AS – ECONOMICS (9708)

MICRO

CHAPTER 1

Basic economic ideas

Topics
Topic1: Basic Economic Ideas
Topic 2: Production Possibility Curve (PPC)
Topic 3: Economic Systems

TOPIC 1: BASIC ECONOMIC IDEAS

Economics

Definition: It is a social science that studies human behavior between unlimited wants and limited resources with their alternative uses. In other words, it just simply tells us how we can make the best use of what we have in order to satisfy our needs and wants. There are TWO broad divisions: Microeconomics: This deals with individual decisions taken by household or firms in a particular market. Macroeconomics: They examine individual variables at the level of aggregate economy.

1. BASIC ECONOMICS PROBLEM/PROBLEM OF SCARCITY

Definition: The resources are limited in this world whereas wants are unlimited which leads to the problem of scarcity or the basic economic problem. This problem is faced by every economy as to how to allocate the scare resources.

Limited Resources + Unlimited Wants = Scarcity

1. Limited Nature of Resources

Definition: Resources are all those materials and efforts which can be used to produce goods and services. E.g. agriculture, farmers, machines etc. Resources are of TWO types:

1. Unlimited or free resources / Free Goods: These are unlimited in supply e.g. sunlight, sea water, air rain etc. These resources are not much of a concern for economists.

2. Scarce resources / Economic Good: These are limited in supply. E.g. machines, building, agricultural area, oil, wheat etc.

2. Opportunity Cost

Definition: People are forced to make choices due to the presence of the basic economic problem mentioned above. Opportunity costs is defined as the next best alternative forgone. In simpler terms, the sacrifice by an individual or organization while giving preference to one product to the other is known as the opportunity cost of a particular decision. Remember that this is made by all economic decision makers: Consumers, businesses and government. Example:

1. Consumer – An individual has $1000 and he/she can either buy a laptop or a smart phone. If the individual chooses the laptop the smart phone becomes the opportunity cost.
2. Businesses – A business has $1million. It can either spend it on expansion to a new country or invest in research and development. If the businesses choose to invest it in expansion, the research and development becomes the opportunity cost.
3. Government – A government has two options either to build roads or building schools in the country. If the government chooses to build roads, developing schools would become the opportunity cost.

3. The THREE basic economic questions

All the three economic agents (Individuals, Firms and Government) try to answer the following three basic economic questions:

Question	Description
1. What to Produce?	What goods and services should be produced and how should the resources be allocated. Private/public goods
2. How to Produce?	How should the economic resources be used to produce the goods and services
3. For whom to produce?	How should the goods be allocated among the population? Understanding the target population. Price mechan

4. The margin and decision making at the margin

Definition | Margin: This means that a small change in one economics variable will lead to future changes in other variables. Both consumers and firms take their decision keeping reference to small changes in mind. Example: A firm will check whether the additional revenue it will receive from selling an extra unit will compensate for the additional cost. A consumer will think the additional benefit of consuming a can of cola for the price paid for it.

5. The time dimensions

Time Dimension	Description
1. Short Run	This is a time period where firm is able to change some and not all factor inputs. Example: Labor might be variable but capital and land might be fixed.
2. Long Run	This is a time period a from can change all factors of production. This makes them more flexible. Example: Hire more labor, more capital etc.
3. Very Long Run	This is when the entire industry/market may be able to adjust. This is because not only that all factors of production are variable but also key inputs like technology, government regulation and social norms are variable.

2. FACTORS OF PRODUCTION

Definition: These elements are required to carry out a business activity are collectively known as the factors of production. These include:

Factor	Description
1. Land	It represents all the natural resources which are consumed during the business activity, e.g. plains, seas, mines etc.
2. Labor	The term refers to any kind of physical or mental human effort. E.g. carpenters, doctors, etc. Labor = no. of hrs · average work hour
3. Capital	The term refers to the manufactured resources required in the production process. E.g. machinery, tools, equipment, vehicles etc.
4. Enterprise	Also known as entrepreneurship. This is the skill and risk-taking ability of the person who brings the other three resources or factors of production together to produce a good or service. They are innovate to promote efficiency For example, the owner of a business.

Note: These factors of production tend to vary from economy to economy. Agricultural economies tend to reply more on the primary output whereas industrialized economies tend to reply on the secondary output.

Return on Factor of production

Factor of Production	Return
1. Land	Rent
2. Labor	Wages and Salaries
3. Capital	Interest on savings
4. Enterprise	Dividends on shares of a company | Profits on running a business

Note: Based on the type of the business these factors of production will vary in quantity. A business-like car manufacturing that employees a greater proportion of machinery as compared to labor is known as capital intensive, on the other hand a business like a law firm that has a greater proportion of labor as compared to machinery that relies on qualified lawyers is called labor intensive.

3. POSITIVE AND NORMATIVE STATEMENTS

Definition | Positive Statements: This is a statement the is based on empirical evidence or facts/actual evidence. This tells us what it is. Example:

1. A fall in supply of petrol *will* lead to an increase in its price...
2. An increase in tourist numbers in the Maldives *will* create more employment...
3. An increase in taxation on cars *will* result in fewer cars being sold...

Definition | Normative Statements: This is a statement that have an opinion or value judgement. This tells what should happen. The above statements can become normative statements, for example, by adding:

1. ... and this *should* be beneficial for the environment.
2. ... and therefore the government of the Republic of Maldives *should* do everything it can to help promote this industry.
3. ... and this *should* reduce traffic congestion.

4. SPECIALIZATION AND DIVISION OF LABOR

Definition | Specialization: The process by which individuals, firms and economies concentrate on producing those goods and services where they have an advantage over others. Specialization refers to performing a specific task of the whole production by an individual worker, or producing one of few products rather than a number of goods and services by a firm, region, or country.

Level	Description
1. Individual	Individuals tend to master a particular skill in life. This allows workers to master their skill and increase productivity.
2. Firm	Businesses around the globe master in a particular industry. Shell in Oil, IKEA in furniture, McDonald's in burgers and fast food etc.
3. Region	Regions in the world specialize in the production of a particular good or service. This is usually because of geographic or social factors. Example: Silicon Valley for IT and communication technology, Paris and Milan for fashion industry.
4. Country	Counties specialize in the production of certain products. Example: Germany in consumer electronic and luxury cars. Pakistan in production of rice and mangos.

Definition | Division of Labor: This is known as specialization at individual level. When the whole production process is divided into several individual tasks and each task is carried out by a single worker.

Advantages and Disadvantages of Specialization/Division of Labor [Economy]

Advantages	**Disadvantages**
1. Efficiency: Specialization results in efficient use of factors of production. This results in higher GDP.	1. Overspecialization: This is a situation where the country specializes in a particular product and this makes its economy vulnerable. Example: Economy's like Iran that are highly dependent on oil export, a trade embargo by the west on oil results in a major economic collapse.
2. Labor Productivity: Labor becomes more productive since due to repetition of jobs their skills are enhances. This leads to greater output in lesser time.	2. High labor turnover: Since the workers are specialist they will continuously be searching for better paid jobs. This result in companies have to rehire which increase the cost.
3. Increase productive capacity: Specialization helps to shift the PPC outwards. However, the shift is usually pivotal because the product the county is specializing in will have a greater increase in output.	3. Low Labor mobility: Since the worker is only skilled in a particular field it would be hard for him to understand other function of the business. This makes the labor force inflexible.
4. Economies of Scale: Since production increases therefore firms enjoy larger economies of scale. These cost cuts can be passed on to consumers in the form of lower prices. Hence reducing inflation.	4. Lack of variety of consumers: Consumers have less choice since the company specializes in only one type of product. This reduces international competitiveness. Standardised product and lack of variety
5. Improved Competitiveness: This gives the firm a competitive advantage in the international market. A competitive advantage results in higher exports, appreciation in currency, higher AD, and improved standard of living.	5. Cost: The cost to employ specialist workers is high. This can lead to expensive products being developed by the firm, ultimately leading reducing profits.

6) Boredome and monotony: People can become bored by doing the same job day after day and this may have a bad effect on the quality of the product

Advantages and Disadvantages of Specialization/Division of Labor [Individual]

Advantages	**Disadvantages**
1. Workers can undertake tasks which match their natural abilities.	1. High labor turnover: Since the workers are specialist they will continuously be searching for better paid jobs. This result in companies have to rehire which increase the cost.
2. Can become more expert through practice	2. Overspecialization: Not able to do any other tasks. Less labor mobility. This can lead to shut down if one person is absent.
3. Waste less time through reduced movement	3. Create problems which may reduce productivity or limit its growth e.g. boredom.
4. Make greater use of machinery which itself is more effective by removing redundant tasks from labor and helps them to focus on value added tasks.	

Specialization, Opportunity Cost and Production Decisions

The concept of specialization and opportunity can cost us to make better production decision. It states that an **individual/firm/country should specialize in the production of a product** in which they **have lower opportunity cost**, even if one is better off with both the products. This will increase the overall production in the economy. We will use a numerical example to explain this concept:

Ali		**Ayesha**	
Pots	Bracelets	Pots	Bracelets
12	0	18	0
9	3	12	12
6	6	6	24
3	9	3	30
0	12	0	36

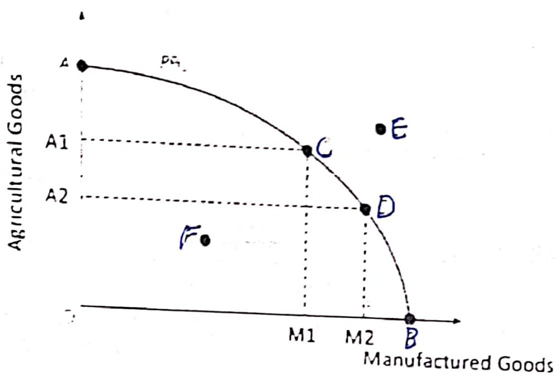
Opportunity costs for Ali	**Opportunity Costs for Ayesha**
Bracelets = 3/3 = 1 pot Pots = 3/3 = 1 bracelets	Bracelets = 6/12 = 0.5 pots Pots = 12/6 = 2 bracelets

Hence Ayesha should produce only bracelets and Ali should produce only pots.

TOPIC 2: PRODUCTION POSSIBILITY CURVES (PPC)

Definition: It is a curve that shows all the maximum possible combinations of two goods and services which a country can produce using all of available resources with efficient technique of production at given state of technology.

1. **Assumptions of PPC: Let's assume that the PPC is of Country A.**
1. Country A produces only two goods, agricultural goods and manufactured goods.
2. Economy is operating at full employment, i.e. all available resources are utilized to produce goods and services.
3. Country A has limited number of factors of production. (Land. Labor. Capital).



The figure above shows that if producers want to increase the production of cars from C1 to C2 the amount of furniture has to be decreased from F1 to F2. The opportunity cost of producing an extra C2-C1 cars is F2-F1.

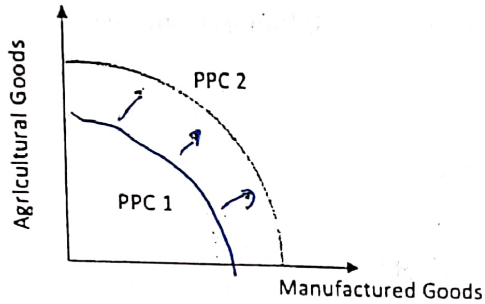
A – All resources dedicated to the production of Agricultural Goods
B – All resources dedicated to the production of Manufactured Goods
C – A1 agricultural goods produced alongside M1 manufactured goods
D – A2 agricultural goods produced alongside M2 manufactured goods cars
E – This point is beyond the PPC and is unattainable since it lies outside of the productive capacity of the economy.
F – This point is within the PPC. The production of both agricultural and manufactured goods can be increased without any opportunity cost as there are idle resources in the economy.

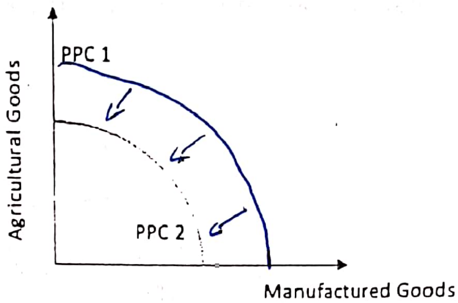
Note: Movement from point F to any point on the PPC shows short-term economic growth and the shift of the PPC represents long term economic growth.

2. SHIFTS IN PCC

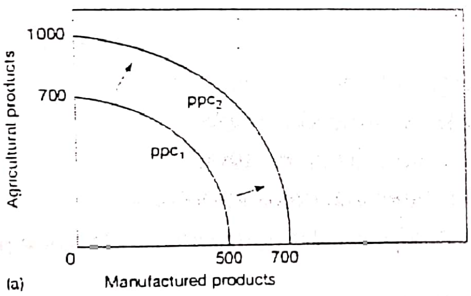
A PPC curve can shift
i) Inward or Outward: Inward shows a decrease and outward shows an increase
ii) Parallel or Pivotal: Depends

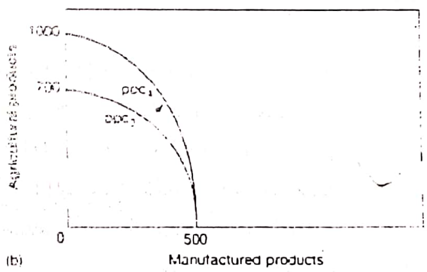
Outward Shift	Inward Shift
An ~~in~~outward shift shows an increase in productivity and output.	An inward shift shows a decrease in productivity and output.





Parallel Shift	Pivotal Shift
Parallel shift of PPC occurs when increase in quantity and quality of resources in equally suitable/disastrous for both goods.	Pivotal shift occurs in PPC when change in quantity and quality of resources affects only one good or affects one good more than the other. Example: A genetic breakthrough in productive of wheat, rice or cotton will increase only the agricultural capacity of a country.





3. SOURCES OF SHIFT IN PPC

There are THREE major sources of shift in PPC of a country:
1. The quantity of factors of production in an economy change
2. The quality/productivity of factors of production change
3. Reallocation of Resources

1. The quantity of factors of production in an economy change

1. Land	
<u>Land may increase because of:</u> 1. Discovery of oil, metal, minerals, reserves etc. 2. Barren land irrigated and made productive Outward shift of PPC	<u>Land may decrease because of:</u> 1. Depletion of non-renewable natural resources e.g. oil, gas etc. 2. Natural disasters like earthquakes, floods etc. Inward shift of PPC

2. Labor	
<u>Labor may increase because of:</u> 1. Increase in working population 2. More immigration than emigration 3. More women in jobs 4. High retirement age Outward shift of PPC	<u>Land may decrease because of:</u> 1. Decrease in working population 2. More emigration than Immigration 3. Less women in jobs 4. Poor health facilities Inward shift of PPC

3. Capital	
<u>Labor may increase because of:</u> 1. Gross Investment* > Depreciation* amount a company has made in an asset Outward shift of PPC	<u>Land may decrease because of:</u> 1. Gross Investment < Depreciation Inward shift of PPC

*Gross Investment: Total spending on capital goods and services in a given time
*Depreciation: Loss in the value of an asset due to wear and tear, obsolesce or just passing time.

2. The quality/productivity of factors of production change

<u>Definition | Productivity:</u> It is defined as output per unit of input. It measures how efficiently factors of production are used. Several factors influence productivity:

Factor	**Description**
1. Technology	Makes capital more productive and increases productive capacity. Technology ↑ Productivity ↑ PPC outward shift Technology ↓ Productivity ↓ PPC inward shift
2. Education and Training of Labor force	It helps to improve labor and hence they can use capital more efficiently and come up with better ideas and products. Education ↑ Productivity ↑ PPC outward shift Education ↓ Productivity ↓ PPC inward shift
3. Research and Technology	This involves better techniques of extractions, improved methods of farming etc. R&D↑ Productivity ↑ PPC outward shift R&D ↓ Productivity ↓ PPC inward shift

3. Reallocation of Resources

Definition: Reallocation means switching factors of production from production of one product to another type of product. There are TWO types of reallocation:

Primary to manufacturing/service sector	Consumer Goods* to Capital Goods*
Since manufacturing and service sector is more productive than the primary sector, more services and manufacturing the economy produces higher the productivity.	Since capital goods have higher added value and can contribute to a larger success of a country in the long run hence more the capital goods higher the productivity.
PPC outward shift Manufacturing/Service > Primary	PPC outward shift Capital Goods > Consumer Goods
PPC inward shift Manufacturing/Service < Primary	PPC inward shift Capital Goods < Consumer Goods

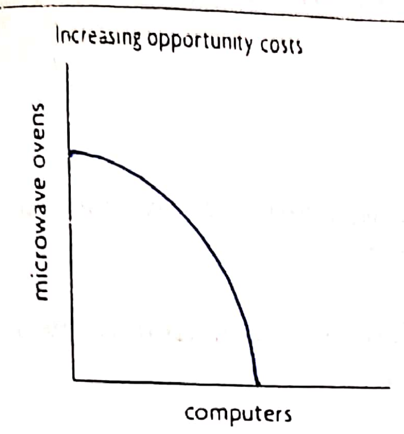
*Capital Goods: Goods that increase the future capacity of an economy. Example: Machinery, factory buildings. The expenditure on these goods in known as **investment**.

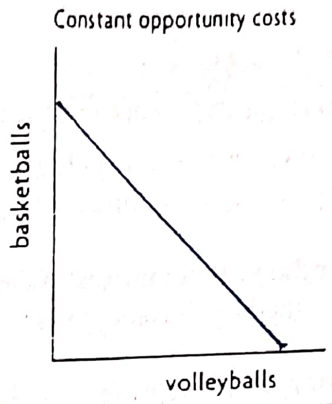
*Consumer Goods: These goods are for present use. Examples: Apple. car. TVs etc. The expenditure on these goods in knowns as **consumption**.

Note: If an economy chooses to produce more capital goods and less consumer goods in the present it will enhances the productive capacity of the economy and this will lead to production of both goods in the future. The decision to produce more capital goods today mean fewer consumer goods today. The choice is of having a higher standard of living today vs. economic prosperity in the future.

4. INCREASING AND CONSTANT OPPORTUNITY COSTS PPC

Increasing Opportunity Cost	Constant Opportunity Cost
Increasing opportunity costs arise as for each additional unit of computers that is produced, the opportunity cost, consisting of microwave ovens sacrificed, gets larger and larger as computer production increases. This happens because of specialization of factors of production, which makes them not equally suitable for the production of different goods and services. As production switches from microwave ovens to more computers, it is necessary to give up increasingly more microwave ovens for each extra unit of computers produced, because factors of production suited to microwave oven production will be less suited to computer production.	Constant opportunity costs arise when the factors of production are equally well suited to the production of both goods, such as in the case of basketballs and volleyballs, which are very similar to each other, therefore needing similarly specialized factors of production to produce them. As we can see in Figure (b), for each additional unit of volleyballs produced, the opportunity cost, or sacrifice of basketballs, does not change.


Increasing opportunity costs
microwave ovens
computers


Constant opportunity costs
basketballs
volleyballs

TOPIC 3: ECONOMIC SYSTEMS

1. LEVELS OF BUSINESS ACTIVITY

1. **Primary:** This sector includes the extractive industries that acquire raw material from naturally available resources, e.g. agriculture, mining etc.

2. **Secondary:** It comprises of the manufacturing industries that convert raw material into semi-finished or finished goods. E.g. Textile industry.

3. **Tertiary:** This represents all kinds of services such as banking, retailing, etc.

Note: The significance of these three sectors varies from country to country depending on factors such as availability of resources, size of the population etc. These sectors are usually compared on the bases of the number of people employed or the proportion each sector has in the total national output. The developing countries such as Pakistan the primary sector is the most dominant one as most of the population lives in the rural areas and have less demand for secondary and tertiary goods. In developed countries like the US and UK. the secondary and tertiary sectors are likely to employ many more workers and these sectors are a major part of their economy.

2. ECONOMICS SYSTEMS

Definition: An economic system describes the way in which an economy is organized and run, including alternative views of how resources are best allocated. There are three main types of economic systems:
1. Market Economy
2. Planned Economy
3. Mixed Economy

1. Market Economy

Definition: A market economy is a system where ownership of resources in the hand of private individuals who allocate them as they see fit and government intervention is minimized. The forces of demand supply (price mechanism) are used to allocate resources and the private sector decision the answer to the three fundamental economic questions.
Features include:
1. No government interference
2. Resources are allocated on the basis of price. Higher the price more the supply, lower the price more the demand. Resources are sold to individuals who have the willingness and ability to pay.
3. Production of profitable products is maximized whereas production of unprofitable products is stopped.
4. There is competition in the market which leads to greater choice for the consumers.

Advantages	Disadvantages
1. Market economies are efficient and pay attention to what consumers want. Due to presence of competition companies try to create unique selling points and tend to develop better technology and try to create innovative products to attract and satisfy their consumers. Respone to consumer demand is quick due to the mechanism of demand and supply	1. Market economies create negative externalities like noise, air and water pollution etc. in an attempt to reduce their private costs under their profit maximization motive.
2. They also have freedom of choice since the government intervention is minimized. Individuals can choose to buy whatever they like. This produces variety of goods and services.	2. Market economy lacks any redistributive mechanism of income. The rich tend to get richer and the poor tend to get poorer.
3. Market economies are driven by the profit motive which motivates business and individuals to work hard. These incentives help boost the economic growth and raise the standard of living.	3. Private firms under profit maximization will produce demerit goods. Demerit goods are bad of society like Alcohol, cigarettes etc.
4. Least interference of govt. eliminates bureaucratic hurdles in economic activities. This improves the ability of a business to response to changes in consumer preferences.	4. Due to absence of government control, public goods such as street lighting, roads, healthcare might not be provided.
	5. Due to competition firms tend to waste valuable resources on activities like excessive advertising to gain competitive advantage. This also leads to consumer exploitation.

2. Planned Economy

Definition: A planned economy is where all the resources are allocated by the government. They use a rationing mechanism of central planning and quotas. The aim in planned economy is collective social welfare. Features include:

1. Basic economic questions answered by the government.
2. Wage differentials are minimal due to the aim of quality and eliminating social gap.
3. There is minimal engagement in international trade as the government prefers to be self-sufficient.

Advantages	Disadvantages
1. There is a large potential for economies of scale by operating large state monopolies like water supply, public transport, electricity. Economies of scale is a situation where by increasing the scale of production average cost per unit decreases.	1. Due to absence of price mechanism the government is unable to guess exact quantities demands which can lead to surplus and shortages in the economy.
2. Due to absence of competition wastage can be reduced. Since costs of advertisement will be nonexistent and state will only provide goods that are necessary.	2. There is a lack of variety of goods which reduces the standard of living. Since the market lacks competition and the government is more focused on being self-sufficient which leads to production of necessities not variety of goods.
3. The gap between rich and poor is minimized. Since the government provides basic needs to be met for everyone in the society. Example: education and health care for all.	3. The economy is less responsive to consumer needs. Since bureaucrats take the decision they don't take entrepreneurial risks and lack innovation.
4. The government keep on externalities like pollution and reduce the production of demerit goods like alcohol, cigarettes etc.	

3. Mixed Economy

Definition: A mixed economy is a combination of both market and planned economy. The degree of private and public involvement is determined by the government. Essential services like health, education, street lighting, public transport is provided by the public sector. The private sector provides goods and services demanded by the consumers like cars, entertainment, tourism etc. This is a good system since it strikes a balance between both the worlds, however it should always be noted that even in a mixed economy consumer sometimes have to pay high prices if there are private monopolies and public sector is prone to inefficiency.

3. ISSUES OF TRANSITION

An economy has to face several issues when it plans to move from a planned to being a mixed or market economy. In this both firms and consumers need to accept there is more freedom to make decisions and let the market forces allocate resources.

— **How can it change:** The task of reforming require the govt. to establish reforms in THREE ways:

1. Price and Trade Liberalization: In planned govt. controls everything, but when price is free demand and supply start to function which will create efficiency. Along with this competition needs to be encouraged to liberalize trade. State monopolies, tariffs, quotas and non-tariff barriers need to be removed and the currency to trade in the foreign market.

2. Privatization: Firms should be given a profit motive along with increasing quality. This can be done through better production techniques, training for managers, better machines etc. However, the implementation might take time.

3. Financial Sector: Establishment of central bank and creating commercial banking institutes and other financial markets. Attracting foreign direct investments. This also allows transfer of technology and management techniques.

— **Why is it difficult?**

1. Lengthy process: It is a lengthy process since firms need time to adjust their production processes.

2. Inflation: It might cause massive inflation as in planned when shortages existed consumers had cash but they were unable to buy the products. However, in free market now excess cash can be used to import goods or offer more to the firm to acquire that product. This causes massive increase in prices.

s privete ector has profit obtive and ould tend increase rices to aximise rnings

3. Unemployment: Imports might increase due to trade liberalization and this might cause massive inflow of imports shutting down local firms and causing unemployment on a large scale. This leads to reduction in govt. tax revenue and govt. needs to spend more on transport and housing causing budget deficits. Has a lot of social costs involved like pollution/over-production of demerit good

Positive Impacts	Negative Impacts
1. Stronger financial system	1. Job losses
2. Attractive business environment	2. Need to make social reforms
3. More sectors in the economy	3. Establish good tax system
4. Variety of goods	4. Consumer exploitation might go up

4) The government should restrict microeconomic intervention like taxes, subsidies and price controls to let the market forces allocate resources according to the consumer's preference. This will prevent any shortages/surpluses to be created in the market.

AS – ECONOMICS (9708)

PAST PAPER SESSION

MICRO

CHAPTER 1

Basic economic ideas

TOPIC 1: BASIC ECONOMIC IDEAS

Variant 1

(M/J 2010, V1), Q2, a focus area application

(a) Explain how division of labour can affect labour productivity. [8]

Definitions: Division of Labor & Labor Productivity: Productivity is output per worker. Specialization involves sub-dividing working processes and concentration on one aspect to raise efficiency.

Advantages	Disadvantages
1. Workers can undertake tasks which match their natural abilities. 2. Can become more expert through practice 3. Waste less time through reduced movement 4. Make greater use of machinery which itself is more effective by removing redundant tasks from labor and helps them to focus on value added tasks.	1. High labor turnover: Since the workers are specialist they will continuously be searching for better paid jobs. This result in companies have to rehire which increase the cost. 2. Overspecialization: Not able to do any other tasks. Less labor mobility. This can lead to shut down if one person is absent. 3. Create problems which may reduce productivity or limit its growth e.g. boredom.

(M/J 2015, V1), Q3, a

(a) Explain how the contribution of each factor of production differs in an agricultural economy from that in an industrialized economy. [8]

Definitions:

1. Factors of Production — These are resources used by the economy to produce goods and services. Land [Natural Resources, oil, raw materials, earnings are called **rent**], Labor [Physical and mental Efforts, engineer, managers, earning are called **wages**], Capital [Man-made resources like machinery, earnings are called **interest**] and Enterprise [skill to combine factors of production, risk taker and innovator, earnings are called **profits**] [Explain all of them with examples].
2. Agricultural economy — Optimizing the production and distribution of food [Reliance on Primary Sector]
3. Industrialized economy — Combining factors of production to produce material goods [Reliance on Secondary Sector]

1. Land: In agricultural economies land is more focused on primary sector output like wheat, cotton sugarcane and the this would be the most significant factor of production. Agricultural economies tend to use this FOP the most and usually tend to specialize in this sector and export the surplus. In industrialized economies have less importance to this sector and usually tend to import these.
2. Labor: In agricultural economies most of the labor is manual and working in farms. Most of the labor is unskilled and production methods are more labor intensive. In industrialized economies labor is more skilled and less labor is used since few skilled labor working at high wages end up producing the same or more amount of output.
3. Capital: In agricultural economies most of the capital would be invested in farming equipment like tractors, fertilizers however these economies rely less on capital. In industrialized economies capital would be the dominant FOP and most of the production would be done using automated plants and converting the raw materials to semi-finished and finished production.
4. Enterprise: In agricultural economies enterprise comprises of small or large businesses owners who mostly have businesses in the agricultural industries. These can involve landlords who are mostly retailing raw materials. In industrialized economies enterprise usually start businesses like manufacturing cars and there is diversity in the production of goods.

(M/J 2016, V1), Q3, a [ECR]

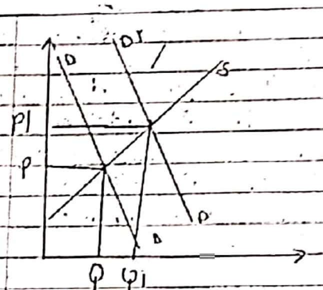
(a) Outline the functions of the factor enterprise in a modern economy, and explain how enterprise responds to a rise in the demand for a good. [8]

3 a Factor enterprise is responsible for organising resources and taken the financial risk in the production process inother to produce good and services with the main aim of profit. Demand is the ~~In this modern economy~~ willingness and ability to purchase the goods at a particular price over a period of time.

In the modern economy, enterprise are responsible for Indentifying the needs or wants of consumers and organising the factors of production land, labour and capital by investing finance into the purchase or hire of these factors of production inother to satisfy the wants of consumers and gain profit.

Enterprise innovate methods to promote efficiency in the use of scarce resources inother to increase productivity and hence increase revenue. They introduce cost effective methods of production inother to improve their revenue. They conduct research and development ~~methods~~ service serveys and they are therefore able to indentify the needs of consumers and find means of solving them effectively.

A rise in the demand for their goods would set as an incentive to increase their ~~P~~ price inother to gain more revenue. However this will depend on the elasticity of demand of their product. If demand for their product is inelastic, the increase in price of good and services would help increase the revenue of the producers. This can be illustrated below.



When demand is inelastic, a ~~small~~ large rise in price would lead to a greate rise in quantity demanded.
When demand is elastic however it would be advisible to reduce price when demand rise.

❶ The candidate starts by stating that the functions of enterprise include organising and risk taking.

❷ The candidate gives a useful outline of the functions of enterprise in a modern economy here, although more could have been written on the risk-taking function. Three marks are awarded for knowledge and understanding.

❸ The candidate recognises that a rise in the demand for a good would consequently lead to a rise in price.

❹ The candidate has produced a good answer in terms of how enterprise responds to an increase in price, so gains all four marks for application.

Mark for (a) = 7/8

Variant 3

(M/J 2010, V3), Q2, a

(a) With the help of examples, explain why different economic decision makers face the problem of scarcity. [8]

Definitions:

1. Scarcity — Results from limited resources and unlimited wants. This means choice is necessary and an opportunity cost occurs.
2. Opportunity cost — The next best alternative foregone
3. Economic Decision makers — These are individuals who answer the three basic economic questions. What to produce, how to produce and for whom to produce.

People are forced to make choices due to the presence of the basic economic problem mentioned above. Opportunity costs is defined as the next best alternative forgone. In simpler terms, the sacrifice by an individual or organization while giving preference to one product to the other is known as the opportunity cost of a particular decision. Remember that this is made by all economic decision makers: Consumers, businesses and government. Examples:

1. Consumer – An individual has $1000 and he/she can either buy a laptop or a smart phone. If the individual chooses the laptop the smart phone becomes the opportunity cost.
2. Businesses – A business has $1million. It can either spend it on expansion to a new country or invest in research and development. If the businesses choose to invest it in expansion, the research and development becomes the opportunity cost.
3. Government – A government has two options either to build roads or building schools in the country. If the government chooses to build roads, developing schools would become the opportunity cost.

TOPIC 2: PRODUCTION POSSIBILITY CURVE

(M/J 2010, V2), Q2, a

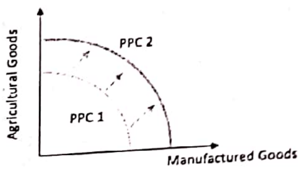
(a) Explain how a country's production possibility curve depends upon its factors of production. [8]

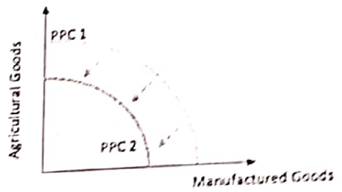
Definitions

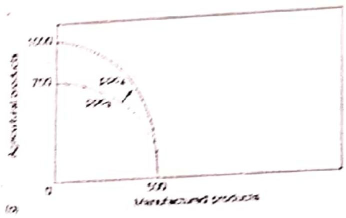
1. PPC — It is a curve that shows all the maximum possible combinations of two goods and services which a country can produce using all of available resources with efficient technique of production at given state of technology. The negative slope represents the opportunity cost. Note: Explain every point the diagram.

2. Factors of Production — These are resources used by the economy to produce goods and services. Land [Natural Resources, oil, raw materials, earnings are called rent], Labor [Physical and mental Efforts, engineer, managers, earning are called wages], Capital [Man-made resources like machinery, earnings are called interest] and Enterprise [skill to combine factors of production, risk taker and innovator, earnings are called profits] [Explain all of them with examples].

The increase or decrease in Quantity and Quality of factors of production can affect the PPC. An increase in the FOPs will shift the curve outside and decrease will shift it inwards. The curve can also shift pivotal if the increase only impacts one good.







Factors of Shift

→ Land: Natural Disasters [Inwards] / Discovery of oil [Outwards]

→ Labor: Emigration (Quant) Poor Health Facility (Qual) [Inwards] / More Population (Quant) Education (Qual) [Outwards]

→ Capital: Less investment (Quant) Less R&D (Qual) [Inwards] / More investment (Quant) Better Tech (Qual) [Outwards]

→ Enterprise: Training Programs can impact both Qual and Quant. If they are present [Outwards] if they are absent [Inwards]

(O/N 2011, V2), Q2, a

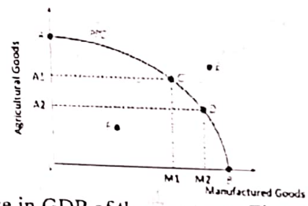
(a) Show how production possibility curves may be used to explain any **two economic ideas.** [8] **[Explain one microeconomic idea and one macroeconomic idea]**

Definitions

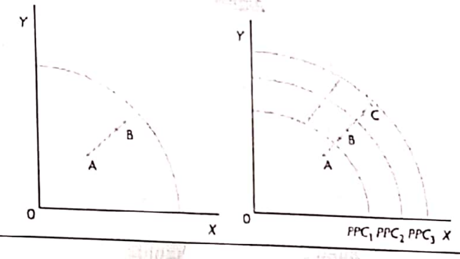
1. Micro — This part of economics study problems related to individuals, firms and govt.
2. Macro — This part of economics study problems related to the whole economy.
3. PPC — Combination of 2 goods, given resources at a given state of technology. [With the diagram and its explanation]

There are **TWO** ideas that can be represented Scarcity [Micro] and Economic Growth [Macro]

1. Scarcity: Results from limited resources and unlimited wants. This means choice is necessary and an opportunity cost occurs. Opportunity cost is the next best alternative foregone. This is measured through the MRT [Marginal Rate of Transformation]. PPC shows max resources. Movement from C to D which highlights Opp. Cost.



2. Economic Growth: This is the increase in GDP of the economy. First diagram Short-run second diagram long-run.

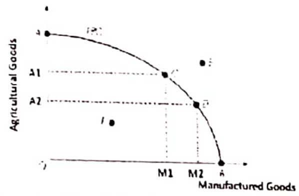


(M/J 2012, V2), Q2, b

(b) Discuss whether an economy's production possibility curve is more likely to move **inward** or **outward** over time. [12] [Similar to (M/J 2010, V2), Q2, a]

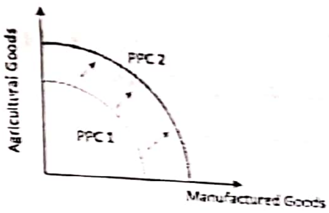
Definitions

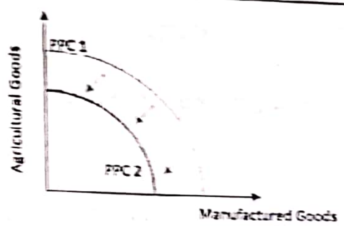
1. PPC — It is a curve that shows all the maximum possible combinations of two goods and services which a country can produce using all of available resources with efficient technique of production at given state of technology. The negative slope represents the opportunity cost. Note: Explain every point the diagram.

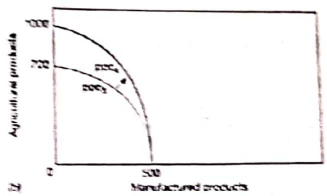


2. Factors of Production — These are resources used by the economy to produce goods and services. Land [Natural Resources, oil, raw materials, earnings are called rent], Labor [Physical and mental Efforts, engineer, managers, earning are called wages], Capital [Man-made resources like machinery, earnings are called interest] and Enterprise [skill to combine factors of production, risk taker and innovator, earnings are called profits] [Explain all of them with examples].

The increase or decrease in Quantity and Quality of factors of production can affect the PPC. An increase in the FOPs will shift the curve outside and decrease will shift it inwards. The curve can also shift pivotal if the increase only impacts one good.







Factors of Shift

→ Land: Natural Disasters [Inwards] / Discovery of oil [Outwards]

→ Labor: Emigration (Quant) Poor Health Facility (Qual) [Inwards] / More Population (Quant) Education (Qual) [Outwards]

→ Capital: Less investment (Quant) Less R&D (Qual) [Inwards] / More investment (Quant) Better Tech (Qual) [Outwards]

→ Enterprise: Training Programs can impact both Qual and Quant. If they are present [Outwards] if they are absent [Inwards]

EVAL: The PPC can shift outwards or inwards but the reasons given an inward shift has a lower probability of occurring for most countries. Countries that are developing or have utilized their resources are more likely to shift outwards. However, countries that face hostile borders might be prevented to do so. To conclude the shift depends on the policy of the govt., consumers and how the resources are managed. Developed countries have a higher chance of an outward shift because they aim for full employment and growth whereas developing countries due to mismanagement might have a movement from on the PPC to inside the PPC due to mismanagement of resources.

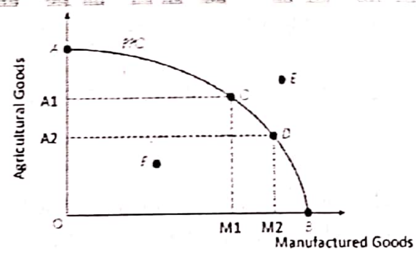
(O/N 2012, V2), Q2, a

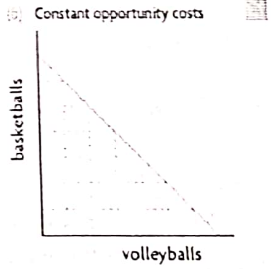
(a) Explain with the help of a production possibility diagram, how the opportunity cost of producing different combinations of goods can be measured. [8] **[Similar to scarcity]**

Definitions

1. PPC — It is a curve that shows all the maximum possible combinations of two goods and services which a country can produce using all of available resources with efficient technique of production at given state of technology. Note: Explain every point the diagram.

2. Opportunity Cost — Next best alternative foregone. The negative slope represents the opportunity cost which is measured by MRT [Marginal Rate of Transformation]. This can be measured by drawing tangents to the curve and taking its gradient. $\frac{\Delta Y}{\Delta X}$





The outward bending curve shows the tradeoff and that resources are not homogenous. As more of one good would be produced the resources would become less efficient. However some goods have constant opp. cost these are represented by a straight line PPC.

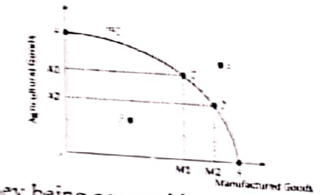
Variant 1

(M/J 2012, V1), Q2, a

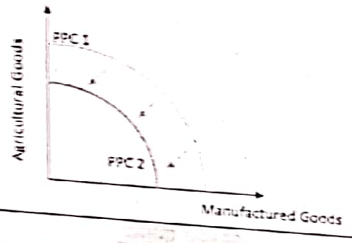
(a) Explain how the loss of confidence in money will affect an economy's production possibility curve. [8]

Definition

1. Money — Anything that is generally acceptable as a means of payment and has four functions [Medium of Exchange, Measure of Value, Store of Value, Standard of Deferred Payment].
2. PPC — Shows the maximum possible combinations of outputs when an economy operates at full employment.



The loss of confidence will prevent money being acceptable and its functions will not operate effectively. This will restrict specialization and output. The result will be lower potential production so fixing the curve nearer to the origin than one with the use of money. This will cause an inward shift the curve.



Similar Questions

(O/N 2017, V2), Q3, a

(a) Show the difference between a movement along, and a shift in, a production possibility curve. Explain what might cause each to occur. Use diagrams to support your answer. [8]
[Similar Question to (M/J 2012, V2, Q2, b)]

(O/N 2015, V3), Q2

(b) Discuss whether an outward shift in an economy's production possibility curve is more likely to occur in a free market economy or a centrally planned economy. [12]

(O/N 2016, V3), Q3

(a) Explain with the help of a diagram why production possibility curves are usually drawn with increasing opportunity costs, and show how they can be used to illustrate scarcity. [8]
(b) Discuss whether it is likely that economies that have an increase in labour and a high rate of technological innovation will come nearer to solving the economic problem. [12]

(O/N 2017, V3), Q3

(a) Explain how a production possibility curve with increasing opportunity costs illustrates the consequences of a government's choice to produce more military goods. Use a diagram to support your answer. [8]

TOPIC 3: ECONOMIC SYSTEMS

(M/J 2011, V2), Q2, a [ECR]

(a) Explain the role that a government should fulfil in a mixed economy. [8]

A mixed economy is a mixture of planned economy and free market economy. A planned economy is run by the government as it solely ~~...~~ makes all the decisions. However, in a free market economy the decisions are taken by the private sector and the market forces, such as demand and supply. There is very little government intervention, such as to maintain law and order. 2

A mixed economy, being a mixture of both the extreme economies, involve two sectors only, private sector and the government. Private sector is free to make decisions but government when want or feel the requirement can intervene and alter the actions of the private sector to an extent only. (2)

In a mixed economy, private sectors make private goods only. They employ the factors of production according to their wants and decide what to make and for whom to make themselves. However their decision is influenced by market structural forces, also known as the invisible hand, demand and supply. Their aim is to maximise p

If the private sector is exploiting the consumers and charging a high price, government can intervene and apply price ceiling or if the producers are ~~being~~ exploited then price flooring can be adopted by the government.

Government collects taxes from the private sector and use them to make public goods for the people. The aim of the government is to maximise welfare so it could create job opportunities for the unemployed without putting any pressure on the private sector to employ more workers.

Government can increase awareness of merit goods and demerit goods and offer subsidies to the producer of merit goods to increase their allocation and impose taxes on the demerit goods to decrease their allocation.

The ~~government~~ government can decide to fix the balance of payments. It has the ability to impose tariffs, place quotas on the imports to improve the balance of payment. The government can also fix the exchange rate ~~sss~~ for a limited time ~~to~~ as it also effects your balance of payments. If there are high imports the government can ~~decrease~~ revalue the currency, making it difficult to import and instead rely on domestic products. ~~OB~~ On the other hand if the exports are falling then the government can ~~cse~~ devalue the currency, making ~~18~~ your exports cheap and demanded more.

~~The~~ It's the government's job to provide the country with law and order & defence. This will make the private sector secure and will concentrate on their production and will feel free to expand.

Most of times, the actions of private sector are not disturbed by the government and ~~[illegible]~~ private sector feels free to ~~[illegible]~~ produce what they want to and how. It's the private sector's choice to decide for whom to produce too. They can give subsidies to ~~ss~~ to help producers & infant industries.

8

8

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(O/N 2012, V2), Q2, b

(b) Discuss the ease with which a planned economy may be changed into a market economy. [12]

Definitions

1. Planned Economies: All the resources are allocated by the government. They use a rationing mechanism of central planning and quotas. The aim in planned economy is collective social welfare. Features include:
1.Basic economic questions answered by the government.
2. Wage differentials are minimal due to the aim of quality and eliminating social gap.
3. There is minimal engagement in international trade as the government prefers to be self-sufficient.

2. Market Economies: Where ownership of resources in the hand of private individuals who allocate them as they see fit and government intervention is minimized. The forces of **demand supply** (price mechanism) are used to allocate resources and the private sector decision the answer to the three fundamental economic questions. No government interference . There is competition in the market which leads to greater choice for the consumers.

How can it change [First Side] — The task of reforming require the govt. to establish reforms in **THREE** ways:
1. Price and Trade Liberalization: In planned govt. controls everything, but when price is free demand and supply start to function which will create efficiency. Along with this competition needs to be encouraged to liberalize trade. State monopolies, tariffs, quotas and non-tariff barriers need to be removed and the currency to trade in the foreign market.
2. Privatization: Firms should be given a profit motive along with increasing quality. This can be done through better production techniques, training for managers, better machines etc. However the implementation might take time.
3. Financial Sector: Establishment of central bank and creating commercial banking institutes and other financial markets. Attracting foreign direct investments. This also allows transfer of technology and management techniques.

Why is it difficult [Second Side]
1. It is a lengthy process since firms need time to adjust their production processes.
2. It might cause massive inflation as in planned when shortages existed consumers had cash but they were unable to buy the products. However in free market now excess cash can be used to import goods or offer more to the firm to acquire that product. This causes massive increase in prices.
3. Imports might increase due to trade liberalization and this might cause massive inflow of imports shutting down local firms and causing unemployment on a large scale. This leads to reduction in govt. tax revenue and govt. needs to spend more on transport and housing causing budget deficits.

EVAL: Transitioning is clearly not an easy task and can only benefit an economy in the long-run. Once the economy can successfully cover its short-term drawbacks only then can it enjoy the benefits. Furthermore it also depends on the efficiency of the firms in the economy and how quickly can labor and these sectors be reformed. The more flexible the economy the easier would be the transition. Lastly it should be noted that the economy should not be completely transformed into a free market. A mixed economic system should always be used to out way the disadvantages when the planned economy transforms into a mixed.

(O/N 2017, V2), Q3, b

(b) Discuss the way in which resources are allocated in planned economies and free market economies. Consider which type of economic system is likely to have the more beneficial outcome. [12]

Definitions

1. Planned Economies: All the resources are allocated by the government. They use a rationing mechanism of central planning and quotas. The aim in planned economy is collective social welfare. Features include:
1.Basic economic questions answered by the government.
2. Wage differentials are minimal due to the aim of quality and eliminating social gap.
3. There is minimal engagement in international trade as the government prefers to be self-sufficient.

Advantages	Disadvantages
1. Large potential for economies of scale: Operating large state monopolies, low prices for consumers. 2. Competition wastage can be reduced. No ads, price wars etc. 3. Gap between rich and poor is minimized: Everyone has access to basic necessities. 4. Government keep on externalities: Pollution, demerit goods restricted. Merit goods produced.	1. Surpluses and Shortages: No price mechanism. 2. Lack of variety: Standard of living falls. 3. Less responsive: Bureaucrats take the decision they don't take entrepreneurial risks and lack innovation. 4. Govt. policy tools are misused: Politicians might use monetary, fiscal and supply side policy to win votes, not allocated resources.

2. Market Economies: Where ownership of resources in the hand of private individuals who allocate them as they see fit and government intervention is minimized. The forces of **demand supply** (price mechanism) are used to allocate resources and the private sector decision the answer to the three fundamental economic questions. Features include:
1. No government interference
2. Resources are allocated on the basis of price. Higher the price more the supply, lower the price more the demand. Resources are sold to individuals who have the willingness and ability to pay.
3. Production of profitable products is maximized whereas production of unprofitable products is stopped.
4. There is competition in the market which leads to greater choice for the consumers.

Advantages	Disadvantages
1. Consumer sovereignty: Consumers determine the goods and services produced, producers make what consumers want. Demand and supply. 2. Variety of goods: More choice, people can decide who to work for, may be choice of suppliers. 3. Profit Incentive: Makes the firm efficient, due to competition, drive down costs, lower prices, profit, this increase output and GDP. 4. Less bureaucratic hurdles: This improves the ability of a business to response to changes in consumer preferences.	1. Inequality of income: The rich can increase their earning potential through saving/receiving a better education, some vulnerable groups, e.g. the sick may find it difficult to earn an income. 2. Private sector monopolies: These may charge high prices, reduce quality and restrict choice. 3. Externalities: Base decision on private costs and benefits, existence of external costs and benefits can cause inefficient choices. 4. Demerit Goods: Certain harmful products (demerit goods) may be over-consumed and so over-produced.

EVAL: The weaknesses of each system often lead to the conclusion that the mixed economy is most beneficial. It depends on the mix however. Economies that want to grow more prefer to keep a higher proportion of free-market because less controls attracts investors and firms quickly which is necessary for growth. However the economy that wants more equality prefers to have a greater proportion of public sector and keeps the key industries like health care, education under the govt. control. To conclude however a higher proportion of free market is still better because once growth is achieved govt. can keep regulating to clear its disadvantages which would be difficult to do if the economy was planned.