can also be a way of making more money. This is because houses can be bought and then **leased** out to a **tenant** in exchange for **rent**. In this way, the owner of the property, also known as the **landlord**, can earn a profit. Unfortunately, however, as more people decide to invest in houses, the prices increase, making it much more difficult for everyday people to afford their own homes.

For most people today, the only way to buy a house is by taking out huge loans from the bank and slowly repaying the loan over a 30-year period. The bank makes a profit by charging people **interest** on money that it lends them. In instances where the collection of rent as profit can help pay the interest off more quickly.

Check your learning 17.3

Remember and understand

- 1 What is a market?
- 2 What is exchanged on the labour market?
- 3 What is a landlord and how do they earn income from houses?

Apply and analyse

- 4 Why do you think the government focuses on creating jobs for Australians?
- 5 How do you think not having a job would affect the way a person lives?
- 6 Use the Internet to conduct the following research about a house in your area;
 - a Visit realestate.com.au via the link in your obook and find a house that is for sale in your area.
 - b Visit the Commonwealth Bank's home loan calculator online via the link in your obook and calculate how much interest you would have to pay on a 30-year loan to purchase that house.

17.4 Supply and demand

Demand

Demand refers to the amount of a good or service that consumers will buy at a particular price. Consumers want to pay as little as possible for a good or service. This way, they will have more money left over to buy other goods and services. If prices go up, consumers are less likely to want to buy. When prices are reduced, consumers are more likely to purchase a good or service. This is known as the **law of demand**, where a larger quantity is demanded when prices drop.

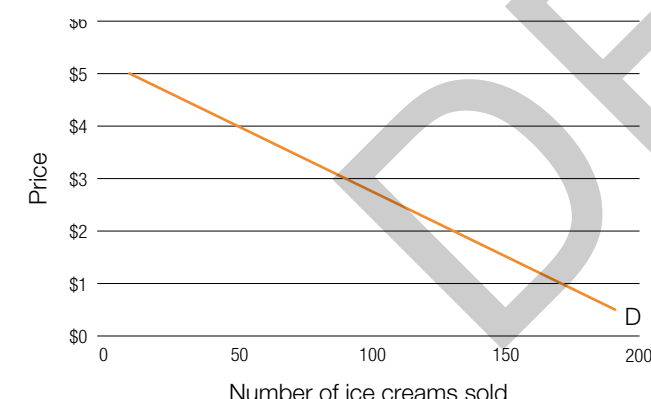
Source 1 Many people go shopping on days when big sales are on, such as Boxing Day.



Imagine the price of ice creams at the school canteen went down to 50 cents, students would be flocking to the canteen trying to buy the cheap ice creams before they run out. Now if the price of those same ice creams went up to \$5, very few would be sold.

Price of an ice cream	Number of ice creams sold
\$0.50	190
\$1	170
\$1.50	150
\$2	130
\$2.50	110
\$3	90
\$3.50	70
\$4	50
\$4.50	30
\$5	10

Source 2 This table shows how many ice creams would be purchased for a given selling price.



Source 3 By graphing the values from Source 2, we can see how the demand for ice cream increases as the price of ice cream decreases.

Supply

While consumers are more willing to buy goods and services if they are cheaper, suppliers are more willing to produce goods and services if they can sell them for a higher price. This is because selling them for a higher price will bring the business greater profits. The **law of supply** states that the higher the price of a product, the higher the quantity that suppliers will want to produce and sell.

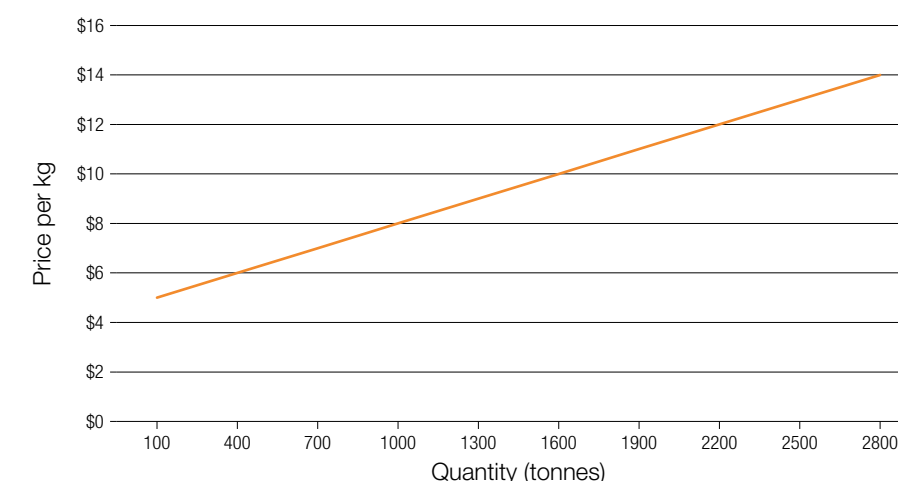
For example, farmers can choose to grow many different fruits and vegetables. They will choose to grow those fruits and vegetables that they believe will sell for a high enough price to earn a profit. There is no point in growing strawberries if no one will buy them at a price that covers the farmers' costs and earns a profit.

The way price can affect the supply and demand of goods and services is known as **price mechanism**.

Price mechanism can also affect the ways consumers and producers respond to and influence each other in the market. For example, in some industries, consumers can negotiate the price with producers in order to create profit in their favour.

Price per kg	Quantity (tonnes)
\$5	100
\$6	400
\$7	700
\$8	1000
\$9	1300
\$10	1600
\$11	1900
\$12	2200
\$13	2500
\$14	2800

Source 4 This table of values demonstrates how many tonnes of strawberries farmers are willing to produce if they can sell them at each given price.



Source 5 By graphing the values from Source 4, we can see how farmers are willing to produce more as the price of strawberries increases.

Check your learning 17.4

Remember and understand

- What is meant by the 'law of demand'?
- Why do consumers like to buy things when they are on sale?
- What is meant by the 'law of supply'?
- Why are producers more willing to produce something that sells at a higher price?

Apply and analyse

- What do you think would happen if the strawberry farmer set a price that consumers were not willing to pay?

- What would happen if the strawberry farmer set a price that was too low?
- Consider the following scenario:
A chef is at a food market to buy 1 tonne of strawberries. The chef notices that there are two strawberry farmers selling their fruit. The first strawberry farmer's fruit looks very ripe and ready to eat, but has priced their strawberries at \$7 per kilogram. The second strawberry farmer, however, has priced their fruit at \$5 per kilogram but they are not as ripe as the first. Which strawberry farmer should the chef buy from and why?

17B rich task

Chocoholics

Chocolate is very unhealthy and highly addictive, but that’s why many people can’t get enough of it. The damage that sugary products like chocolate do to our health is causing many people to look at ways of kicking the bad habit. Some people suggest that if the government taxes sugary products, the higher price will stop people from buying so many of them. The government taxes other unhealthy products such as alcohol and cigarettes, but let’s see if it would work for sugary products like chocolate.

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Constructing a demand graph

Constructing supply and demand graphs is an important skill for economists. They allow us to look at how supply and demand for a good or service will respond to changes in price. This is especially important for businesses as they decide on what to produce, and how much to produce. The following steps are used to draw a demand graph, but the steps are very similar for drawing a supply graph.

- Step 1** Gather data about how much will be demanded at different price levels.
- Step 2** Create a table of values to show this (like the one from page 444)
- Step 3** Draw an L-shaped axis like you would in maths (like the one from page 445).
- Step 4** Label the vertical axis as ‘Price’ and fill in the values from your table.
- Step 5** Label the horizontal axis as ‘Quantity’ and fill in the values from your table.
- Step 6** Plot the points from the table onto the graph.
- Step 7** Draw a line connecting the graph (like the one from page 445).

Apply your skill

- 1 Using steps 1 and 2, fill out a table showing how many of your favourite chocolate bars you think you would buy in an average week at the following prices.

Price	Quantity (number of chocolate bars per week)
\$0.50	
\$1	
\$2	
\$3	
\$4	
\$5	
\$6	
\$7	
\$8	
\$9	
\$10	

- 2 Using the table that you have just filled out, follow steps 3 to 7 to draw a demand graph (like the one on page 445).
- 3 Looking at your graph, do you believe a tax would be effective in making people eat less sugar?
- 4 What do you think would happen if a tax was not applied to chocolate?

Source 1 While delicious, chocolate is filled with sugar and fat, which can cause many health problems.



Extend your understanding

- 1 Use the internet to research and make a list of sugars effects on health.
- 2 Make a pros and cons list of cutting sugar out of your diet
- 3 Looking at the results of your pros and cons list, should you cut out sugar from your diet?
- 4 When people become addicted to sugary products such as chocolate, nutritionists often suggest that they replace these with natural sugar. Using the Internet, research foods that contain natural sugar that can be used as an alternative.