



Basic Economic Problem And PPC

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What is Economics

- Economics is the study of resources and how to use these resources to achieve maximum production.

Basic Economic Problem

- Refers to the situation that every country in the world has **limited resources and unlimited wants**, which means that no country in the world can produce everything that it needs or especially what it wants.
- The concept of Basic Economic Problem is also sometimes known as Scarcity.
- Because countries cannot produce everything, they need to prioritize between different products which results in Opportunity Cost.

Opportunity Cost

- The product / benefit that is given up to produce something else is known as opportunity cost.
- Opportunity Cost is the benefit of the **next best alternative forgone**.

Opportunity Cost

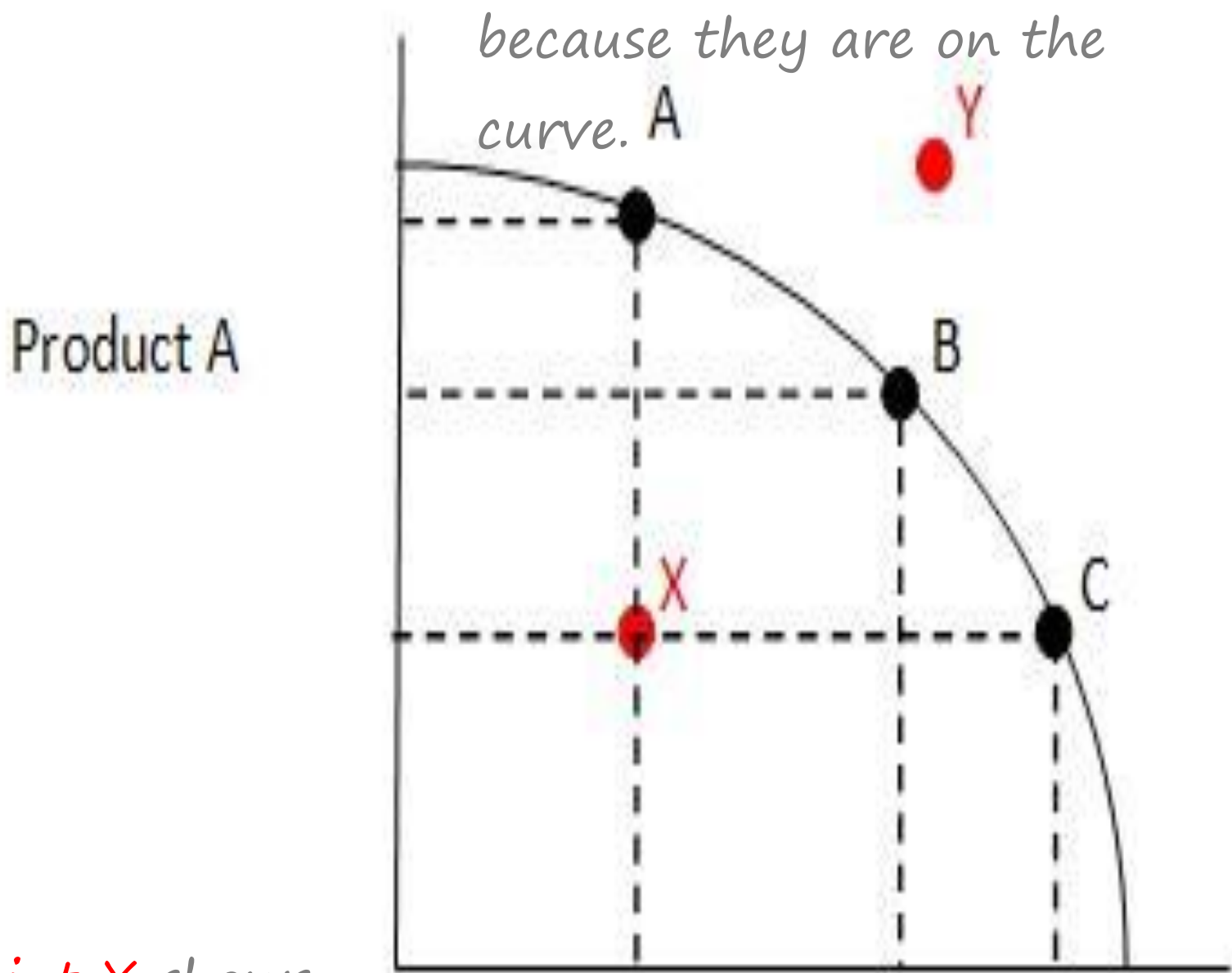
- Opportunity Cost refers to lost benefit that arises because of our choices.
- For instance if someone has Rs 100 and he can either purchase a bottle of coke or a book but not both; then if person prefers to consume coke the lost pleasure of reading the book will be his / her decision's Opportunity Cost.
- **All decisions** whether personal, business or government level involve some Opportunity Cost so our choices should consider the sacrifices / opportunity cost we have to pay.

Production Possibility Curve - PPC

- PPC is a graph that shows the maximum output that a country can produce in terms of 2 goods.
- PPC explains the concept of basic economic problem and opportunity cost.
- PPC is sometimes also called **Production Possibility Frontier** - PPF.

Production Possibility Curve - PPC

Points A, B and C shows full employment of resources because they are on the curve.



Point X shows unemployment of resources because it is within the curve.

Product B

Point Y is unattainable because it is outside the curve.

Shifts in PPC

Overtime, changes in economy's resources will cause its PPC to shift inwards or outwards due to **improvement or deterioration** of its production possibilities respectively.

1. Increase in resources will cause the PPC to shift outwards
2. Decrease in resources will cause the PPC to shift inwards

Outward Shift in PPC

1. Discovery of more natural resources e.g Pakistan discovers more coal, gold etc.
2. More educated and trained workforce – with more labor force the country can produce more
3. Invention of new technology e.g tractors, harvesters, fertilizers etc.

Inward Shift in PPC

1. Natural disasters like floods, earthquakes etc. which destroys country's resources

2. Depletion of resources – is when a country has made use of all of its resources like coal, oil,

Factors of Production

All resources are divided in following 4 categories:

- **Land:** Any natural resources are called land. This not only includes physical land but also natural resources like wood, metals, timber, leather etc.
- **Capital:** All man-made tools / resources are known as capital. Eg machinery, cars, cellphones, laptops etc

Factors of Production

- **Labor:** All physical or mental efforts made by humans is known as labor. Labor can be further divided in two categories namely skilled and unskilled labor.
- **Enterprise / Entrepreneur:** Business organization or business-person that arranges other factors of production and takes the investment risk is known as

enterprise or entrepreneur.



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Division of Labor

- **Specialization** is when workers / employees focus on few tasks and activities like an economics teacher will always teach economics and similarly a doctor will always work as a doctor.
- **Advantage:** more efficiency and faster production
- **Disadvantage:** employees might get bored from doing the same task again and again. However the company can help employees kill their boredom by engaging them in more diverse tasks.

Division of Labor

- Specialization at individual level is known as division of labor.

Individuals' productivity is found to be **higher** when they specialize in few activities rather than multi or diverse tasks.

- An ideal example of division of labor will be of a teacher who works only as a teacher and then purchases all other goods / services that he / she needs which obviously the teacher cannot produce on his / her own like clothes, laptop, phone etc.

Specialization of Countries

- Just like employees specialize so do countries for instance due to *abundance of land and labor* Pakistan is good at producing agricultural products and other countries are good at producing other products.
- So Pakistan specializes in production of goods it is good at like *agricultural goods*, export the excessive production / surplus and import the products that Pakistan does not produce or is not good at producing like machinery etc.

Classification of Goods

- **Consumer Goods:** Any good or service that is purchased for consumption purposes. For instance radio, newspaper, television cellphone, food
- Consumer goods are further divided into two categories namely durable consumer goods and non-durable consumer goods. The first type refers to goods that have comparatively longer life like cars, houses, refrigerators etc. The second type are the ones that are perishable like food, clothing, etc.
- **Capital Goods:** Any good that is not needed for its consumption but is used for producing other goods and services like production machinery, tools etc.

Classification of Goods

- *Another classification of goods divide goods in private and public goods.*
- Unlike private goods that are excludable and rivalry, public goods are non-excludable and non-rivalry.
- *Parks, military services, roads, street lights* are all examples of public goods. Non-excludable refers to inability of individuals to restrict anyone from consuming certain good. Non-rivalry refers to characteristic of a good that does not diminish its benefit due to its consumption by more individuals.

Private Goods

- Private Goods have **clearly defined property rights** like my laptop, your cell phone, my car, your house etc.

Public Goods

- Public Goods have **joint ownership** like roads, motorways, parks, defense etc.

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Merit Goods

- Any product that is **beneficial** for consumers like education, health care, vaccinations etc.

Demerit Goods

- Any product that is **harmful** for consumers like alcohol, junk food, smoking etc