OCR Economics A-level

Microeconomics

Topic 2 – The Role of Markets

Definitions and Concepts

2.1 – Specialisation and trade

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.

Division of labour - When labour becomes specialised during the production process so workers carry out a specific task in co-operation with other workers.

2.2 – Demand

Competitive demand - When goods are substitutes, so buying one means you don't buy the other**.**
Composite supply - When a good or service can be obtained from different sources.

Demand - The quantity of a good/service that consumers are able and willing to buy at a given price during a given period of time.

Individual demand - Demand of an individual or firm, measured by the quantity bought at a certain price at one point in time.

Joint demand - When goods are bought together.
Market demand - Sum of all individual demands in a market

2.3 – Supply

Competitive supply - When a business could make more than one good with its resources, and producing one means they can't produce the other.

Composite supply - When a good or service can be obtained from different sources.

Individual supply - Supply of a single firm.
Joint supply - Increasing supply of one good causes an increase in the supply of a by-product.

Market supply - Sum of all individual supplies in the market.

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

2.4 – Consumer and producer surplus

Consumer surplus - The difference between the price the consumer is willing to pay and the price they actually pay.

Producer surplus - The difference between the price the producer is willing to charge and the price they actually charge.

2.5 – The interaction of markets

Derived demand - The demand for one good is linked to the demand for a related good.

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.

Market - Where demand and supply interact; the collection of many sub-markets.

2.6 – Elasticity

Complementary goods - Negative XED; if good B becomes more expensive, demand for good A falls.

Cross elasticity of demand - The responsiveness of demand of one good (A) to a change in price of another good (B), calculated by: %change in QD of A divided by %change in P of B

Elasticity - How responsive demand or supply is to a change in price.

Income elasticity of demand - The responsiveness of demand to a change in income, calculated by:

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

Luxury goods - YED>1; an increase in incomes causes an even bigger increase in demand.

Normal goods - YED>0; demand increases as income increases.

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.

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.

Price elasticity of demand - The responsiveness of demand to a change in price, calculated by: %change in QD divided by %change in P.

Price elasticity of supply - The responsive of supply to a change in price, calculated by: %change in QS divided by %change in P

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.

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

Unrelated goods - XED=0; if the price of good B changes, it has no impact on the demand for good A.

2.7 – The concept of a margin

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.

Margin - The effect of an additional action.

2.8 – Market failure and externalities

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

Marginal external benefit - The extra benefit to a third party not involved in the economic activity, per unit consumed

Marginal external cost - The extra cost to a third party not involved in the economic activity, per unit consumed, expressed by: marginal social cost- marginal private cost.

Marginal private benefit - The extra benefit to the individual per unit consumed.

Marginal private cost - The extra cost to the individual per unit consumed.

Marginal social benefit - The extra benefit to society per unit consumed, expressed by: marginal external benefit + marginal private benefit.

Marginal social cost - The extra cost to society per unit consumed, expressed by: marginal external cost + marginal private cost.

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.

Negative externalities of consumption - Where the social benefits of consuming a good is less than the private benefit of consuming a good.

Negative externalities of production - Where the social costs of producing a good are greater than the private costs of producing the good.

Positive externalities of consumption - Where the social benefits of consuming a good are larger than the private benefits of consuming that good.

Positive externalities of production - Where the social costs of producing a good are less than the private costs of producing a good