<u>**Central Economic Problem – Summary**</u>

Important: This set of summary notes does NOT replace the importance of the main set of notes in providing a clear understanding of the topic that is required in the A Levels.

<u>**Check list – Key requirements.**</u>

□Differentiate between positive and normative statements
□Define and explain the concept of opportunity cost and the nature of trade-offs in the allocation of resources
□Explain rational decision making by economic agents – Marginalist Principle

Use the PPC model to explain and illustrate:
  □Scarcity, choice and opportunity cost
  □Attainable and unattainable points
  □Efficiency
□Explain and illustrate the effects of changes on the PPC curve

<u>**Key information**</u>

- A **positive statement** is <u>a statement of fact</u>. It may be right or wrong, but <u>its accuracy can be tested or verified by appealing to the facts</u>. A **normative statement**, on the other hand, is <u>a statement of value or opinion</u>. It is a statement about what ought or ought not to be, about whether something is good or bad, desirable or undesirable.
- All societies face the basic economic problem of **scarcity** which arises from **limited resources** and **unlimited wants.**
- **Factors of Production include**
  - <u>**Capital**</u> typically refers to <u>physical capital</u>. Capitals in economics are man-made resources and include machines, factories, transportation and other equipment
  - <u>**Entrepreneurship:**</u> An entrepreneur is one who performs the functions of organising and managing the other factors of production, innovating new products and ways of production and taking the risks of being in business.
  - <u>**Land**</u> refers to <u>all the natural resources available</u>, which could be renewable or non-renewable in nature.
  - <u>**Labour**</u>, also known as human capital, refers to people, including their skills and abilities.
- The opportunity cost is the benefits from the next best alternative that is forgone.
- Opportunity costs may include both explicit costs and implicit costs of making a decision.
  - Explicit costs are costs that require a direct money payment
  - implicit costs are costs that do not require a direct money payment such as time.
- The Marginalist Principle - of weighing the marginal benefits and marginal costs of an activity to achieve their aim – maximise utility / profits or social welfare. Rational decision making occurs when the economic agent undertake an activity (or do more of it) if the marginal benefit is at least as great as the marginal cost.
- Law of Diminishing Marginal Utility – As the consumer becomes more satisfied, each additional unit of the good consumed will gives less additional utility than previous units.
- Law of Diminishing Marginal Returns - when increasing amounts of a variable factor of production are used with a given amount of a fixed factor, there will come a point when each extra unit of the variable factor will produce less extra output than the previous unit
- 3 economic questions

- What and how much to produce? choices need to be made on what goods and services get to be produced and in what quantities.
- How to produce? Most goods can be produced by a variety of methods with varying combinations of resources.
- For whom to produce? How will the total output be distributed among members of the society?

- PPC shows all the maximum attainable combinations of two goods that a country can produce within a specified time period with all its resources fully and efficiently employed, at a given state of technology.
- Scarcity is illustrated by the country being able to produce only at one of the points on or within the PPC. All points outside the PPC illustrates the problem of scarcity.

Typical types of essay questions in Central Economic Problem

[2021]: The market for bicycles is often said to generate external benefits such as reduced traffic congestion and reduced air pollution.

(a) Explain how economic theory suggests consumers act rationally to decide whether or not to buy a bicycle, and how producers of bicycles act rationally to determine their level of output. [10]