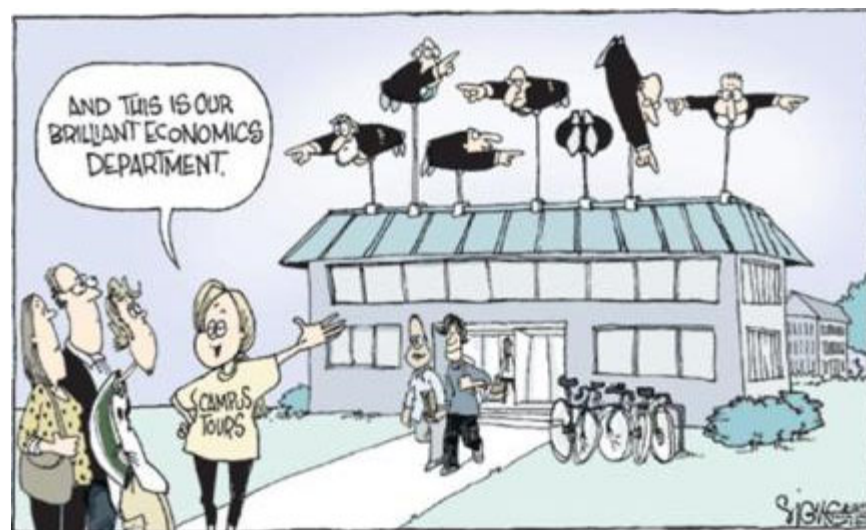


Topic 1—The Nature of Economics

Key Terms	
Model	A simplified representation of reality used to provide insight into economic decisions and events
Ceteris Paribus	A Latin phrase meaning 'other things being equal'; It is used in economics when we focus on changes in one variable while holding other influences constant
Positive Statement	A statement about what is (i.e. the facts)
Normative Statement	A statement that involves a value judgement about what ought to be
Scarcity	A situation that arises when people have unlimited wants in the face of limited resources
Opportunity Cost	In decision making, the value of the next-best alternative forgone
Marginal Analysis	An approach to economic decision making based on considering the additional (marginal) benefits and costs of a change in behaviour
Factors of Production	Resources used in the production process; inputs into production, particularly including labour, capital, land and enterprise
Renewable Resources	Natural resources that can be replenished, such as forests or solar energy
Non-Renewable Resources	Natural resources that once used cannot be replenished, such as coal or oil



Specification Link

- 1.1.1 Economics as a social science
- 1.1.2 Positive and normative statements

Introduction

Economics sets out to tackle some complex issues concerning what is a very complex real world. This means we must use models to simply the world in our attempts to better understand what it does.

Positive and Normative Statements

An example of a positive statement: 'If the government raises the tax on beer, this will lead to a fall in profits of the brewers.'

An example of a normative statement: 'The congestion charge for drivers of petrol-guzzling cars should increase to £25.'

Normative statements involve a value judgement, an opinion on whether something is good or bad.

The Fundamental Economic Problem

Due to the nature of the economy, we have unlimited wants but only limited resources, this leads to the concept of opportunity cost. If you choose to watch TV, you are using that time which could have been used for something else e.g. revision, this is your opportunity cost. Individuals and businesses must consider their marginal utility (added happiness), if watching TV makes them happier than revising, this is the best choice and vice versa.

In each topic of economics, you must discuss the impact on a range of economic agents, these are as follows:

Households (or individuals): e.g. consumers or the supply of labour, their aim is to have a good choice of goods and services as a low cost

Firms: They aim to maximise profits by supplying goods and services

Government: They undertake expenditure and also influence the economy through taxation and regulation

There are four factors of production: Land, labour, capital and entrepreneurship which make up the inputs required for any business to operate. These include both physical and human resources.

There are 3 key questions that economists are setting out to investigate:

What? E.g. What goods and services should be produced in a society from its scarce resources?

How? E.g. How should the productive resources of the economy be used to produce these goods and services

For Whom? E.g. Having produced a range of goods and services, how should these be allocated among the population for consumption?

Topic 1—The Nature of Economics

Key Terms	
Production Possibility Frontier	A curve showing the maximum combination of goods and services that can be produced in a given period with available resources
Potential Economic Growth	An expansion in the productive capacity of the economy
Gross Domestic Product (GDP)	A measure of the economic activity carried out in an economy over a period of time
Division of Labour	A process whereby the production procedure is broken down into a sequence of stages, and workers are assigned to a particular stage
Market	A set of arrangements that allow transactions to take place
Market Economy	An economy in which market forces are allowed to guide the allocation of resources
Command Economy	An economy in which decisions on resource allocation are guided by the state
Mixed Economy	An economy in which resources are allocated partly through price signals and partly on the basis of intervention by the state

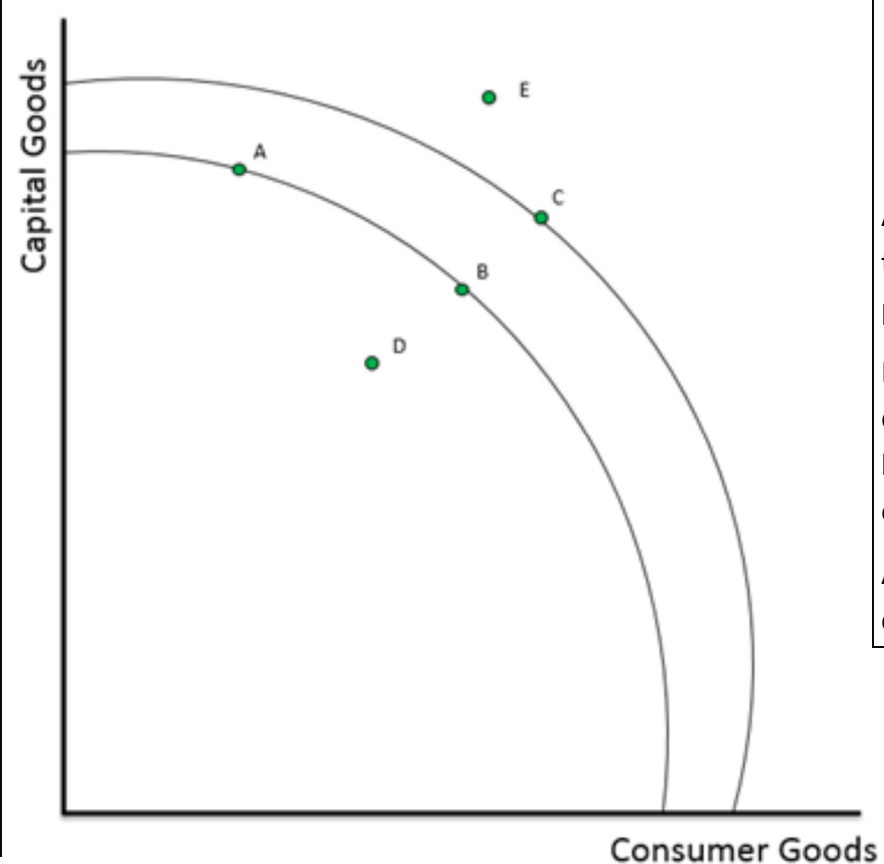
The Production Possibility Frontier

The PPF assumes an economy that only sells 2 goods (capital and consumer). Consumer goods are for present use whereas capital goods are to be used to increase the future capacity of the economy – i.e. for investment.

The diagram below shows an example of a PPF, the movement of dots illustrate the following:

- A – B: An example of opportunity cost, more consumer goods are requested, so less capital goods can be made to compensate
- B – C: An increase in potential economic growth
- D: Not operating efficiently, there is spare resources so more consumer and capital goods can be made
- E: this point is unattainable as there is not enough resources to make this many goods.

The total output of the economy is measured by its GDP; this can be used to measure the average amount of resources per person or income per head.



Specification Link

1.1.4 Production possibility frontiers

1.1.5 Specialisation and the division of labour

Specialisation

The idea of division of labour was created by Adam Smith. He argued that when a production process is split down into individual tasks, it allows each worker to specialise in a particular area which means they are faster than if they had not specialised. This increases the total amount of output that can be created.

Over-specialisation can be a problem as the team can become inflexible, so if one worker is ill it may be difficult to fill the gap left.

Specialisation can also be linked to whole firms and economies. E.g. all components of the car are not made by one firm, instead there are specialist businesses that make individual components at a much cheaper price than if they made the whole car. Economies also specialise, e.g. the UK specialises in financial services.

Markets

Markets need not be a physical place due to the growth of the internet.

Money holds a range of functions:

- A medium of exchange
- Unit of account
- Measure of value
- Standard of deferred payment

Adam Smith advocated for a market economy, he believed that there was an 'invisible hand' which guided the price of products to ensure equilibrium

Karl Marx believed that a market economy would lead to exploitation and eventually there would be a revolution, leading to a more command economy. North Korea are an example of a command economy

A mixed economy is an example of both and is much more common, it tries to take the best from both.