

THE M. & E. HANDBOOK SERIES

ECONOMICS FOR "O" LEVEL

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PREFACE TO THE FIRST EDITION

This HANDBOOK has been produced for those who are beginning a study of economics leading to the G.C.E. "O" Level examination and its equivalents, and for those who have completed their course of study and require an aid to swift and intensive revision.

The text consists of a series of study notes and Progress Tests. The content of the notes is based, in general, on the requirements of the G.C.E. "O" Level syllabus.

Those who are beginning their study of economics may care to use the following scheme of study, which is divided into four parts.

The first part consists of *reading through the text*, in a methodical manner, so as to obtain a general view of the scope of the subject matter. At this stage the Progress Tests need not be attempted.

The second part of the study scheme is the most important. It involves a *detailed study of the text*—the study to be spread over as long a period as possible—and the memorisation of important principles and definitions. Memorisation should be attempted only after definitions and principles are understood clearly. At the end of each chapter the Progress Test should be completed, and the answers checked with the text. There should be no movement from chapter to chapter until the appropriate test has been completed.

A *general revision* should follow, based on a swift reading of all the chapters, and this should be followed by three separate sessions, in examination conditions, in which the *three test papers* in Appendix III are attempted.

Those who intend to use the HANDBOOK as a means of pre-examination revision should read each chapter, attempt each of the Progress Tests, and should then work through *all* the questions in the three test papers.

I wish to thank the National Chamber of Trade for kind permission to quote, in Chapter IX, from one of its publications.

The questions from "O" Level papers in Economics, Social Economics and Economic and Public Affairs which form Appendix III are reprinted by kind permission of the University of London School Examinations Department, the Joint Matriculation Board, the Southern Universities' Joint Board for School Examinations and the Associated Examining Board for the General Certificate of Education.

February 1971

L.B.C.

PREFACE TO THE THIRD EDITION

Advantage has been taken of the opportunity presented by a new edition of recording a number of additional features in a changing economic scene. Statistics have been updated and further material included on commercial banks. I wish to thank the National Westminster Bank Ltd., for kind permission to reproduce its balance sheet for 1977. The Appendix on Examination Technique has been extended so as to include a section on demand and supply "curve-shift" questions.

October 1978

L.B.C.

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PART ONE

ECONOMICS: THE PRELIMINARIES

CHAPTER I

WHAT IS ECONOMICS?

ECONOMIC ACTIVITY

1. A general view. Consider a community at work. Miners, farmers, factory workers, shopkeepers, engineers, transport drivers, teachers, chemists and clerks—each of these groups is involved in some form of economic activity. *An economic activity takes place in the context of meeting the economic requirements of the community, e.g. for coal, food, manufactured articles, transport, etc.* Activities of this nature include:

- (a) *producing* goods and services;
- (b) *exchanging* goods and services;
- (c) *consuming* goods and services.

2. The essence of economic activity. Economic activity has its origins in the *wants* of a community; its main purpose is the satisfaction of those wants.

(a) Where wants are relatively few, as in a primitive community, economic activity will be restricted to the production and utilisation of basic things, such as food and shelter.

(b) In the case of a highly developed community, such as that envisaged in 1 above, economic activity will be on a very extensive scale, reflecting the many and varied wants of the population.

(c) Economic activities take place in the framework of an *economic system* (see 24–25 below).

3. Economic activity: the subject matter of economics. Economics is concerned essentially with activities relating to wealth (see II, 15), i.e.:

(a) *Production* (see III, 1), e.g. the manufacture of a motor car or the printing of a book.

(b) *Consumption* (see III, 2), e.g. the eating of food or the wearing of a suit of clothes.

(c) *Exchange* (see X, 2), e.g. the sale and purchase of food in a shop, or the transfer of money at a theatre booking-office in return for a ticket.

(d) *Distribution* (see XIII, 1), e.g. a miner, a teacher and a factory owner each receiving his share of the national income.

These activities form the subject matter of economics.

SCARCITY AND CHOICE

4. Wants. Economic activity arises because of *wants*. We may say, of such economic wants, that:

(a) They may result in a demand for goods and services.

(b) They vary from person to person, from community to community, from time to time and from generation to generation. Compare, for example, the basic diet of an average household in 1877 with one a century later.

(c) They are innumerable.

(d) They are competitive.

(e) They are often complementary.

NOTE: A certain type of want (e.g. for harmful drugs) may create harm to an individual, but it remains, nevertheless, an economic want, because economic activity must be undertaken for its satisfaction.

5. Scarcity. Most things (with very few exceptions, such as air) are scarce, i.e. they are *limited in supply*. The statement that "all goods are scarce" refers to their scarcity relative to the community's desire for them at a given time. Wants are innumerable, but the resources for satisfying those wants are severely limited. From this fundamental fact arises *the basic economic problem of choice*.

6. Choice. Choice between alternative courses of action is at the basis of much economic activity; the house owner deciding whether to spend money on either repainting or repairing property; the board of directors considering whether to build a new factory or re-equip an existing one; or the government faced with the problem of building houses or schools. Each of

these cases illustrates the importance of choice in the determination of economic activity. In general:

- (a) resources are limited, *i.e.* are relatively scarce, and, therefore,
- (b) individuals (and groups, such as businessmen and governments) must choose between competing wants.

7. Opportunity cost. Choice involves a selection from alternatives. Hence, the *real cost* of a good, *i.e.* the real cost of satisfying a want, may be considered as *the alternative that is forgone*. This real cost is known as the *opportunity cost*. Thus, if we assume that the government (*see* 6 above) decides to build homes rather than schools, the opportunity cost of the homes (*i.e.* cost considered as a forgone opportunity) is the schools that could have been built.

THE ESSENCE OF ECONOMICS

8. Its scope. Economics studies the many activities undertaken in relation to wealth. Its scope is, therefore, very wide; *any activities of man in relation to wealth, e.g.* the ways in which he selects and organises his scarce resources so as to *produce* wealth and the ways in which he *exchanges* that wealth, are within the province of economics.

9. The derivation of "economics." "Economics" originates in the Greek word *oikonomia*, meaning "household management." (It apparently derives its meaning from the processes commonly associated with the careful management of household revenues.) Until quite recently its title was "political economy" ("political" is derived from the Greek *polis*, meaning "a city state"), and the phrase obviously implied effective management of a state's resources.

10. Some definitions of economics. There are many definitions of economics—perhaps as many as there are economists! Some of the more important are:

- (a) "The art of managing the resources of a people and of its government": Adam Smith (1723–90).
- (b) "The theoretical science of the laws of production and distribution of wealth": J. R. McCulloch (1789–1864).
- (c) "The practical science of the production and distribution of wealth": John Stuart Mill (1806–73).

(d) "That part of knowledge which relates to wealth": F. A. Walker (1840-97).

(e) "A study of mankind in the ordinary business of life; it examines that part of individual and social action which is most closely associated with the attainment and with the use of the material requisites of well being": Alfred Marshall (1842-1924).

(f) "Economics is the study of how men and society end up choosing, with or without the use of money, to employ scarce productive sources that could have alternative uses, to produce various commodities and distribute them for consumption, now or in the future, among various people and groups in society. It analyses the costs and benefits of improving patterns of resource allocation": P. A. Samuelson (b. 1915).

11. Robbins' definition. Lord Robbins (b. 1898) gave the following definition, which has gained wide acceptance: "Economics is the science which studies human behaviour as a relationship between ends and scarce means which have alternative uses." Note the following points:

(a) The definition states that economics is a science (see 14 below).

(b) The science is based on the observation of the activities of human beings.

(c) These activities arise when persons wish to attain certain ends (*i.e.* the satisfaction of their wants) and have to choose appropriate resources and methods.

12. A working definition. For the purpose of this text economics is considered as *the study of man in his attempts to gain a living by utilising his limited resources.*

13. Branches of economics. The branches of economics may be classified as follows:

(a) *Pure economics* (or economic theory or principles): the theoretical principles which are derived from a study of economic activity.

(b) *Descriptive economics*: the description of the framework and institutions forming the economic system.

(c) *Applied economics*: the application of economic theory to the study of practical problems within the economic system.

NOTE: The term *macro-economics* is concerned with aggregate economic quantities, e.g. national income, total expenditure; the term *micro-economics* is concerned with individual units, e.g. the demand of individual consumers.

ECONOMICS AS A SCIENCE

14. What is a science? The term "science" (*scientia*, from *scire*, meaning "to know") is usually applied to a department of *systematised knowledge*, i.e. systems of facts and principles concerning a subject. In order that an organised body of knowledge might be classified as a science, it would have to be:

(a) based on the collection, arrangement and classification of facts; and

(b) concerned with the possibility of deriving and formulating from those facts, by the use of appropriate methods, a series of hypothetical *laws*, in the form of general statements.

15. The scientific basis of economics. An economist may use scientific method in the following ways:

(a) *He collects data*, e.g. prices of goods during a particular period.

(b) *He arranges and classifies the data*, e.g. demand for the goods at particular prices.

(c) *He interprets the data and draws conclusions*, where this is possible, e.g. that price and demand are related in particular ways.

(d) *He attempts to check his conclusions by applying them to other relevant aspects of economic activity.*

(e) *He formulates a generalisation*, perhaps in the form of an economic law (see 19 below).

16. Methods of investigation. The following methods can be used, singly or in combination, in arriving at conclusions:

(a) *The deductive method.* The economist begins with a *hypothesis* (which may be a mere guess); he then *deduces*