

1 The economic problem – Part 2

Name: _____ Class: _____ Date: _____

Vocabulary

Write each word three times.

English	Write it 3 times (English)		
production possi- bility curve	_____	_____	_____
unemployment	_____	_____	_____
economic growth	_____	_____	_____
allocate	_____	_____	_____
market economy	_____	_____	_____
planned economy	_____	_____	_____
mixed economy	_____	_____	_____
price mechanism	_____	_____	_____
private good	_____	_____	_____
public good	_____	_____	_____
national defence	_____	_____	_____
free-rider problem	_____	_____	_____
merit good	_____	_____	_____
demerit good	_____	_____	_____

Recall

In **Part 1** you met scarcity, the economic problem, opportunity cost, and the four factors of production. Part 2 adds a **diagram** of an economy’s choices, how countries **organise** their economy, and the main **types of good**.

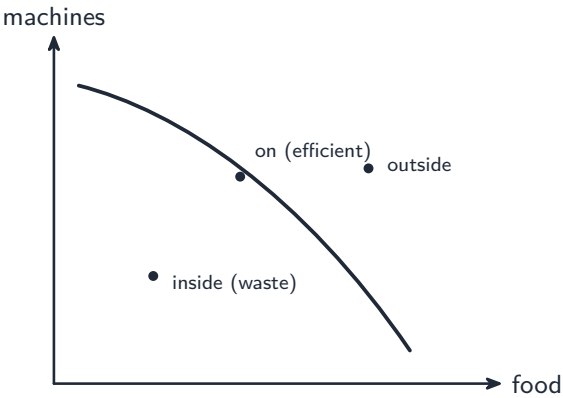
New ideas

■ 1 The production possibility curve

A **production possibility curve** (PPC) shows the largest combinations of two goods an economy can make when all its resources are fully and well used.

- a point **on** the curve – all resources used, so it is **efficient**;
- a point **inside** the curve – resources are wasted (for example **unemployment**);
- a point **outside** the curve – impossible today, because resources are scarce.

Moving along the curve shows **opportunity cost** – to make more of one good, you give up some of the other. The whole curve shifts **outward** with **economic growth** (more or better resources).



Micro-check. What does a point **inside** the PPC show? [1]

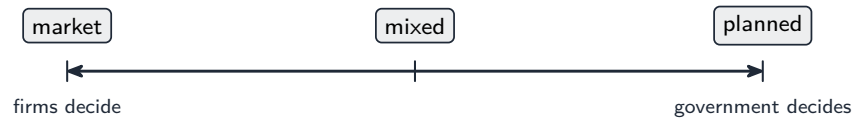
■ 2 Economic systems

A country must decide how to **allocate** (share out) its scarce resources. There are three systems:

- a **market economy** – firms and people own resources, and prices decide what is made;

- a **planned economy** – the government owns resources and decides what is made;
- a **mixed economy** – a blend of the two (almost every real country).

In a market, the **price mechanism** does three jobs: it **signals** where goods are wanted, gives an **incentive** to supply, and **rations** scarce goods to those willing to pay.



Micro-check. In which system does the **government** own most resources? [1]

■ 3 Types of goods

- a **private good** is scarce: it has **rivalry** (if I use it, you cannot) and is **excludable** (you can be stopped from using it unless you pay);
- a **public good** (street lighting, **national defence**) has **non-rivalry** and **non-excludability**, so private firms cannot make a profit from it (the **free-rider problem**) – the government must provide it.

A **merit good** (like education) is good for you, so people buy too **little**; a **demerit good** (like cigarettes) is harmful, so people buy too **much**.

private good
rivalry + excludable
firms can sell it (a sandwich)

public good
non-rivalry + non-excludable
government provides it (street lighting)

Micro-check. Is education a **merit** or a **demerit** good? [1]

Watch out: on the PPC = efficient; inside = wasteful (e.g. unemployment); outside = impossible now. A *public* good has *both* non-rivalry and non-excludability (the free-rider problem). Merit goods are *under*-consumed; demerit goods *over*-consumed.

Practice

1.1 On a PPC, state what each point shows: (a) on the curve, (b) inside the curve, (c) outside the curve. [3]

1.2 State what causes the whole PPC to shift **outward**. [1]

1.3 State one difference between a **market economy** and a **planned economy**. [2]

1.4 State the two features of a **public good**. [2]

1.5 State whether each is a **merit** or a **demerit** good: (a) health care, (b) alcohol. [2]

1.6 Challenge. Explain why a private firm is unlikely to provide street lighting, so the government must instead. [2]