The economic problem and economic assumptions

Edexcel IGCSE Economics 4EC1 sections 1.1.1-1.1.2 full package

The economic problem and economic assumptions

- explain **scarcity** and why it forces people, firms and governments to choose;
- explain opportunity cost and give examples for consumers, producers and the government;
- draw and use a **production possibility curve**;

The economic problem and economic assumptions (2)

- explain the causes of economic growth and of negative growth;
- explain the assumptions economists make about consumers and producers, and why these may not hold.

The economic problem

- **A consumer**: Li Na has 100 yuan. She can buy a concert ticket or a pair of trainers, not both. If she buys the ticket, the opportunity cost is the trainers.
- **A producer**: a farmer with one field can grow rice or vegetables. If she plants rice, the opportunity cost is the vegetables she could have sold.
- **The government**: in October 2023 the UK government cancelled the northern part of its HS2 high-speed railway and said the £36 billion it saved would pay for other transport projects instead. Money spent on one project cannot be spent on another.

The economic problem (2)

- A point **on** the curve: all resources are fully employed.
- A point **inside** the curve: some resources are unemployed or not fully used.
- A point **outside** the curve: impossible to produce with today's resources. It is unobtainable.

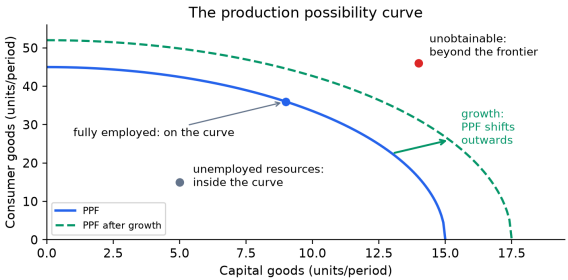
The economic problem (3)

- A **movement along** the curve: resources move from one good to the other, so more of one good means less of the other. The good given up is the opportunity cost.
- A **shift** of the whole curve: outwards with economic growth, inwards with negative growth.
- more resources, such as more workers or more machines and factories;

The economic problem (4)

- better technology, which gets more output from the same resources;
- better education and training, which make workers more productive.

Figure: The economic problem



- The **production possibility curve**: points on, inside and beyond the curve, and an outward shift with economic growth.
- Read the axes and units first.

Economic assumptions

- **consumers** aim to **maximise their benefit** : they spend their money to get the most satisfaction from it;
- **producers** (firms) aim to **maximise their profit** : they choose the output and price that give the largest difference between **revenue** and costs.
- they are not always good at calculating their benefits: many people pay for a gym they rarely visit;

Economic assumptions (2)

- **habits** are hard to give up: shoppers keep buying the same brand even when a cheaper, equally good one is on the shelf;
- they copy other people: in 2024 and 2025 people queued for hours to buy Pop Mart's Labubu dolls, largely because everyone else wanted them.
- managers may aim to maximise **revenue** or **sales** instead, because a larger firm brings them more status or bigger bonuses;

Economic assumptions (3)

- some firms put caring for their customers first: a shop may keep prices low for regular customers in a hard year;
- some firms do **charitable work** : in 2022 the founder of the clothing firm Patagonia gave the company away so that its profits would pay to fight climate change.
- The opportunity cost of one desk is $\frac{40}{20} = 2$ chairs.

Economic assumptions (4)

- Making 5 more desks costs $5 \times 2 = 10$ chairs.
- The curve is a straight line because the workers are equally good at both jobs, so the opportunity cost stays the same.
- If the workshop has idle machines and gets a new order, it moves from inside its curve towards the curve. The curve does not shift: the capacity was there all along.

Common errors

- Defining opportunity cost as "the cost of something" or "all the alternatives". It is the **next best** alternative given up.
- Saying a point inside the curve is impossible. Inside is possible but wasteful; outside is impossible.
- Calling a movement along the curve "growth". Only a shift of the curve outwards is economic growth.

Common errors (2)

- Forgetting to label the axes, the curve and the points on a PPC diagram.
- Writing that consumers and producers "always" maximise benefit or profit. Learn the three exceptions for each.

Key terms

- **Scarcity**: unlimited **wants** but **finite** resources.
- **Opportunity cost**: the next best alternative given up when a choice is made.
- **Production possibility curve**: the maximum combinations of two goods an economy can make with its resources and technology.

Key terms (2)

- **Economic growth**: an increase in an economy's productive potential, shown by an outward shift of the curve.
- **Profit maximisation**: producing where the gap between **revenue** and costs is largest.

Check yourself

- 1.
- Explain why **scarcity** means that choices must be made. 2.
- A city council spends 50 million yuan on a new sports centre instead of a new library.
- What is the opportunity cost? 3.