

# **IGCSE Economics Subject Content 1**

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# Contents

<b>1</b>	<b>The Basic Economic Problem</b>	<b>iii</b>
1.1	The Nature of the Economic Problem . . . . .	iii
1.1.1	Finite resources and unlimited wants . . . . .	iii
1.1.2	Economic and free goods . . . . .	iii
1.2	The Factors of Production . . . . .	iv
1.2.1	Definitions of the factors of production and their rewards . . . . .	iv
1.2.2	Mobility of the factors of production . . . . .	iv
1.3	Opportunity Cost . . . . .	iv
1.3.1	Definition of opportunity cost . . . . .	iv
1.3.2	The influence of opportunity cost on decision making . . . . .	iv
1.4	Production Possibility Curve Diagrams (PPC) . . . . .	v
1.4.1	Definition of PPC . . . . .	v
1.4.2	Points under, on, and beyond a PPC . . . . .	v
1.4.3	Movements along a PPC . . . . .	vi
1.4.4	Shifts in a PPC . . . . .	vi

# Chapter 1

## The Basic Economic Problem

### Key points from this section:

1. Define the nature of the economic problem.
2. Define the factors of production.
3. Define opportunity cost and illustration of the concept.
4. Demonstrate how production possibility curves can be used to illustrate choice and resource allocation.
5. Evaluate the implications of particular courses of action in terms of opportunity cost.

### 1.1 The Nature of the Economic Problem

#### 1.1.1 Finite resources and unlimited wants

- **The basic economic problem:** How to allocate scarce resources to satisfy unlimited needs and wants.
- **Scarcity:** Unlimited wants and not enough resources to fulfill the wants.
- **Unlimited wants:** The unlimited desires that people have.
- **Limited resources:** The limited factors of production (resources) that we have on Earth.
- **Needs:** Things which we require in order to survive.
- **Wants:** Things that we do not need but want for enjoyment or utility.
- **Basic economic questions:**
  1. What to produce.
  2. How to produce it.
  3. For whom to produce it.

#### 1.1.2 Economic and free goods

- **Goods:** Physical items, e.g. books, computers, and food.
- **Services:** Non-physical items, e.g. haircuts and internet access.
- **Economic goods:** Goods that are limited in supply, e.g. cars, paper, and oil.
- **Free goods:** Goods that are unlimited in supply, e.g. air, sea, and public web pages.
- **Economic agents:** Individuals, firms, and the government.

## 1.2 The Factors of Production

### 1.2.1 Definitions of the factors of production and their rewards

- **Four factors of production (LLCE):**
  1. **Land:** The natural resources required in a production process, e.g. wood and oil.
  2. **Labor:** The human resources required in a production (physical or mental, skilled or unskilled), e.g. teacher and police.
  3. **Capital:** The manufactured resources required in a production, e.g. machinery and tools.
  4. **Enterprise:** The skills in a business person requires to manage the other three factors of production and the ability to undertake risks.
- **Four rewards to factors of production (RWIP):**
  1. **Rent:** Reward or payment for *land* resources.
  2. **Wage/Salary:** Reward or payment for *labor* resources.
  3. **Interest:** Reward or payment for *capital* resources.
  4. **Profit:** Reward or payment for *enterprise* resources.

### 1.2.2 Mobility of the factors of production

- **Geographical mobility:** The ability of factors of production (except land) to move around an area, region or country in order to work.
- **Horizontal mobility:** The ability of factors of production (mostly labor) to move from one occupation to another with the same social level.
- **Occupational mobility:** The ability of factors of production (mostly labor) to switch career fields.

## 1.3 Opportunity Cost

### 1.3.1 Definition of opportunity cost

- **Opportunity cost:** The next best alternative given up when making a decision. (Doesn't have to be money)
  - The opportunity cost of taking economics course is the other subject you would be studying instead.
  - The opportunity cost of playing games is the other things that you could be instead like studying.
  - The opportunity cost of funding the military could be free or well-funded healthcare.

### 1.3.2 The influence of opportunity cost on decision making

- **Consumers:** Purchasing one good causes opportunity cost of the other good.
- **Producers:** Producing one good causes opportunity cost of the other good.
- **Government:** Passing one policy causes opportunity cost of the other policy.

## 1.4 Production Possibility Curve Diagrams (PPC)

### 1.4.1 Definition of PPC

- **Production possibility curve:** A graph illustrating the production of two goods, used to display opportunity cost.
- It is a graph with the number of production of two goods as the two axes, where the two goods share a certain factor of production to produce. Thus, resulting in a downward sloping curve.
- **Two types of PPC**

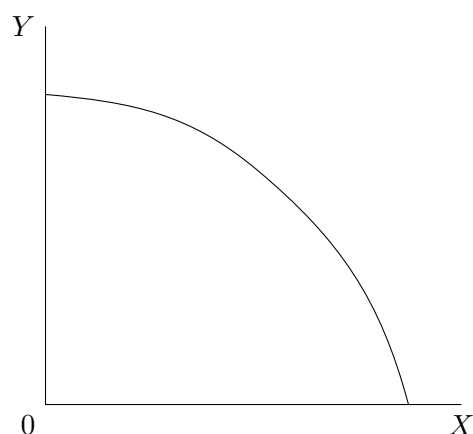


Figure 1.1: PPC with specialization

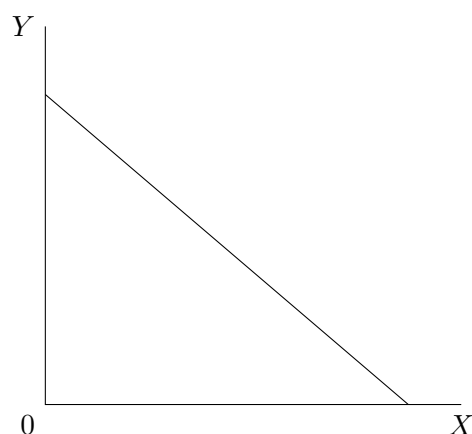


Figure 1.2: PPC without specialization

- *Figure 1.1:* Increasing opportunity cost due to specialization. (Resources required are not the same)
- *Figure 1.2:* Constant opportunity cost due to no specialization. (Resources required are identical)

### 1.4.2 Points under, on, and beyond a PPC

**Keys:**

- **Point A:** All resources dedicated to the production of good Y.
- **Point B:** All resources dedicated to the production of good X.
- **Point C:**  $Y_1$  amount of good Y produced along with  $X_1$  amount of good X.
- **Point D:**  $Y_2$  amount of good Y produced along with  $X_2$  amount of good X.
- **Point E:** Resources are not allocated at the maximum efficiency.
- **Point F:** This point of production is unattainable. (Not enough resources)

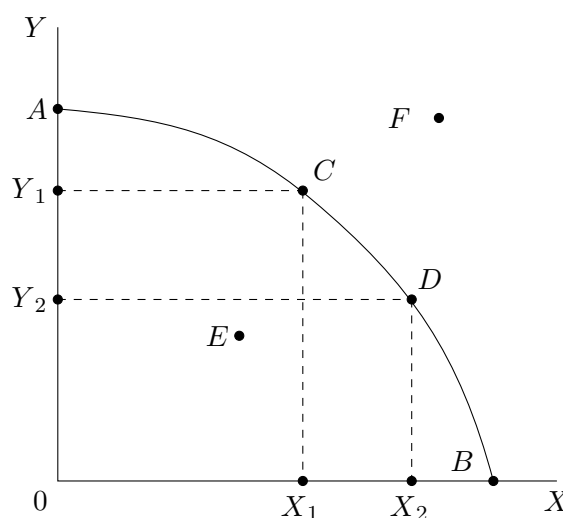


Figure 1.3: Generic PPC graph with points

**1.4.3 Movements along a PPC**

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**1.4.4 Shifts in a PPC**

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