Edexcel (A) Economics A-level

Theme 3: Business Behaviour and the Labour Market

Definitions

Keywords	Definition
Allocative efficiency	When resources are allocated to the best interests of society, when there is maximum social welfare and maximum utility; P=MC
Asymmetric information	Where one party has more information than the other, leading to market failure and causing problems for regulators
Average cost/average total cost (AC/ATC)	The cost of production per unit $\frac{\text{total costs}}{\text{quantity produced}}$
Average revenue (AR)	The price each unit is sold for $\frac{\text{TR}}{\text{quantity sold}}$
Bilateral monopoly	Where there is only one buyer and one seller in the market
Cartels	A formal collusive agreement where firms enter into an agreement to mutually set prices
Collusion	Occurs when firms agree to work together, for example by setting a price or fixing the quantity they produce
Competition policy	Government action to increase competition in markets
Competitive tendering	When the government contracts out the provision of a good or service and invites firms to bid for the contract
Conglomerate integration	The merger of firms with no common connection
Constant returns to scale	Output increases by the same proportion that the inputs increase by
Contestable market	When there is the threat of new entrants into the market, forcing firms to be efficient
Decreasing returns to scale	An increase in inputs by a certain proportion will lead to output increasing by a smaller proportion
Demergers	A single business is broken into two or more businesses to operate on their own, to be sold or to be dissolved
Deregulation	The removal of legal barriers to allow private enterprises to compete in a previously protected market
Derived demand	The demand for one good is linked to the demand for a related good
Diminishing marginal productivity	If a variable factor is increased when another factor is fixed, there will come a point when each extra unit of the variable factor will produce

	less extra output than the previous unit; after a certain point, marginal output falls
Diseconomies of scale	The disadvantages that arise in large businesses that reduce efficiency and cause average costs to rise
Divorce of ownership from control	Firms are owned by shareholders, who have little say in the day to day running of the business, and controlled by managers; this leads to the principal-agent problem
Dynamic efficiency	Efficiency in the long run; concerned with new technology and increases in productivity which causes efficiency to increase over a period of time
Economies of scale	The advantages of large scale production that enable a large business to produce at a lower average cost than a smaller business
External economies of scale	An advantage which arises from the growth of the industry within which the firm operates, independent of the firm itself
Fixed cost	Costs which do not vary with output
For-profit business	A business whose main aim is to make money
Game theory	Used to predict the outcome of a decision made by one firm, when it has incomplete information about the other firm
Geographical mobility of labour	The ease and speed at which labour can move from one area to another
Horizontal integration	The merger of firms in the same industry at the same stage of production
Increasing returns to scale	An increase in inputs by a certain proportion will lead to an increase in output by a larger proportion
Interdependent	The actions of one firm directly affects another firm
Internal economies of scale	An advantage that a firm is able to enjoy because of growth in the firm, independent of anything happening to other firms or the industry in general
Limit pricing	When firms set prices low in order to prevent new entrants; used in contestable markets
Loss	When revenue does not cover costs
Marginal cost	The additional cost of producing one extra unit of good
Marginal revenue	The additional revenue gained by selling one extra unit of good
Maximum wage	A ceiling wage which people cannot earn above

Minimum efficient scale	The lowest level of output necessary to fully exploit economies of scale
Minimum wage	A floor wage which people cannot earn below
Monopolistic competition	Where there are a large number of buyers and sellers who are relatively small and act independently, selling non-homogeneous goods
Monopoly	A single seller in the market
Monopsony	A single buyer in the market
N-firm concentration ratio	The percentage of market share held by the 'n' biggest firms
Nationalisation	When a private sector company or industry is brought under state control, to be owned and managed by the government
Natural monopoly	Where economies of scale are so large that not even a single producer is able to fully exploit them; it is more efficient for there to be a monopoly than many sellers
Non-collusive oligopoly	When firms in an oligopoly compete against each other, rather than making agreements to reduce competition
Non-price competition	When firms compete on factors other than price, for example customer service or quality; they aim to increase the loyalty to the brand which makes demand more inelastic
Normal profit	The minimum reward required to keep entrepreneurs supplying their enterprise, the return sufficient to keep the factors of production committed to the business; TC=TR
Not-for-profit business	Where firms are run in order to maximise social welfare and help individuals and groups; any profit they do make is used to support their aims
Occupational mobility of labour	The ease and speed at which labour can move from one type of job to another
Oligopoly	Where a few firms dominate the market and have the majority of market share, they act interdependently
Organic growth	Where firms grow by increasing their output
Overt collusion	Collusion where firms come to a formal agreement, for example a cartel
Perfect competition	A market with many buyers and sellers selling homogenous goods with perfect information and freedom of entry and exit

Perfectly contestable market	A market with no barriers to entry, where a new firm can easily enter and compete against incumbent firms completely equally
Predatory pricing	When a large, established firm is threatened by new entrants so sets such a low price that other firms make losses and are driven out the market
Price leadership	Where one firm sets prices and other firms tend to follow this firm as they are fearful of engaging in a price war
Price wars	Where firms continuously drive prices down to the point where they are frequently making losses and firms are forced to leave
Principal-agent problem	Where the agent makes decisions on behalf of the principal; the agent should maximise the benefits of the principal but have the temptation of maximising their own benefits
Private sector	The part of the economy that is owned and run by individuals or groups of individuals
Privatisation	The sale of government equity in nationalised industries or other firms to private investors
Productive efficiency	When resources are used to give the maximum possible output at the lowest possible cost; MC=AC
Profit maximisation	When firms produce at a point which derives the greatest profit; MC=MR
Profit satisficing	When a firm earn just enough profit to keep its shareholders happy
Public sector	The part of the economy that is owned or controlled by local or central government
Regulatory capture	When regulators become more empathetic and are able to 'see things from the firm's perspective', which removes impartiality and weakens their ability to regulate
Revenue maximisation	When firms produce at a point which derives the greatest revenue; MR=0
Sales maximisation	When firms produce at a point where they sell as many of their goods and services as possible without making a loss; AR=AC
Static efficiency	The level of efficiency at one point in time
Sunk cost	Costs that cannot be recovered once they have been spent
Supernormal profit	The profit above normal profit, TR>TC
Tacit collusion	Collusion where there is no formal agreement, such as price leadership

Third degree price discrimination	When monopolists charge different prices to different groups for the same good or service
Total cost	The cost to produce a given level of output total variable costs+total fixed costs
Total revenue	Revenue generated from the sale of a given level of output price x quantity sold
Variable cost	Costs which change with output
Vertical integration	When a firm merges or takes over another firm in the same industry, but at a different stage of production
X-inefficiency	When firms produce at a cost above the AC curve