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Edexcel IGCSE Economics

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1 Preface

This is a revision guide made for the IGCSE Economics course. It is not made to be used on its own, but rather to promote understanding and help condense and compress key information in the course. Thiss allows for a more efficient revision process, and helps students make connections between topics efficiently. This greatly helps for the extended response questions.

I hope you enjoy reading this and make good use of the revision notes.

2 Brief Overview of the Course

The IGCSE Economics course is split into 2 sections, each of the sections having their own exam paper, Macroeconomics and Microeconomics.

Macroeconomics focuses on the economy as a whole whereas Microeconomics focuses on the individual parts of the economy like households and firms.

Both papers are 80 marks in 90 minutes and are under codes 04/EC01 and 04/Ec02 for micro and macro respectively.

2.1 Assessment Objectives

There are 4 assessment objectives that make up the papers.

2.1.1 AO1

recall, select and communicate knowledge of economic terms, concepts and issue.

Paper 1 - **7.5%** , Paper 2 - **7.5%** and **14-15%** of the total grade.

2.1.2 AO2

Demonstrate knowledge and understanding by using appropriate terms, concepts, and theories and calculations effectively in specific contexts.

Paper 1 - **24.4%** , Paper 2 - **24.4%** and **48-49%** of the total grade.

2.1.3 AO3

Select, organise and interpret information from sources to investigate and analyse economic issues.

Paper 1 - **11.8%** , Paper 2 - **11.8%** and **23-24%** of the total grade.

2.1.4 AO4

Evaluate economic information to make reasoned judgements and draw conclusions Paper 1 - **6.3%** , Paper 2 - **6.3%** and **12-13%** of the total grade.

3 Microeconomics

3.1 The Economic Problem: Scarcity

"There is a *finite* amount of reosources and an *infinite* amount of wants."

Meaning, the **demand** for economic goods is higher than the **supply**.

This is the basic **economic problem** which leads to 3 questions:
1. What to produce? (not all goods and services can be produced)
2. How to produce? (different production methods)
3. For whom to produce? (different groups of people who need it, how much they should get)

This requires **decision makers** to make a choice. This is called **opportunity cost**.

Decision makers are:
1. **Governments**
2. **Producers**
3. **Consumers**

The **opportunity cost** is the cost giving up *next best alternative* when a choice is made.

Choosing what goods to produce is an opportunity cost, This can be illustrated using a PPC (Production Possibility Curve).

The PPC shows the maximum amount of goods that can be produced with the available resources. Often it shows the relationship between two goods.

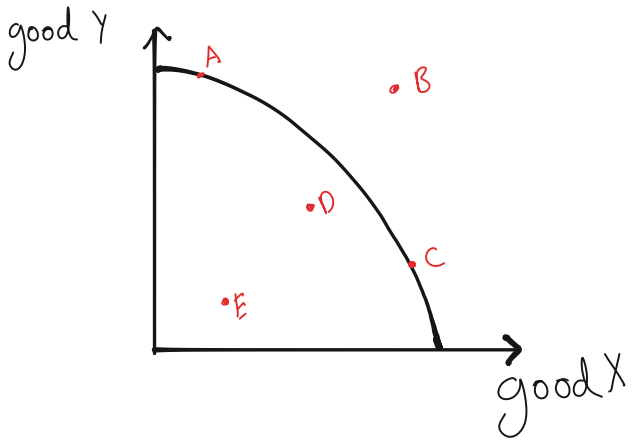


Figure 1: A production possibility curve illustrating the relationship between the production of a good X and Y.

1. Point B is unachievable (due to a lack of resources)
2. Point E & D are inefficient (waste of resources)
3. Point A & C are efficient (maximising output with the resources available)

3.1.1 Economic Growth

The increased production of goods and services in an economy over a period of time, or GDP.

Factors that affect economic growth:
1. **Population growth** - more people = more demand
2. **Labour productivity** - more output per worker
3. **Capital productivity** - more output per unit of capital
4. **Technological change** - new technology = more output

5. **Natural resources** - more resources = more output

Economic Growth influences the PPC, as it shifts it outwards (increase in production).

3.1.2 Economic Assumptions

Economists make assumptions about the economy to make it easier to analyse and understand. Economists assume that individuals will behave rationally:

1. Consumers aim to maximise benfits or util.
2. Producers aim to maximise profits.

However, there are reasons why this may not be true:

1. For consumers:
    1. **Information asymmetry** - consumers may not have all the information
    2. **Moral hazard** - consumers may not be able to control their spending, (addictions)
    3. **bandwagon effect** - consumers may copy other consumers behaviour
2. For producers:
    1. **Social enterprise** - producers may not be motivated by profit
    2. Perfomance may be influenced by other aims like selling more goods
    3. Producer has alternative business objectives.

3.2 Demand and Supply

3.2.1 Demand

"The amount of a economic good that would be bought at a certain price point."

Demand and **price** are *inversely proportional*. This means that as the price of a good **increases**, the demand for it **decreases** (typically). So a change in price results in movement along the demand curve.

The demand curve illustrates this relationship as a line. The demand curve is *downward sloping* and is denoted with a capital D.

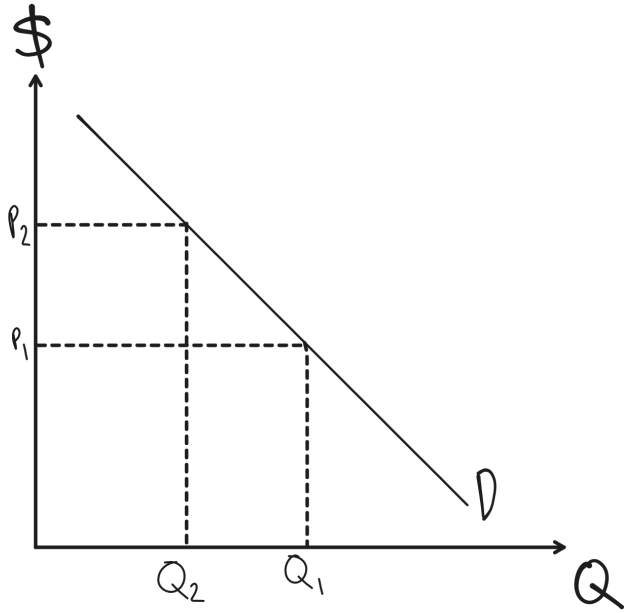


Figure 2: A demand curve showing the relationship between price and quantity demanded at different price points.

3.2.1.1 Factors affecting Demand

The demand curve is affected by 6 non-price factors:

1. **Fashion & Taste** - (proportional)
2. **Disposable Income** - if average income increases, demand increases (proportional)
3. **Price of Complementary goods** - if price of complementary goods increase, demand for the good decreases (inversely proportional)
4. **Price of Substitute goods** - if price of substitute goods increase, demand for the good increases (proportional)
5. **Advertising** - if advertising increases, demand increases (proportional)
6. **Demographics** - if there is a larger demographic that a product targets, demand increases (proportional)

These factors cause shifts in the demand curve -

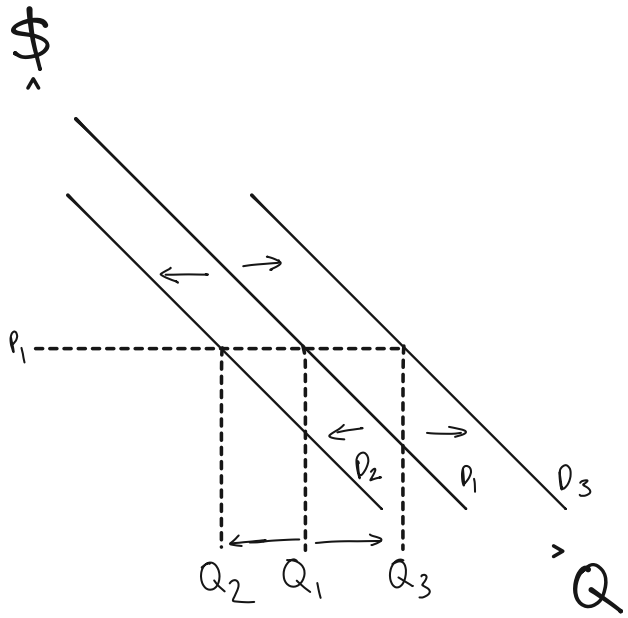


Figure 3: When demand shifts to the left, quantity falls. When demand shifts to the right quantity rises.

3.2.1.2 Price Elasticity of Demand

The **price elasticity of demand** is the responsiveness of demand to a change in price. It is measured by the percentage change in quantity demanded divided by the percentage change in price.

Note: Price elasticity of demand is *always* a *negative* number.

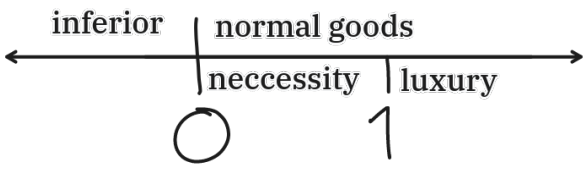
PED is equal to the change in quantity demand over the change in price. This is also the gradient of the curve.

$$P = \frac{\Delta D\%}{\Delta P\%}$$

For the absolute values of PED:

value	description
x = 0	fixed demand
0 < x < 1	inelastic
x = 1	unit elastic
x > 1	elastic
x = ∞	perfectly elastic

The categories of goods depending on their PED.



In relation to revenue:

- with a lower PED (inelastic), it is lucrative to increase the price as it increases total revenue.
- with a higher PED (elastic), it is lucrative to decrease the price as it increase total revenue.

3.2.1.2.1.1 Factors of PED:

1. **Substitutes** - if there are many substitutes, PED is higher (proportional)
2. **Necessities** - if the good is a necessity, PED is lower (inversely proportional)
3. **Time** - The longer it takes for a consumer to change products, the higher the PED (proportional)
4. **Proportion of Income** - The higher the proportion of income spent on a good, the higher the PED (proportional)
5. **Utility** - The higher the util value of a good, the higher the PED (proportional)
6. **Addictivity** - The more addictive a good is, the higher the PED (proportional)

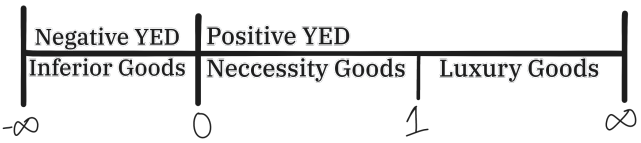
3.2.1.2.1.2 Applications of PED

3.2.1.3 Income Elasticity of Demand

The responsiveness of quantity demanded to a change in disposable income. The formula for YED is the same as PED, but with income instead of price. (It is not IED as IED stands for something different)

YED is equal to the change in quantity demand over the change in income. $\frac{\%\Delta D}{\%\Delta I}$

3.2.1.3.1.1 Determinants of YED



3.2.1.3.1.2 Applications of YED

1. YED, Producers and the Economic Cycle.
   - Economic growth -> Rise in income -> Demand for goods with high YED increases.
   - Recession -> Fall in income -> Demand for goods with low YED increases.
2. YED and the Economy
   - High YED for services
   - Medium YED for manufactured goods
   - Low YED for primary commodoties

3.2.1.4 Cross Elasticity of Demand

Cross elasticity of demand (XED) illustrates the elasticity of a change in press for a good X compared to the change in demand for a good Y. It is measured by the percentage change in quantity demanded for good X divided by the percentage change in price of good Y.

XED is equal to the change in quantity demand for good X over the change in price of good Y. $\frac{\%\Delta D_X}{\%\Delta P_Y}$

3.2.1.4.1 Deterimants of XED

- If XED is positive, the goods are substitutes
- If XED is negative, the goods are complements

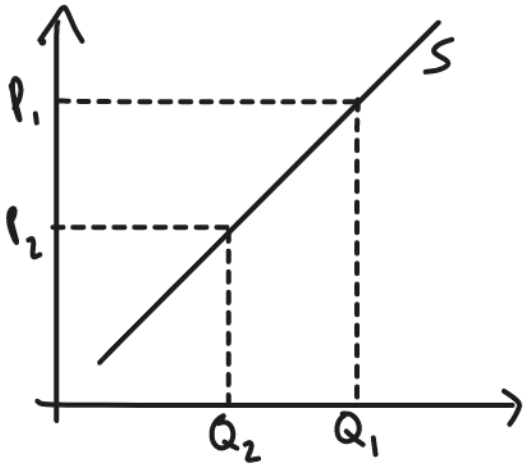
3.2.1.4.2 Applications of XED

- Similar products
- Rival firms
- Mergers between firms
- Complementary goods

3.2.2 Supply

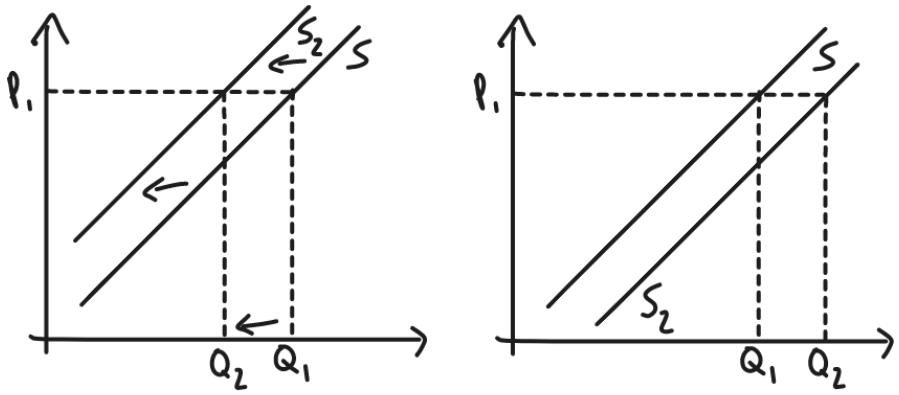
"The amount of a economic good that can be produced at a certain price point."

Supply and **price** are *directly proportional*. This means that as the price of a good **increases**, the supply for it **increases** (typically). So a change in price results in movement along the supply curve.



3.2.2.1 Non-price Determinants of Supply

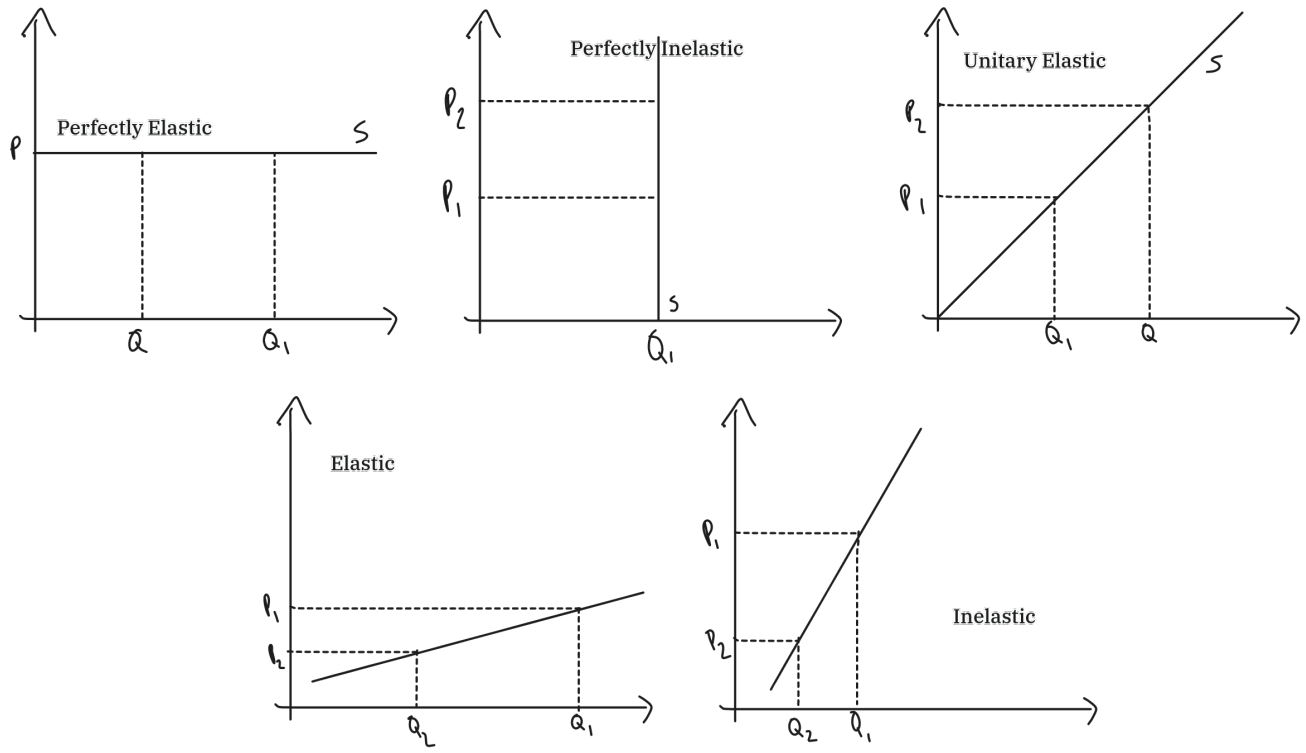
1. Cost of production - A higher cost of production means that less can be produced (inversely proportional)
2. technology - Better technology means that more can be produced at a lower cost (proportional)
3. Indirect taxes - if indirect taxes increase, supply decreases (inversely proportional)
4. Subsidies - if subsidies increase, supply increases (proportional)
5. Natural factors - natural factors can lower supply (inversely proportional)
6. Price of related goods
   - Joint supply - if supply of a joint good increases, supply of the good increases (proportional)
   - Competitive supply - if supply of a competitive good increases, supply of the good decreases (inversely proportional)
7. Number of producers - if the number of producers increases, supply increases (proportional)
8. Expectations at firms - goods may be withold if prices are expected to rise



3.2.2.2 Price Elasticity of Supply

A measure of the responsiveness of supply to a change in price. (**PES**)

PES = $\frac{\%\Delta S}{\%\Delta P}$



3.2.2.2.1 Non-price factors of PES

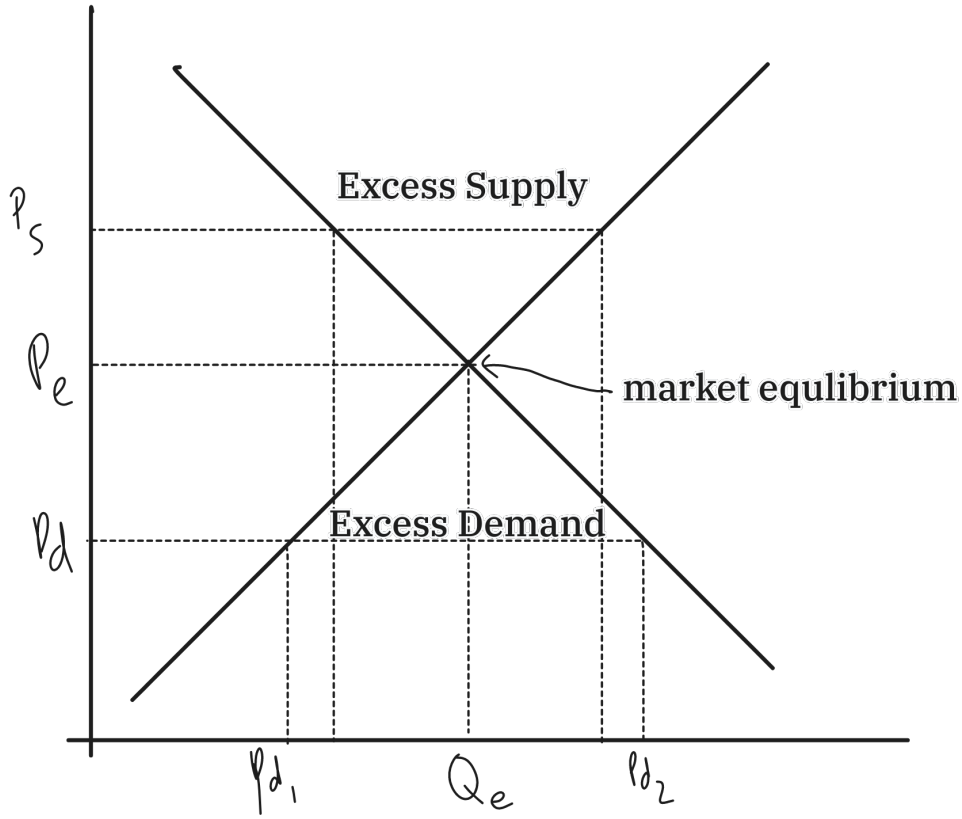
- Time - the longer it takes to produce a good, the higher the PES (**proportional**)
- Mobility of factors of production - the more mobile the factors of production, the higher the PES (**proportional**)
- Wasted capacity - the more capacity wasted, the lower the PES (**proportional**)
- Shelf Life - the longer the shelf life, the higher the PES (**proportional**)

3.2.2.2.2 Applications of PES

1. Primary commodoties have lower PES than manufactured goods because
   - Time to respond is higher
   - Low mobility
   - Limited land
   - Time is required to make investments for oil, gas and mineral production
   - Better irrigation systems are needed for cultivaition of crops.

3.2.3 Markets

"the long awaited crossover of demand and supply"



The **market equilibrium** is where the *quantitied supplied* is equal to *quantity demanded*.

This equilibrium is reached by a the **price mechanism** / **forces**.

- Excess **Supply**: $Q_s - Q_d$. When quantity supplied exceeds quantity demanded, the price falls until the quantity supplied is equal to the quantity demanded.
- Excess **Demand**: $Q_d - Q_s$. When quantity demanded exceeds quantity supplied, the price rises until the quantity supplied is equal to the quantity demanded.

When describing changes in equlibrium, keep in mind:
- Which curve it affects?
- Which curve replaces the other?
- What factors caused it to shift?
- What is the new equlibrium?
- What is the movement in the other curve?

3.3 The Price Mechanism

also known as the **invisible hand**, **market mechanism**, **forces of supply and demand**, **market forces** or **resource allocation**. It is the process by which the price of a good is determined by the interaction of supply and demand. This occurs mostly in **free markets**

The condition of scarcity of resources and infinite wants forces decisionmakers to make decisions like:
- What to produce? (which point on the PPC)
- How to produce? (which combination and amount of resources)

There are two functions that makes up the price mechanism:
- The signalling function
  - Prices communicate information to decision makers about whether to leave or enter markets.
- The incentive function
  - Prices motivate decision makers to respond to the information.

3.4 Economies

An economy is a system that attempts to solve the economic problem.

There are 3 major types of economies:
1. The free market
   - Entities have complete freedom.
   - Economic goods are determined by market forces
2. The mixed economy
   - Use both free and command economy ideology
   - Some governement intervention to prevent market failure.
3. The command economy
   - Government makes all decisions
   - Can be rather ineffecient due to lack of information.

3.4.1 Mixed Economies

The main focus of this course is on mixed economies. This is because they are the most common type of economy in the world.

It is made up of two different sectors, the private sector and the public sector.

Public goods have two characteristics.
- Non excludable
  - Once the good is in the market no consumer can be prevented or excluded from the consumption of the good.
- Non rivalrous
  - Consumption of a product doesn't deplete the amount for others.

These two characteristics lead to the **free rider problem**. A free rider is someone who consumes a public good without paying for it. This leads to a situation where the public sector is unable to recover the costs of producing the good.

Private goods do not face these issues.

3.4.1.1 Private Sector

The private sector is comprised of individual entites like a sole trader, partnerships or companies/firms.

Aims: (production of private goods)
- Survival and *profit*
- Growth
- Social responsibility

3.4.1.2 Public Sector

The public sector is comprised of central governed organizations, state owned enterprises or local authority services (non-exhaustive.)

Aims: (production of public goods)
- Improve *quality* of services
- Minimize costs, maximise profits.

- allow for **social cost** + benefit.

3.4.1.3 Privatization

The transfer of a business, industry or service from public to private control and ownership.

party	effects
Government - positive effect	• Less fiscal burden • Generates revenue • Removal of responsibility
Firm - neutral effect	• No *government interference* -> have to face higher **competition** • Shifted objectives to **profit** and no *social responsibility* -> more **efficient** • Increased **investment**
Consumers - neutral effect	• *Prices* may rise of fall depending on the asset transferred
Workers - negative effect	• May cause mass **firings** to reduce costs • Removal of redundant workers • Higher *productivities*
The Economy	• Higher **efficiency** due to higher competition • Private **monopolies** may abuse their position

3.4.2 Market Failure

A situation where there is an inefficient distribution of economic goods as well as raw materials in the market.

The free rider problem is an example of market failure.

Other cases include:

- Externalities
- Lack of competition
- Missing markets
- Lack of information
- Low mobility of factors of production

3.4.2.1 Externalities

Externalities is one of the major market failures discussed. Externalities are the cost or benefit of an economic activity onto a third party. These are described as a spill over effect.

Externalities are a result of consumption or production.

There are also private costs and benefits, these are costs incurred or benefits of economic activity onto the first party.

This leads to social costs and benefits, the sum of private and external costs and benefits.

Social cost = private cost + external cost

Social benefit = private benefit + external benefit

So what does the government do about externalities?

- Negative production externalities
  - Government regulations
  - Taxes on output
  - Taxes on pollutants
- Negative consumption externalities
  - Government regulations
  - Advertising against the good
  - Market based policies (payments)
    - indirect taxes.
- Positive production externalities
  - Direct governemnt provision
  - Subsidies
- Positive consumption externalities
  - Legislation (compulsory education on topics like vaccines or medicine)
  - Advertising
  - Direct provision
  - Subsidising consumption

3.4.3 Production

4 Macroeconomics

5 Glossary