

Summary of week 2

The Economic Approach

Although it is impossible to remove scarcity completely, it is at least possible to minimize the negative consequences of scarcity. Economists observe that people, facing situations of scarcity, make an attempt to influence the relation between the amount of goods used, on the one hand, and the degree of satisfaction of needs, on the other. This relation would be irrelevant if goods were available in unlimited amounts. However, scarcity forces people to pay attention to this relation.

Usually, people apply the so-called economic principle. In general terms, the economic principle recommends that the goal at hand be achieved at the maximum level possible given the means available. This is known as the maximum principle. The economic principle can be formulated from another perspective as well. The minimum principle requires that a goal be achieved to a given level using the minimum amount of resources.

A situation in which the economic principle is fulfilled is called an “efficient” situation. Efficiency implies the absence of any wasting of goods. Each kind of behavior which is based on the economic principle is called economic behavior (or rational behavior). Every agent behaving economically is called an economic agent.

The circular flow

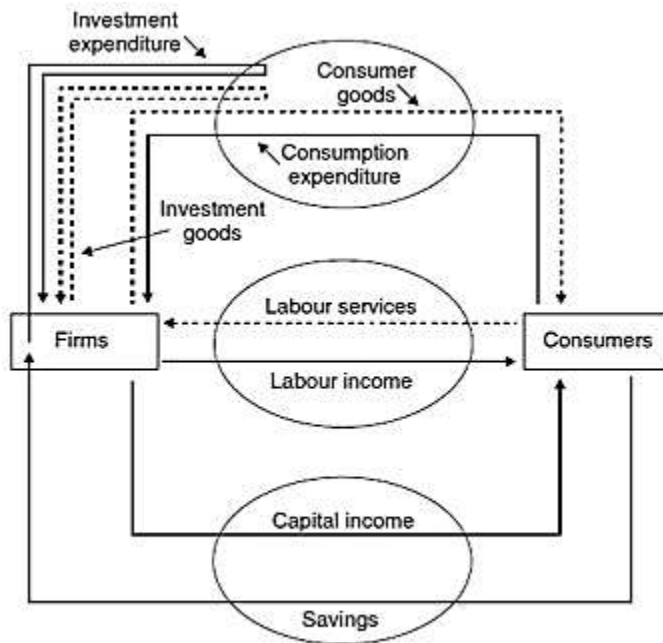


Fig. 3.1 The circular flow

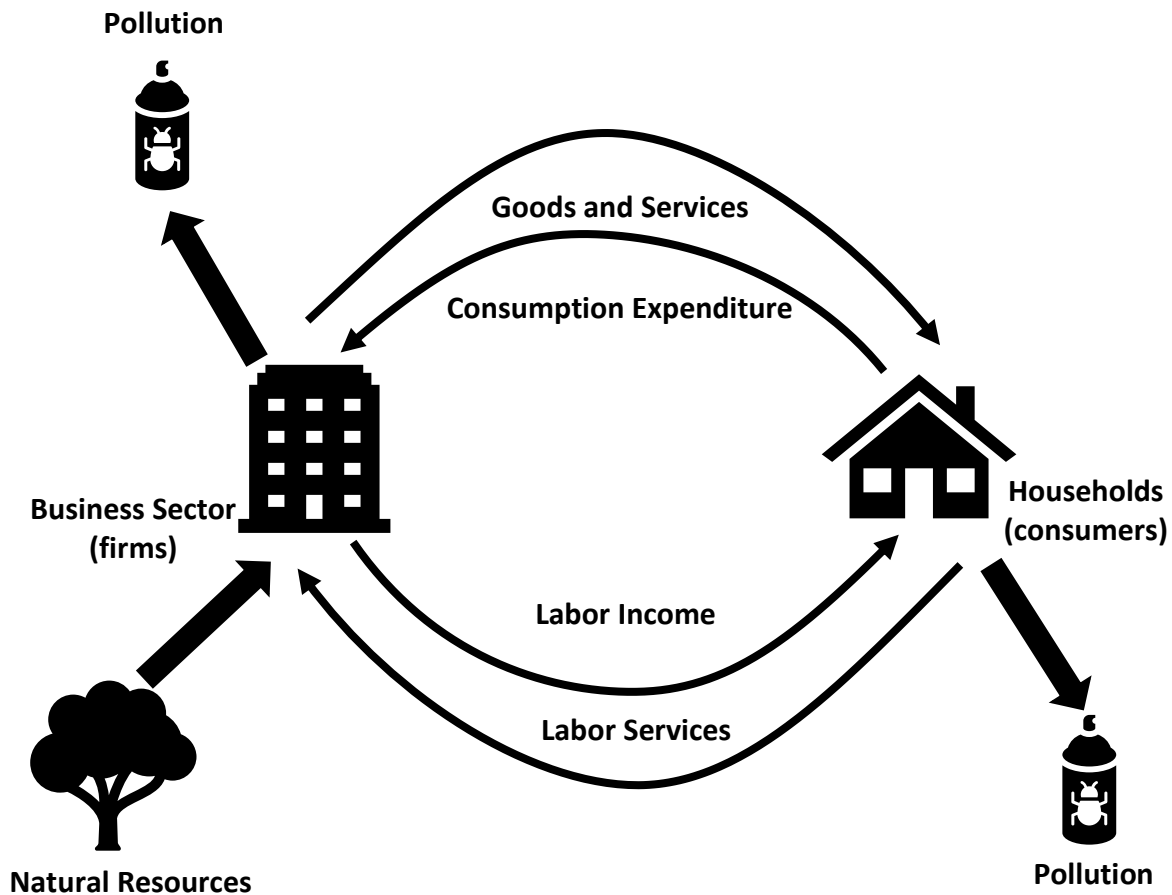
The circular flow is a simplified representation of the interaction between economic agents. In the above figure, the circular flow portrays the structure of real and monetary transactions between the various sectors of an economy.

There are three main questions that are related to the interactions between economic agents, which are represented graphically in the previous circular flow:

1. How could economic efficiency be achieved?
2. How could social equity be achieved?
3. How could ecological sustainability be achieved?

The above-three questions are called “goals of resource management”

The Circular Flow and the Three Goals of Resource Management



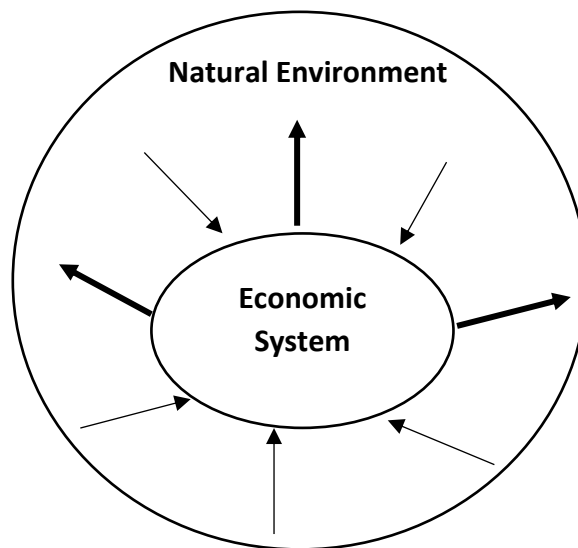
It should be noted that:

In recent decades, growing awareness of environmental issues and their relationship to the economy has led to the emergence of three main policy goals in natural resource management: efficiency, equity and sustainability. The previous three goals are important elements in any sustainable development. Sustainable development can be defined as development that meets the needs of the present without compromising the ability of future generations to meet their own needs. This requires balancing the demand for natural resources with the protection of ecosystems that also contribute goods and services necessary for economic growth. Certainly, not only does the

environmental pollution strongly affect the current generation, but the environmental degradation affects future generations as well. Distortion occurs when those who cause pollution do not bear its costs but instead impose them on society.

As shown above, it might be possible to integrate natural factors of production into the circular flow. In this case, it would appear merely as a supplier of raw materials for human economic activity. However, some ecological economists suggest that human economic activity is embedded within the natural environment and crucially dependent on numerous services provided by nature. Therefore, the economic system created and operated by mankind must be viewed as subordinate to nature and a subsystem of nature. As, without certain services of nature, human economic activity could not take place at all. For instance, without the ozone layer's protective functions, human life would not be possible on earth. This can be shown in the following figure:

The Natural Environment and Economic System



The arrows in the figure represent the diverse interdependencies between the natural and economic systems. The arrows going into the economic system may represent the extraction of productive factors from their stocks, which are part of the natural environment (wood, minerals). The arrows coming out of the economic system may stand for waste emissions or for changes in landscape caused by productive activities.