

Topic 1 – The basic economic problem

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1.1 The nature of the economic problem

Nature of the economic problem

- Limited resources + unlimited wants = scarcity
- What / How / For whom to produce

Economic agents - households, firms & gov

Goods: physical items that can be produced, bought & sold

Services: non-physical items that can be provided & paid for by customers

Needs: essential goods/services for human survival

Wants: goods/wants that are unnecessary for survival but are human desires

Economic goods: limited in supply

Free goods: unlimited supply, no oppo cost in production & consumption

1.2 The factors of production

Factors of production

	Definition	Reward
Capital	all man-made goods used in production	interest
Enterprise	risk bearing and decision making function Eg Entrepreneurs take risks, develop new ideas & business opportunities & motivate workers	profit
Labour	all physical and mental effort of workers	wages
Land	natural resources	rent

Factor mobility: resources can be changed from one productive activity to another

Labour mobility

Geographical mobility	Occupational mobility
<ul style="list-style-type: none"> Willingness & ability of a person to move to different locations X coz family ties, cost of living 	<ul style="list-style-type: none"> Ability of person to change between jobs Improved through training & upskilling

Causes of changes in quantity & quality of fop

- Capital** - investment in tech & equipment
- advances in tech ↑ efficiency
- Enterprise** - ↑ price but consumers still willing to pay, ↑ profit
- more & better business advices & support for entrepreneurs
- Labour** - ↑ wages persuade more employment
- ↑ education ↑ skills
- Land** - ↑ rent persuade more landowners to release land into production uses

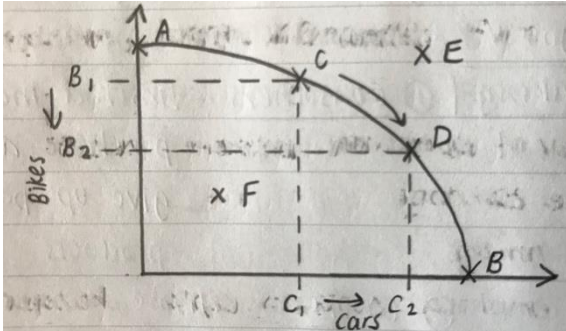
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1.3 Opportunity cost

Opportunity cost: cost of next best opportunity forgone when making decision

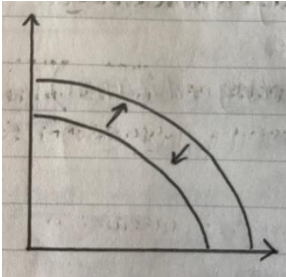
1.4 Production possibility curve diagrams (PPC)

Production possibility curve (PPC): shows max combination of goods/services which can be produced in economy



- A - all resources are dedicated to production of bikes
- B - all resources are dedicated to production of cars
- A-D - use all resources to fullest, most efficient
- E - outside curve → don't have enough resources → unattainable
- F - within curve → didn't use resources to fullest → inefficient
- C-D - ↑cars ↓bikes produced

Shifts of curves



Outwards e.g. ↑ tech, education, healthcare ↑ productive capacity

Inwards e.g. natural disasters, ↓ productive capacity

Exam questions

2 In 2013, an earthquake on the Iran/Pakistan border destroyed many factories and homes. Some officials wanted the Governments to rebuild the factories and homes, even though there would be an opportunity cost. Others suggested that some people should be encouraged to emigrate.

- (a) Define 'opportunity cost'. [2]
- (b) Explain why the economic problem can never be solved. [4]
- (c) Using a production possibility curve diagram, analyse the effect of the destruction of some of its resources on an economy. [6]
- (d) Discuss whether a country will benefit from the emigration of some of its people. [8]

2 (a) Define 'opportunity cost'. [2]

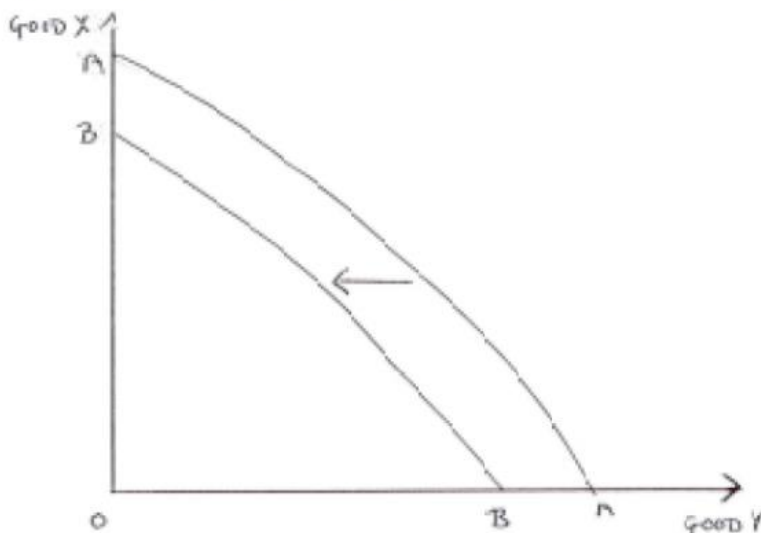
- (next) best alternative (1) forgone (1)

(b) Explain why the economic problem can never be solved. [4]

- the economic problem is scarcity (1)
- infinite wants (1) finite resources (1)
- wants exceed resources (1) as wants grow faster than resources/growth of resources will not exceed growth of wants (1)

(c) Using a production possibility curve diagram, analyse the effect of the destruction of some of its resources on an economy. [6]

Up to 4 marks for the diagram:



- 7 In 2014 Cuban doctors were given pay rises that significantly increased their salaries. This made doctors' pay more than twice that received by nurses. Cuba is devoting more resources to both medical care and tourism, altering the country's production possibility curve. Living standards are increasing in the country but at a slower rate than some other nearby countries.
- (a) What is meant by a production possibility curve? [2]
- (b) Explain, giving examples, **two** factors of production used in the tourism industry. [4]
- (c) Analyse why doctors are paid more than nurses. [6]
- (d) Discuss whether living standards are always lower in developing countries than in developed countries. [8]
- 7 (a) **What is meant by a production possibility curve?** [2]
- A curve that shows the maximum output of two types of products / combination of two products (1) that can be made with given resources/technology (1) it shows opportunity cost (1)
 - Allow 1 mark for some understanding shown about potential maximum output
 - Allow up to 2 marks for a diagram which is explained – with correct labelling (1) and correct curve (1)
- (b) **Explain, giving examples, two factors of production used in the tourism industry.** [4]
- Labour which is human effort (1) e.g. tourist guides (1).
 - Land which is natural resources (1) e.g. beaches (1).
 - Capital which is human-made goods and services used in production (1) e.g. hotels (1)
 - Enterprise which is risk bearing and decision making (1) e.g. may be undertaken by the owner of a hotel (1).