



## Basic economic ideas

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- The fundamental economic problem
- Factors of production
- Positive and Normative statement
- **Production possibility curves**
- Movement in PPC curve
- Shift in PPC curve
- **Money**
- Characteristics of money and barter

# The fundamental economic problem

The fundamental economic problem is:

'scarce resources in relation to unlimited wants'.

1

2

3

- 1 Scarcity: The excess of human wants over what can actually be produced to fulfil these wants
- 2 Resources: inputs available for the production of goods and services.
- 3 Wants: needs that are not always realised.

## Choice

Choice underpins the concept that resources are scarce so choices have to be made by consumers, firms, and governments.



## Sacrifice

Choice involves sacrifice. The more food you choose to buy, the less money you will have to spend on other goods.



## Opportunity cost

In other words, the production or consumption of one thing involves the sacrifice of alternatives. This sacrifice of alternatives in the production (or consumption) of a good is known as its opportunity cost.

Opportunity cost is the cost expressed in terms of the best alternative that is forgone.

# Factors of production

The central economic problem is that of scarcity. Given that there is a limited supply of factors of production, it is impossible to provide everybody with everything they want. Potential demands exceed potential supplies.

Factors of production are the inputs into the production of goods and services. The four factors of production are:

1

## Land

This factor is the natural resource.

Examples: Surface of the earth, lakes, rivers, forests or the area of land that makes up a farm or factory.

The reward for owning land is the income that is generated.

2

## Labour

This factor is the human resource

The basic determinant of which is the nation's population.

The reward for labour is the wage or salary that is paid.

3

## Capital

This factor is any man-made aid to production.

Capital consists of all those inputs that have each had to be produced in the first place.

Capital goods help land and labour produce more units of output – they improve the output from land and labour.

Examples: factories, machines, transportation and other equipment.

The reward to capital is the rate of return that is earned. These three factors are organised into units of production by firms.

4

## Entrepreneur

This factor carries out two functions.

Enterprise:

▶ organises the other three factors of production.

▶ involves taking the risk of production

The return for enterprise is the profits that are made.

# Positive and Normative statement

## Positive statement



A positive statement is a statement of fact.

It may be right or wrong, but its accuracy can be tested by appealing to the facts.

### Examples

'Unemployment is rising',

'Inflation will be over 6 per cent by next year',

'If the government cuts taxes, imports will rise'

**No value judgments are involved.**

## Normative statement



A normative statement is a statement of value.

It is a statement about what ought or ought not to be, about whether something is good or bad, desirable or undesirable.

Here an opinion or value judgment is being made.

They cannot be proved or disproved by a simple appeal to the fact

### Examples

'It is right to tax the rich more than the poor',

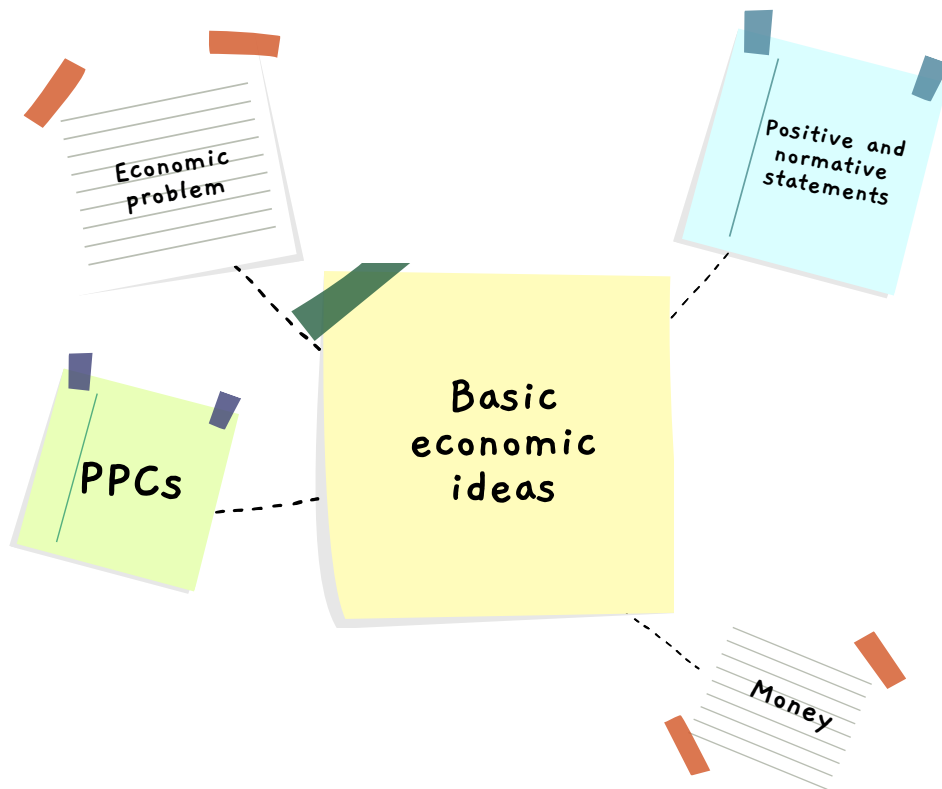
'The government ought to reduce inflation',

'Old-age pensions ought to be increased'



# MAKE A MINDMAP

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# Production possibility curves

## Production possibility curve

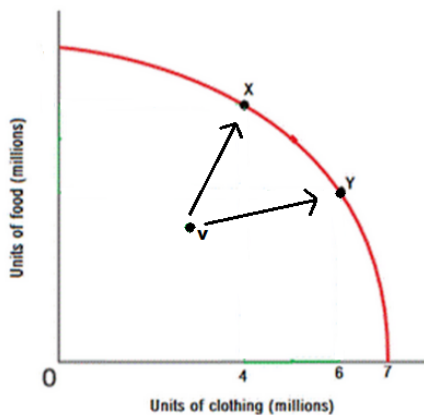


A production possibility curve is a curve showing all the possible combinations of two goods that an economy can produce within a specified time period with all its resources fully and efficiently employed.

### Diagram 1: A production possibility curve



### Diagram 2: Making a fuller use of resources



There is no guarantee that resources will be fully employed, or that they will be used in the most efficient way possible. The nation may thus be producing at a point inside the curve: for example, point v.

By using its resources to the full, the nation could move out onto the curve: to point x or y. It could thus produce more clothing and more food.

# Movement in PPC curve

## Movement in the production possibility curve

A movement in the production possibility curve is caused by the decision to change the composition of goods produced.

For example, this could happen as a result of government directives in a command economy for example or through changes in demand for alternative goods in a market economy.

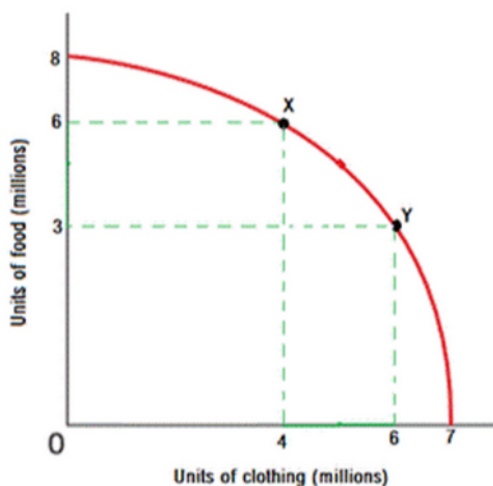
## Slope of the PPC curve

Consider an example where the free market decides to produce more clothing instead of food because it has become more profitable

This sacrifice of food is the opportunity cost of extra clothing.

The fact that to produce more of one good involves producing less of the other is illustrated by the downward sloping nature of the PPC curve.

## Diagram 1: Movement in PPC curve



For example, the country could move from point x to point y in the figure below, in doing so, it would be producing an extra 2 million units of clothing, but 3 million units less of food. Thus the opportunity cost of the 2 million extra units of clothing would be 3 million units of food forgone.



A production possibility curve illustrates the microeconomic issues of choice and opportunity cost.

# Shift in PPC curve

## Shift in the production possibility curve

There will be a shift in the production possibility curve when economies can gain or lose resources; the quality of resources and the state of technical knowledge can also change.

The figures below show the outcomes of changes in the quantity and quality of resources and changes in technology.

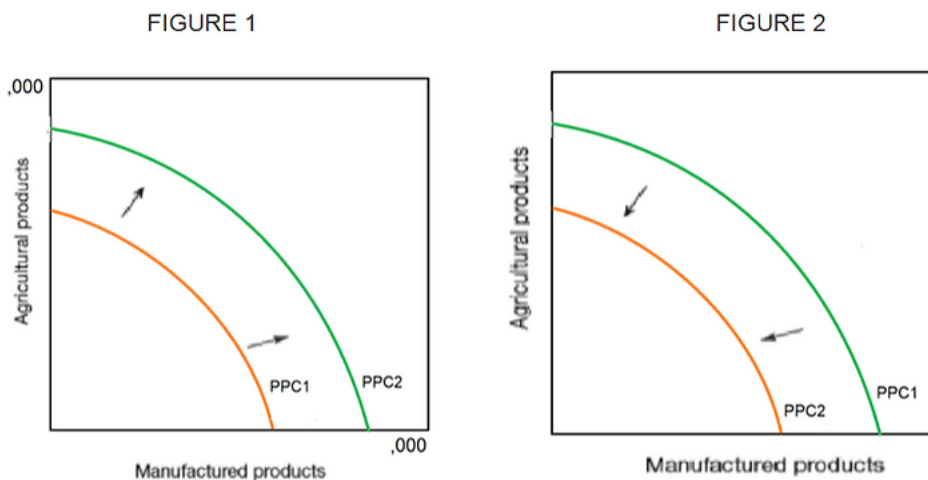
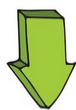


FIGURE 1

Figure 1 shows a situation in which the production possibilities available to an economy have expanded. The production possibility curve has shifted outwards from ppc1 to ppc2. This is known as economic growth. This could be due to an increase in the quantity or the quality of resources available to the economy or an advance in the state of technology. Here the changes have improved the economy's ability to produce both agricultural and manufactured products.



**A production possibility curve illustrates the macroeconomic concept of economic growth.**

FIGURE 2

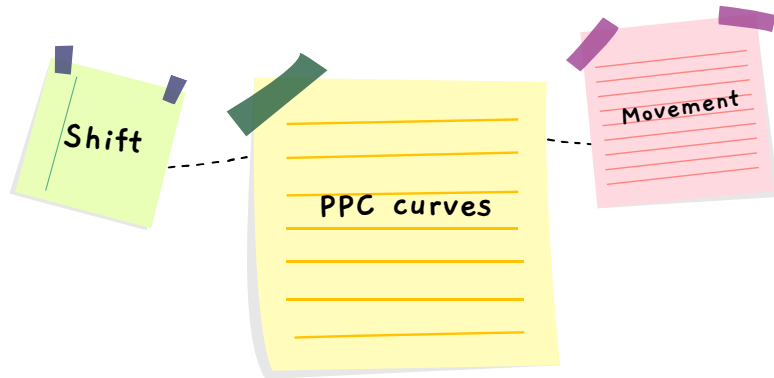
The production possibilities could have declined. This could be because in some way the resources available to the economy have declined. Perhaps some of the economy's natural resources have become exhausted or the working population is falling. In this case, the production possibility curve would shift inwards from ppc1 to ppc2.





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# Money

## Money



A simple definition of money is that it is anything that is regularly used to buy goods and services.

Money is generally cash in the form of coins and notes but the definition also includes bank deposits, cheques, debit cards and credit cards.

## Near money



This is a term that is used to denote non-cash assets that can be quickly and easily turned into cash. Such assets include foreign currencies, savings accounts, bonds and certificates of deposits.

## Functions of money

1

### A medium of exchange:

Money is the 'medium', or form, that buyers use for purchases; sellers are willing to accept this medium in exchange for these purchases.

2

### A unit of account:

Money is a unit of account, as it measures the market value of different goods and services. It is for more efficient for trading purposes to express the price of goods and services in dollars

3

### A standard for deferred payment:

People often want to agree today the price of some future payment. For example, workers and managers will want to agree the wage rate for the coming year.

4

### A store of value:

Money is a store of value as it can be stored and used at a later date in the future. This means that money must be able to hold its purchasing power over time.

# Characteristics of money and barter

## Characteristics

Money has the following characteristics:

1

### Durability and portability

To be acceptable from a day to day practical standpoint, money must be portable and durable.

2

### Acceptability

Money is widely recognised and accepted as a medium of payment for goods and services.

3

### Divisibility

As money is a measure of the value of goods and services, it must be divisible. Cattle and livestock do not make 'useful' money as they are not truly divisible.

4

### Scarcity

Money must be limited in supply in order for it to keep its value.

## The barter system

In the absence of money, people have to use a barter system in order to trade goods and services. Bartering is the act of swapping items in exchange for other items through a process of bargaining and negotiation.

For example, someone might trade five sacks of rice for one cow, or four chickens for a sheep.

### Problems with a barter system:

1

#### The need for a double coincidence of wants

The person with chickens must find a trader who wants chickens in exchange for their sheep. As two people engaged in a trade must both want what the other person is offering, bartering is highly inefficient.

2

#### Divisibility

Half a sheep or two-thirds of a chicken is not very useful for traders.

3

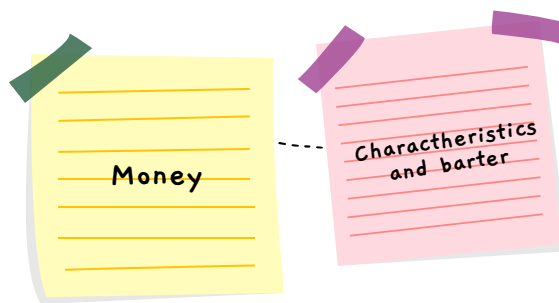
#### Portability

Compare the portability of a sheep or fish with that of paper money (banknotes).



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- 10.Market structures
- 11.Behavioural economics
- 12.Types of goods
- 13.Costs and benefits
- 14.Market failure
- 15.Microeconomic policies
- 16.Population
- 17.Aggregate demand and supply
- 18.Inflation and deflation
- 19.Policies to correct inflation and deflation
- 20.Unemployment
- 21.Macroeconomic policies
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Opportunity cost is the cost expressed in terms of the best alternative that is forgone.

**EXAMPLE**

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## Question

'Both the take-up rate and number of journeys per bus pass have been falling in recent years.'

Explain two factors which could lead to an increase in the demand for bus travel in the future.

(10 marks)

Category: Demand and supply

AQA AS ECONOMICS November 2020

## Answer

Tip: Generally, AQA exam questions are accompanied by an extract (although we have not included it here for simplicity). To score higher marks, refer back to the data (facts and figures) given in the extract, when writing your essay! Note that in this question you are asked to 'explain TWO factors'. In this case, it's a good idea to break your essay into two parts: Factor 1 and factor 2.

(Step 1: Define 'demand' in the introduction)

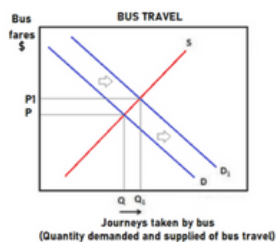
Demand refers to both the willingness and the ability of customers to pay a given price to buy a good or service. There are several factors which could lead to an increase in the demand for bus travel in the future.

(Step 2: Explain TWO factors which could increase the demand for bus travel)

Factor 1: A change in tastes or social norms will increase the demand for bus travel.

Today, travelling by bus has the image of being unpleasant, unreliable and for the 'lower class'. However, more awareness is being raised about air pollution, climate change and CO<sub>2</sub> emissions. People in the future may perceive bus travel as being more ecologically and economically efficient. Furthermore, with the introduction of smart lanes and electric buses, the experience of travelling by bus will improve with time. These factors will encourage people to take the bus.

If more people become aware that travelling by bus is environmentally friendly, more people will opt for bus travel to reduce their carbon footprint. The demand for bus travel will increase. The effect of an increase in demand for bus travel can be shown using a diagram. The diagram below shows the demand and supply curves of bus travel.



Initially, people are unaware of the environmental benefits of bus travel, the equilibrium price (bus fare) is P and the equilibrium quantity (number of journeys taken by bus) is Q. Following campaigns raising awareness about air pollution, more people will be encouraged to travel by bus instead of using their cars. The demand curve for bus travel shifts rightward from D to D<sub>1</sub>. The quantity demanded and supplied for bus travel increases from Q to Q<sub>1</sub>.

Factor 2: If the price of substitutes such as car travel increases, then people will turn to bus travel instead because of its more favourable relative price.

Substitutes are alternative goods and can satisfy the same want or need. Examples of substitutes are car travel and bus travel. For example, if the price of car travel increases significantly, people will look for cheaper alternatives, such as bus travel.

The cost of travelling by car can increase in the future, for instance, due to higher fuel prices. Consequently, if the cost of travelling by car goes up in the future, people will avoid travelling by car, and take the bus instead. The demand for bus travel will increase.

The government may also subsidise bus travel in the future, making bus fares cheaper. This will encourage people to switch away from using their cars to travelling by bus.

(Step 3: Conclude)

To conclude, the demand for bus travel could increase in the future if people perceive buses as being more ecologically and economically efficient. Also, if the price of substitutes such as car travel increases, then people will turn to bus travel instead because of its more favourable relative price.

MARKING SCHEME

- Relevant issues include:
- meaning of demand
  - lower relative price and/or greater availability compared with substitute goods
  - increased subsidy
  - changes in tastes and/or social norms
  - changes in income and/or consideration of bus travel as an inferior good
  - increased population and/or changes in age structure
  - the significance of elasticities.

Level 3

- An answer that:
- identifies two valid factors
  - shows sound knowledge and understanding of relevant economic terminology, concepts and principles
  - includes good application of relevant economic principles and/or good use of data to support the response
  - includes well-structured analysis with a clear, logical chain of reasoning
  - may include a relevant diagram to support their explanation

EXAMPLE

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03

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**SKIM THE DATA**  
Start by skimming the data. Read the text quickly to get a general idea of meaning.

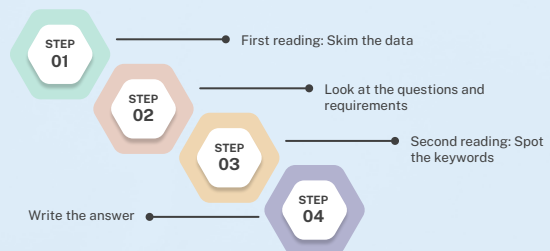
**LOOK AT THE TITLE**  
Look at the title as it may give some clues about its content.

**ANALYSE FACTS, FIGURES AND TABLES**  
Analyse facts, figures tables and diagrams. See if you know what they mean. Pick out any notable features of a chart or diagram.

**COMPETITION IN THE SKIES OVER EUROPE**

It was predicted that this would lead to an increase in the market share for the top five European airlines from 50% of the European market in 2019 to match the top five United States (US) airlines, which control 77% of the US market.

## STEPS TO ANSWER A DATA RESPONSE QUESTION



## Read the Requirements

Always read the requirement first as this enables you to focus on the detail of the question with the specific task in mind.

What is the point in reading a scenario if you don't know what you are looking for? If you don't read and understand the requirements carefully, then you will find that you are not actually answering the question. If you are not answering the question, then you are not earning marks.

Pay attention to (1) The content and (2) The instructions

**Explain** what is meant by a contestable market and discuss how making the airline market more **contestable** could benefit passengers.

... contestable market...benefit

**THE CONTENT**  
When you read each part of the requirement, highlight the 'content'. This is simply what the question is about. This helps you to focus your mind on answering the actual question rather than answering what you thought the question was going to ask you.

**THE INSTRUCTIONS**  
This instruction could be a whole variety of verbs ranging from numerical requirements such as calculate and apply, or more wordy requirements such as describe, interpret, outline or compare. The verb used has been carefully thought about by the examiner, taking into account any restrictions imposed by the syllabus.

### Explain

Explain what is meant by a contestable market and discuss how making the airline market more contestable could benefit passengers.

**(d) Explain two reasons why a government may privatise an industry. [4]**

There are several reasons why a government may privatise an industry, such as air travel.

**STRUCTURE**

**CLEAR HEADINGS**

**Reason 1: Privatising an industry may lead to an increase in government revenue.**

The government may earn more tax revenue if it privatises a state-owned industry. This is because a privately owned industry has to pay corporation tax. A corporation tax is a tax levied on companies profits.

**PARAGRAPHS**

The sale of a state-owned enterprise to the private sector will also raise money for the government.

**REFERENCE TO THE DATA**

In the data, it was mentioned that a successful sale of Air India to the private sector would have raised money for the Indian government.

More tax revenue will enable the government to increase its spending on education, healthcare or infrastructure. This will help to promote development in the country.

**SIMPLE ENGLISH**

**Reason 2: The government may privatise an industry because the industry is making a loss.**

The need to use tax revenue to finance the loss-making industry will be reduced. The private sector may also manage the industry with greater efficiency and turn the loss into a profit. This is because the private sector, motivated to make a profit, will increase productivity and reduce costs.

**EXAMPLE**

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Questions

Paper and year

Topic

Answers and Explanations

**Scarcity, Choice and Opportunity Cost Multiple Choice Questions**

1. Which terms summarise the nature of the economic problem?  
 A finite resources and limited wants  
 B finite resources and unlimited wants  
 C infinite resources and limited wants  
 D infinite resources and unlimited wants  
 [210/P220]

2. The government of a country with a rapidly increasing population decides to switch resources from investment to increased subsidies to farmers. What is the opportunity cost of this decision?  
 A the profit earned by farmers  
 B the rest of the land on which food is grown  
 C the reduction in investment  
 D the wages of the farm workers  
 [210/P247]

3. Which economic change would increase the problem of scarcity?  
 A a decrease in fish stocks  
 B a discovery of a new oil field  
 C an increase in labour productivity  
 D a reduction in waste  
 [110/P1/052]

4. What makes choice an important element in the basic economic problem?  
 A increased demand leads to higher market prices.  
 B limited resources have many alternative uses.

C Reaching a market equilibrium may take a long time.  
 D Scarce economic resources are distributed equally.  
 [101/P1/011]

A government of a country is faced with the need to end an epidemic of a disease. Of what is this an example?  
 A conservation of resources  
 B monetary policy  
 C opportunity cost  
 D substitution of factors  
 [101/P1/011]

5. A firm decides stop manufacturing & producing a product washing machines instead. What is the opportunity cost to the firm?  
 A the additional washing machines produced  
 B the cost of producing ovens  
 C the cost of producing washing machines  
 D the cost of the production of ovens  
 [211/P1/001]

6. What is meant by the economic problem?  
 A An unbalanced supply and demand  
 B The need to choose between alternative uses of limited resources  
 C The need to choose between alternative uses of limited resources between public and private sectors  
 D The need to choose between alternative uses of limited resources against finite resources  
 E How to decide which methods to use to exploit all resources

7. A firm has two production processes. The first process uses 10 units of resource X and 20 units of resource Y to produce 100 units of output. The second process uses 20 units of resource X and 10 units of resource Y to produce 100 units of output. If the firm has 100 units of resource X and 200 units of resource Y, what is the maximum number of units of output it can produce?  
 A 100  
 B 200  
 C 300  
 D 400  
 E 500  
 [101/P1/011]

8. The production of a good involves the use of resources. If the price of a resource rises, what happens to the cost of producing the good?  
 A It falls  
 B It rises  
 C It remains the same  
 D It becomes zero  
 E It becomes negative  
 [101/P1/011]

9. A firm has two production processes. The first process uses 10 units of resource X and 20 units of resource Y to produce 100 units of output. The second process uses 20 units of resource X and 10 units of resource Y to produce 100 units of output. If the firm has 100 units of resource X and 200 units of resource Y, what is the maximum number of units of output it can produce?  
 A 100  
 B 200  
 C 300  
 D 400  
 E 500  
 [101/P1/011]

O level topics

01	Economic Problems
02	Factors of Production
03	Economic Systems
04	Demand, Supply and Equilibrium
05	Perfect Competition and Monopoly
06	Aims of Government and its Role
07	Market Failure
08	Public Expenditure vs Private Expenditure
09	Banks and Stock Exchanges
10	Labour Market
11	Motives for Spending, Saving and Borrowing
12	Different Types and Sizes of Firms
13	Production, Costs, Revenues and Profits

AS level topics

01	Basic Economic Ideas And Resource Allocation
02	Production Possibility Curves
03	Classification Of Goods And Services
04	The Price System And The Micro Economy
05	Price Elasticity
06	The Macro Economy
07	International Trade
08	Protectionism
09	Exchange Rates
10	Government Macro Intervention

A level topics

01	Law of Diminishing Marginal Utility, Indifference Curves and Budget Lines
02	Types of Cost, Revenue and Profit
03	Firms and Market Structures
04	Efficient resource allocation
05	Equity and Policies towards Income and Wealth Redistribution
06	Labour Market Forces
07	National Income Statistics
08	The Circular Flow of Income
09	Money Supply (theory)
10	Economic Growth, Economic Development and Sustainability
11	Government Macroeconomic Policy Aims

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# ECONOMICS

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## Chapter 1

# Introducing Economics

### Topics

The basic economic problem  
Scarcity, choice and opportunity cost  
The Production Possibility Curve (PPC)  
The economic problem  
Economic systems

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## Chapter 2

# Basic economic ideas

### Topics

The fundamental economic problem

Factors of production

Positive and Normative statement

Production possibility curves

Movement in PPC curve

Shift in PPC curve

Money

Characteristics of money and barter

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## Chapter 3

# Economic systems

### Topics

Economic systems

The Free Market

The Free Market Pros and Cons

The planned economy

The planned economy Pros and Cons

Mixed economy

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## Chapter 4

# Demand and supply

### Topics

#### Demand

Demand curve

Movement along the demand curve

Factors influencing demand

Shifts in the demand curve

1Markets in equilibrium

1Markets disequilibrium

1Consumer surplus

1Producer surplus

#### Supply

Supply curve

Movement along the supply curve

Factors influencing supply

Shifts in the supply curve





## Chapter 5

# Elasticity

### Topics

#### Price elasticity of demand

Elastic demand

Inelastic demand

Special cases of price elasticity of demand

Uses of price elasticity of demand

Determinants of price elasticity of demand

#### Cross elasticity of demand

XED for substitutes

XED for complements

#### Income elasticity of demand (YED)

#### Price elasticity of supply (PES)

Factors influencing PES

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## Chapter 6

# Money

### Topics

Functions of money

Properties of money

Forms of money

Central bank

Commercial bank

Credit creation

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## Chapter 7

# Production, Costs and Specialisation

### Topics

Factors of production

Specialisation

Division of labour

Costs of production

Economies of scale

Diseconomies of scale

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## Chapter 8

# Market structures

### Topics

#### Market structures

Barriers to entry

Long run and short run

#### Perfect competition

Perfect competition – Short run

Perfect competition – Long run

#### Monopolistic competition

Monopolistic competition – short run

Monopolistic competition – long run

#### Oligopoly

Oligopoly – Price wars or non-price competition?

Cooperation and collusion between oligopolists

Oligopoly – diagram

#### Monopoly

Monopoly–diagram

Comparing monopoly with perfect competition

Deadweight loss under monopoly

#### Contestable markets



## Chapter 9

# The Organization Of Firms

### Topics

Private sector firms

Why small businesses survive

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## Chapter 10

# Firm's cost structure

### Topics

Profit

Fixed costs and variable costs

Marginal cost and Marginal  
revenue

Average costs

Economies of scale

Marginal cost and average  
costs

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## Chapter 11

# Behavioral economics

### Topics

Rational economic decision

Utility

Law of diminishing marginal utility

Total Utility Curve

Marginal Utility Curve

The optimum combination of  
goods consumed

Equi-marginal principle

Deriving Demand Curves from  
marginal utility curves

Indifference curve

Budget lines

Normal, inferior and Giffen goods

Are consumers rational?

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## Chapter 12

# Types of goods

### Topics

Types of goods

Private goods

Public goods

Merit goods

Demerit good

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## Chapter 13

# Costs and benefits

### Topics

Private, external and social costs

Private, external and social benefits

Cost-benefit analysis

Concepts of Marginal private benefit,  
Marginal private cost, Marginal social  
benefit (MSB) and Marginal social cost  
(MSC)

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## Chapter 14

# Market failure

### Topics

Market failure

#### **Externalities**

Negative production externalities

Government intervention and negative production externalities

Positive production externalities

Government intervention and positive production externalities

Merit goods and demerit goods

#### **Merit good-Positive consumption externalities**

Government intervention and positive consumption externalities

**Demerit goods- Negative consumption externalities**

Government intervention and negative consumption externalities

Demerit goods and Merit goods - Welfare loss

Nudge theory

#### **Public goods**

Public goods and government-provided goods

Monopoly

Lack of competition and monopoly

Deadweight loss under monopoly

Approaches to the problem of monopoly

Government failure



## Chapter 15

# Microeconomic policies

### Topics

Part 1 – taxes

Taxes

Types of tax

The effect of imposing a tax

Incidence of tax

Incidence of tax and elasticity

Relationship between taxes and income

The impact of taxation

Part 2

Maximum price

Minimum price

Subsidies

Transfer payments

Direct provision

Nationalisation

Privatisation



## Chapter 16

# Population

### Topics

Factors that affect size of population

The Optimum Population

Population structure

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## Chapter 17

# Aggregate demand and Aggregate supply

### Topics

Macroeconomic policy objectives

#### Aggregate demand

The aggregate demand curve

The aggregate demand and price  
level

#### Aggregate supply

Short-run aggregate supply

Long-run aggregate supply

Keynesians LRAS curve

Classical LRAS curve

Interaction of aggregate demand  
and aggregate supply



## Chapter 18

# Inflation and deflation

## Topics

Part 1

Inflation

Measuring Inflation

The CPI versus the RPI

Demand-pull inflation

Aggregate demand and inflation

Causes of demand-pull inflation

Cost push inflation

Causes of cost push inflation

The consequences of inflation

Benefits of inflation

1Effects of inflation

Part 2

Deflation

Good deflation

Bad deflation



## Chapter 19

# Policies to correct inflation and deflation

### Topics

#### Part 1

Policies to correct inflation

Fiscal policy

Monetary policy

Deflationary policies – Diagram

Supply-side policy

Supply-side policy– Diagram

#### Part 2

Policies to correct deflation

Fiscal policy

Monetary policy

Diagram



## Chapter 20

# Unemployment

### Topics

Types of unemployment

The consequences of unemployment

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## Chapter 21

# Macroeconomic policies

## Topics

Types of policies

### **Fiscal policy**

The budget

The relationship between the budget and the state of the economy

Automatic stabilisers and discretionary fiscal policy

Limitations of fiscal policy

### **Monetary policy**

Limitations of monetary policy

### **Supply-side policy**

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## Chapter 22

# International trade

## Topics

### International trade

The benefits of free trade

Absolute advantage

Comparative advantage

### Protectionism

Tariffs

Quotas

Other methods of protectionism

Arguments in favour of  
protectionism

Arguments against  
protectionism

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## Chapter 23

# Exchange rates

### Topics

Exchange rates  
Floating exchange rate system  
Demand and supply of the currency  
Floating exchange rate Pros  
Floating exchange rate Cons  
Fixed exchange rate  
Managed float  
Factors changing foreign exchange rates  
Depreciation/ Devaluation  
Depreciation/ Devaluation Effects  
Marshall learner condition  
The J curve effect  
Appreciation/Revaluation  
Reverse J-curve

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## Chapter 24

# Balance of payments

### Topics

- The balance of payments
  - The current account
  - Financial and capital account
  - Current account deficit
  - Causes of a current account deficit
  - Consequences of a current account deficit
  - Causes of a current account surplus
  - Impact of a current account surplus
  - Terms of trade
  - Causes of changes in the terms of trade
-



## Chapter 25

# Policies to correct balance of payment disequilibrium

### Topics

Policies to correct balance of  
payments disequilibrium

Expenditure switching policies

Expenditure switching policies  
examples

Expenditure reducing policies

Expenditure reducing policies – Fiscal  
policy

Expenditure reducing policies –

Monetary policy

Supply-side policy

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