Edexcel (A) Economics A-level

Theme 1: Introduction to Markets and Market Failure

Definitions

Key word	Definition
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	Where one party has more information than the other, leading to market failure
Capital	One of the four factors of production; goods which can be used in the production process
Capital goods	Goods produced in order to aid production of consumer goods in the future
Ceteris paribus	All other things remaining the same
Command economy	All factors of production are allocated by the state, so they decide what, how and for whom to produce goods
Complementary goods	Negative XED; if good B becomes more expensive, demand for good A falls
Consumer goods	Goods bought and demanded by households and individuals
Consumer surplus	The difference between the price the consumer is willing to pay and the price they actually pay
Cross elasticity of demand (XED)	The responsiveness of demand for one good (A) to a change in price of another good (B) $\frac{\%\text{change in QD of A}}{\%\text{change in P of B}}$
Demand	The quantity of a good/service that consumers are able and willing to buy at a given price at a given moment of time
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	When labour becomes specialised during the production process so do a specific task in cooperation with other workers
Economic problem	The problem of scarcity; wants are unlimited but resources are finite so choices have to be made
Efficiency	When resources are allocated optimally, so every consumer benefits and waste is minimised
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	Where demand equals supply so there are no more market forces bringing about change to price or quantity demanded
Excess demand	When price is set too low so demand is greater than supply
Excess supply	When price is set too high so supply is greater than demand
Externalities	The cost or benefit a third party receives from an economic transaction outside of the market mechanism
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	An economy where the market mechanism allocates resources so consumers and producers make decisions about what is produced, how to produce and for whom
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	When government intervention leads to a net welfare loss in society
Habitual behaviour	A cause of irrational behaviour; when consumers are in the habit of making certain decisions
Incidence of tax	The tax burden on the taxpayer
Income elasticity of demand (YED)	The responsiveness of demand to a change in income $\frac{\%\text{change in QD}}{\%\text{change in Y}}$
Indirect tax	Taxes on expenditure which increase production costs and lead to a fall in supply
Inferior goods	YED<0; goods which see a fall in demand as income increases
Information gap	When an economic agent lacks the information needed to make a rational, informed decision
Information provision	When the government intervenes to provide information to correct market failure
Labour	One of the four factors of production; human capital
Land	One of the four factors of production; natural resources such as oil, coal, wheat, physical space
Luxury goods	YED>1; an increase in incomes causes an even bigger increase in demand
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	Forces in free markets which act to reduce prices when there is excess supply and increase them when there is excess demand
Maximum price	A ceiling price which a firm cannot charge above
Minimum price	A floor price which a firm cannot charge below
Mixed economy	Both the free market mechanism and the government allocate resources
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	Where the social costs of producing a good are greater than the private costs of producing the good
Non-excludable	A characteristic of public goods; someone cannot be prevented from using the good
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	A characteristic of public goods; one person's use of the good does not prevent someone else from using it
Normal goods	YED>0; demand increases as income increases
Normative statement	Subjective statements based on value judgements and opinions; cannot be proven or disproven
Opportunity cost	The value of the next best alternative forgone
Perfectly price elastic good	PED/PES=Infinity; quantity demanded/supplied falls to 0 when price changes
Perfectly price inelastic good	PED/PES=0; quantity demanded/supplied does not change when price changes
Positive externalities of consumption	Where the social benefits of consuming a good are larger than the private benefits of consuming that good
Positive statement	Objective statements which can be tested with factual evidence to be proven or disproven
Possibility production frontier (PPF)	Depicts the maximum productive potential of an economy, using a combination of two goods or services, when resources are fully and efficiently employed
Price elasticity of demand (PED)	The responsiveness of demand to a change in price %change in QD

	%change in P
Price elasticity of supply (PES)	The responsive of supply to a change in price %change in QD %change in P
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	The cost/benefit to the individual participating in the economic activity
Private goods	Goods that are rivalry and excludable
Producer surplus	The difference between the price the producer is willing to charge and the price they actually charge
Public goods	Goods that are non-excludable and non-rivalry
Rationality	Decision-making that leads to economic agents maximising their utility
Regulation	Laws to address market failure and promote competition between firms
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	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	Resources which can be replenished, so the stock of resources can be maintained over a period of time
Scarcity	The shortage of resources in relation to the quantity of human wants
Social cost/benefit	The cost/benefit to society as a whole due to the economic activity
Social optimum position	Where social costs equals social benefits; the amount which should be produced/consumed in order to maximise social welfare
Social science	The study of societies and human behaviour
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	A tax imposed on a good where the value of the tax is dependent on the quantity that is bought

State provision of goods	Through taxation, the government provides public goods or merit goods which are underprovided in the free market
Subsidy	Government payments to a producer to lower their costs of production and encourage them to produce more
Substitutes	Positive XED; if good B becomes more expensive, demand for good A rises
Supply	The ability and willingness to provide a particular good/service at a given price at a given moment in time
Symmetric information	Where buyers and sellers both have access to the same information
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	When PED/PES=1; a change in price leads to a change in output by the same proportion
Utility	The satisfaction derived from consuming a good
Weakness at computation	A cause of irrational behaviour; when consumers are bad at making calculations, estimating probabilities and working out future benefits/costs