Edexcel (A) Economics A Level

Theme 1: An introduction to markets and market failure

Flashcards

Ad valorem tax

Ad valorem tax

An indirect tax imposed on a good where the value of the tax is dependent on the value of the good

Asymmetric information

Asymmetric information

Where one party has more information than the other, leading to market failure

Capital

Capital

One of the four factors of production; goods which can be used in the production process

Capital goods

Capital goods

Goods produced in order to aid production of consumer goods in the future

Ceteris paribus

Ceteris paribus

All other things remaining the same

Command economy

Command economy

All factors of production are allocated by the state, so they decide what, how and for whom to produce goods

Complementary goods

Complementary goods

Negative XED; if good B becomes more expensive, demand for good A falls

Consumer goods

Consumer goods

Goods bought and demanded by households and individuals

Consumer surplus

Consumer surplus

The difference between the price the consumer is willing to pay and the price they actually pay

Cross elasticity of demand (XED)

Cross elasticity of demand (XED)

The responsiveness of demand for one good to a change in the price of another good

Demand

Demand

The quantity of a good/service that consumers are able and willing to buy at a given price at a given moment in time

Diminishing marginal utility

Diminishing marginal utility

The extra benefit gained from consumption of a good generally declines as extra units are consumed; explains why the demand curve is downward sloping

Division of labour

Division of labour

When labour becomes specialised during the production process so do a specific task in cooperation with other workers

Economic problem

Economic problem

The problem of scarcity; wants are unlimited by resources are finite so choices have to be made

Efficiency

Efficiency

When resources are allocated optimally, so every consumer benefits and waste is minimised

Enterprise

Enterprise

One of the four factors of production; the willingness and ability to take risks and combine the three other factors of production

Equilibrium price/quantity

Equilibrium price/quantity

Where demand equals supply so there are no more market forces bringing about change to price or quantity sold

Excess demand

Excess demand

When price is set too low so demand is greater than supply

Excess supply

Excess supply

When price is set too high so supply is greater than demand

Externalities

Externalities

The cost of benefit a third party receives from an economic transaction outside of the market mechanism.

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External cost/benefit

External cost/benefit

The cost/benefit to a third party not involved in the economic activity; the difference between social cost/benefit and private cost/benefit

Free market

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Free market

An economy where the market mechanism allocates resources so consumers and producers make decision about what is produced, how to produce it and for whom

Free rider principle

Free rider principle

People who do not pay for a public good still receive benefits from it so the private sector will under-provide the good as they cannot make a profit

Government failure

Government failure

When government intervention leads to a net welfare loss in society

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Habitual behaviour

Habitual behaviour

A cause of irrational behaviour; when consumers are in the habit of making certain decisions

Incidence of tax

Incidence of tax

The tax burden on the taxpayer

Income elasticity of demand (YED)

Income elasticity of demand (YED)

The responsiveness of demand to a change in income

Indirect tax

Indirect tax

Taxes levied on goods and services which increase production and leads to a fall in supply, although this is often partially, or fully, passed onto consumers.

Inferior goods

Inferior goods

YED<0; goods which see a fall in demand as income increases

Information gaps

Information gaps

When an economic agent lacks the information needs to make a rational, informed decision

Labour

Labour

One of the four factors of production; human capital

Land

Land

One of the four factors of production; natural resources such as oil, coal, wheat, physical space

Luxury goods

Luxury goods

YED>1; an increase in incomes causes an even bigger increase in demand

Market failure

Market failure

When the free market fails to allocate resources to the best interest of society, so there is an inefficient allocation of scarce resources

Market forces

Market forces

Forces in free markets which act to reduce prices when there is excess supply and increase them when there is excess demand

Minimum price

Minimum price

A floor price which a firm cannot charge below

Mixed economy

Mixed economy

Both the free market mechanism and the government allocate resources

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Model

Model

A hypothesis which can be proven or tested by evidence; it tends to be mathematical whilst a theory is in words

Negative externalities of production

Negative externalities of production

Where the social costs of producing a good are greater than the private costs of producing the good

Non-excludability

Non-excludability

A characteristic of public goods; someone cannot be prevent from using the good

Non-renewable resources

Non-renewable resources

Resources which cannot be readily replenished or replaced at a level equal to consumption; the stock level decreases over time as they are consumed

Non-rivalry

Non-rivalry

A characteristic of public goods; one person's use of the good does not prevent someone else from using it

Normal goods

Normal goods

YED>0; demand increases as income increases

Normative statements

Normative statements

Subjective statements based on value judgements and opinions; cannot be proven or disproven

Opportunity cost

Opportunity cost

The value of the next best alternative forgone

Perfectly price elastic good

Perfectly price elastic good

PED/PES=Infinity; quantity demanded/supplied falls to 0 when price changes

Perfectly price inelastic good

Perfectly price inelastic good

PED/PES=0; quantity demanded/supplied does not change when price changes

Positive externalities of consumption

Positive externalities of consumption

Where the social benefits of consuming a good are larger than the private benefits of consuming that good

Positive statements

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Positive statements

Objective statements which can be tested with factual evidence to be proven or disproven

Possibility production frontier (PPF)

Possibility production frontier (PPF)

Depicts the maximum productive potential of an economy, using a combination of two goods or services

Price elasticity of demand

Price elasticity of demand

The responsiveness of demand to a change in price

Price elasticity of supply

Price elasticity of supply

The responsive of supply to a change in price

Price mechanism

Price mechanism

The system of resource allocation based on the free market movement of prices, determined by the demand and supply curves

Private cost/benefit

Private cost/benefit

The cost/benefit to the individual participating in the economic activity

Private goods

Private goods

Goods that are rivalry and excludable

Producer surplus

Producer surplus

The difference between the price the producer is willing to charge and the price they actually charge

Public good

Public good

Goods that are non-excludable, non-rivalry, non-rejectable and have zero marginal cost

Rationality

Rationality

Decision-making that leads to economic agents maximising their utility

Regulation

Regulation

Laws to address market failure and promote competition between firms

Relatively price elastic good

Relatively price elastic good

When PED/PES>1; demand/ supply is relatively responsive to a change in price so a small change in price leads to a large change in quantity demanded/supplied

Relatively price inelastic good

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Relatively price inelastic good

When PED/PES<1; demand/supply is relatively unresponsive to a change in price so a large change in price leads to a large change in quantity demanded/supplied

Renewable resources

Renewable resources

Resources which can be replenished, so the stock of resources can be maintained over a period of time

Scarcity

Scarcity

The shortage of resources in relation to the quantity of human wants

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Social cost/benefit

Social cost/benefit

The cost/benefit to society as a whole due to the economic activity

Social optimum position

Social optimum position

Where social costs equal social benefits; the amount which should be produced/consumed in order to maximise social welfare

Social science

Social science

The study of societies and human behaviour

Specialisation

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Specialisation

The production of a limited range of goods by a company/country/individual so they aren’t self-sufficient and have to trade with others

Specific tax

Specific tax

A tax imposed on a good where the value of the tax is dependent on the quantity that is bought

State provision

State provision

When the government provides public goods or merit goods which are underprovided in the free market

Subsidy

Subsidy

Government payments to a producer to lower their costs of production and encourage them to produce more

Substitutes

Substitutes

Positive XED; if good B becomes more expensive, demand for good A rises

Supply

Supply

The ability and willingness to provide a particular good/service at a given price at a given moment in time

Symmetric information

Symmetric information

Where buyers and sellers both have access to the same information

Trade pollution permits

Trade pollution permits

Licenses which allow businesses to pollute up to a certain amount. The government controls the number of licenses and so can control the amount of pollution. Businesses are allowed to sell and buy the permits which means there may be incentive to reduce the amount they pollute

Unitary price elastic good

Unitary price elastic good

When PED/PES=1; a change in price leads to a change in output by the same proportion

Utility

Utility

The satisfaction derived from consuming a good

Weakness at computation

Weakness at computation

A cause of irrational behaviour; when consumers are bad at making calculations, estimating probabilities and working out future benefits/costs