Economics Unit 1 OCR Revision Guide - 11.05.2015

FINISHED

PLEASE DO NOT REMOVE CONTENT -Makashima

Revision material comprised by several nice economic students

http://us21.chatzy.com/53097549070021

CHATROOM for general economics discussion

password: makishima

- Notes kindly sent by Kevin Longe - http://www.mediafire.com/view/8ait8byiqje9963/Economics_AS_Level_Notes.docx

Economic problem - How to allocate scarce resources amongst alternative uses.What to produce, for whom and how. Demand is greater than supply

Scarcity - A situation where there are finite resources to meet unlimited wants. Demand is greater than supply.

Opportunity cost - The cost of a decision in terms of the benefits of the next best alternative forgone.

Factors of Production - The resource inputs available to an economy for the production of goods and services.

(The 4) Factors of Production: remember as CELL - capital, enterprise, land, labour

- Labour - The human input involved in production.
- Capital - Man made machinery used to aid in production (i.e. goods that have been made in order to produce some other good or service).
- Land - Natural resources in an economy/Physical infrastructure
- Enterprise - The factor that brings together the other factors in order to produce a profitable product. It is associated with risk taking and finding new businesses.

Specialisation - The concentration of a worker, firm, region or a country to produce a narrow range of goods and services.

Division of labour - The specialisation of labour where the production process is broken down into separate tasks.
The +ves and -ves are the same as for specialisation?

Advantages of Division of Labour:

- More efficient workers
- More goods can be produced than before
- Leading to higher skills thus can demand higher wages

Disadvantages of Division of Labour:

- Lack of flexibility of workers - boredom
- Over specialising - workers are unable to switch to other jobs

Advantages of Specialisation:

- Increase in world output
- Increase in widening range of good available
- Possible increased trade between developed and developing countries could increase world equality
- Increases size of marker for suppliers which can give opportunities for economies of scale. Also increases competition so firms must make efficiency gains to survive in global marker.

Disadvantages of Specialisation:

- Specialisation may refer purchasings technology and capitals that can replace workers thus unemployment increases.
- Adverse weather / political events can disrupt trade. Dangerous if countries are dependant on each other could be damaging to economy.
- Increased transport of goods across world increases greenhouse gas emissions
- Reduced flexibility
- If the production relies on finite resources, when it runs out the economy will suffer

---

Production Possibility Curve (PPC) - A PPC shows the maximum potential output of two goods (or classes of goods) that can be produced in the current time period if all resources are efficiently employed.
Graph can be including: Capital Goods vs Consumer Goods; Good A vs Good B; Specific Good vs Specific Good

Market - A market exists wherever consumers and producers come together for the purpose of an exchange of goods and services.

Consumer Surplus - the difference in price between what consumers are willing to buy goods and services for and the price at which they actually buy goods and services

Producer Surplus - the difference in price between what producers are willing to sell their goods and services for and the price at which they actually buy goods and services

Substitutes - A good which can be replaced by another good to satisfy a want.

Complements - Goods that are consumed together.

Allocative Efficiency - SMC = SMB (or where the quantity demanded is equal to the quantity supplied) OR Customer satisfaction is maximised

Productive Efficiency - Where production takes place using the least amount of scarce resources (for maximum output).

Externalities:

Externalities - Costs accruing to 3rd parties who are not involved in a transaction
Negative Externalities - Where the social costs of an activity is greater than the private costs.
Positive Externalities - Where the social benefits of an activity exceeds the private benefit.

Market Failure - Where the free market mechanism fails to achieve economic efficiency

Information Failure - A lack of information resulting in consumers and producers making decisions that do not maximise welfare.

Demand and Supply:

Demand - The quantity of the product that the consumers are willing and able to pay at a given price over a period of time.

Derived Demand - Where the demand for one good arises from the demand for another good or service.

Consumer surplus - The difference between the price the consumer is willing to pay and what is actually paid (the market price).The extra amount amount a consumer is willing to pay above the price that is actually paid

Determinants of Demand:
*NOTE: (If the question ask about the determinant of demand, don't say **price**)*

Remember through PASIFIC - its basically the ocean, spelt wrong

- **P**opulation
- **A**dvertising
- **S**ubstitutes
- **I**ncome
- **F**ashion
- **I**nterest Rates
- **C**omplements

- **E**xpectations of Future Prices

Supply- The quantity of the product that the suppliers are willing and able to produce at a given price over a period of time. Will decrease with price rise

Producer surplus - The difference between the price the producer is willing to accept and what is actually paid (the market price). Will increase with price rise

Determinants of Supply:
Remember through PINTS WC. If you have too many PINTS you have to use the WC xD
Or Alternatively SPLAT - Subsidies, Percentage of income, Luxury, Addiction and Technology.

- Productivity/Percentage of income
- Indirect tax (included in costs of production)
- Number of firms
- Technology
- Subsidies
- Weather
- Cost of production
- Changes in price/profitability of other goods the firm could supply (i.e. changes in the price/profitability of substitutes in supply)

<u>Elasticity & Their Calculations:</u>

To work out %change - change in value / original value * 100

Price Elasticity of Demand (PED) - Measures the responsiveness of quantity demanded to a change in price of a product. **Always negative**.

$$\frac{\%\ Change\ in\ Quantity\ Demanded}{\%\ Change\ in\ Price}$$

- Inelastic = 0-1
- Elastic = +1

Determinants of Price Elasticity of Demand:
- Time
- Price of the good as a % of income
- Availability of substitutes
- Degree of necessity
- Addictiveness

Determinants of Price Elasticity of Supply:
- Number of stocks

- Spare capacity
- Time to produce
- Perishability of good - if a good has a short life then this affects how long it can be kept as stocks
- Flexibility of resources
- Availability of resources - if a firm has lots of resources available they can quickly produce more to increase supply in response to a change in price

Cross Elasticity of Demand (XED) - Measures the responsiveness of the quantity demanded of product A in relation to the change in price of product B. Either complements (-ve XED) or substitutes (+ve XED). Can be weak or strong.

- "% Change in QD of Good A" DIVIDED BY "% Change in Price of Good B"

Income Elasticity of Demand (YED) - measures the responsiveness of demand to a change in income levels of a product. Either normal good (0-1 YED) or inferior good (- YED) or superior / luxury good (1+ YED). Greater than 1 - elastic YED, less than 1 - inelastic YED

- "% Change in QD" DIVIDED BY "% Change in Price"

Types of Goods:

Merit Goods - A good that is under-consumed/produced because of consumer's lack of information
Demerit Goods - A good that is over-consumed/produced because of consumer's lack of information

Public Good - "Non-excludable" & "Non-rivalry in Consumption"
Private Good - Excludable & Rivalrous
Quasi Public Goods - Goods that have some but not all the characteristics of a public good

---

Policy Definitions:

Subsidies - A subsidy is a payment, usually from the government, to encourage production or consumption of a product, by reducing the costs of production

Information Provision - Providing information that helps enable consumers and producers make decisions that maximise welfare

Indirect tax - A tax levied on goods and services

Regulations - Legislation, rules, limits set by governments to reduce/control consumption or production of a good (typically one that generates negative externalities).

Tradable Permits - A permit that allows the owner to emit a certain amount of pollution and if unused or partially used can be sold on to another polluter

---

Elasticities:

- When referring to the calculated elasticity figures do not say “It is elastic”, must refer it as “The PED figure is …”. Based from the 2014 exam mark scheme, examiners complained the vagueness of the word “it’s”
- For comment marks: The data are only estimates possibly based on consumer surveys thus the results could be inaccurate therefore unreliable and may change over time (1-2 marks) (These will only get marks once you’ve applied business relevance to the question!) E.g PES .. / supply tends to be price inelastic in the short term where it is difficult to switch production. Over time supply becomes more price elastic…
- Apply to ceteris paribus, assuming nothing else changes the e.g. determinants of demand, e.g income, fashion/trends etc ..
- Also might be based on past data that does not reflect current market conditions / account for time lag of consumers changing preferences according to change in price/ income etc.

<table>
<tr><th colspan="2">Discuss whether tradeable pollution permits are the most effective method of correcting market failure arising from the negative externalities of pollution?</th></tr>
<tr><td colspan="2">Definitions:
tradable permits
market failure
negative externalities</td></tr>
<tr><td>FOR (how it works?)
creates market of permits
do a diagram with a vertical supply curve and normal demand curve (NO SHIFTS!)
Tradeable pollution diagram
without the shift
if firms have any left over they can sell them on
this encourages them to reduce pollution as they gain profit from selling the permits. Thus a market for tradable permits is created. This will encourage innovation and research due to profit motives.</td><td>AGAINST
difficult to enforce and monitor CO2 being emitted.
Countries / firms have incentive to lie / bend rules (i.e. the carrying over of pollution permits from previous over-generous agreements as many European countries has makes current limits meaningless)
cost of policing to make sure firms don't go over their limit - if this exceeds benefit of TP then this is government failure
how many permits - if too high then market failure still occurring - if too low then may make goods too high decreasing their international competitiveness thus effecting economy
Firms will/might switch their production to another country, which does not have any regulation. We become less internationally competitive</td></tr>
</table>

● Likely to be more effective than fines as fines will mean firms innovate to the point where they won't be fined whereas TP encourages firms to drive pollution down to 0 ● helps to internalise the negative externality correcting the market failure. ● Increase some firms cost of production, therefore price increase, people consume it less - this is only good if the product is a demerit good.	● Distribution of these permits between firm ● how would the government decide how many to allocate to each firm? This would require inspection of each firm to see their pollution levels… very ● costly ● Critics say it fails to emphasise the need to invest in renewable energies and move away from fossil fuels Alternative methods: ● regulations - setting fines for polluting OR firms can only supply a certain amount every year ● Tax firms for polluting - this is better because it provides revenue for the govt which can be spent on providing merit goods or goods that produce positive externalities ● Subsidies- biofuel innovations or more sustainable fuel methods
Conclusion	

<u>Discuss whether subsidies are the most effective method to correct market failure arising from merit goods?</u>	
Definitions subsidies merit goods market failure	
For ● Maximises social welfare ● Government will benefit in the long run(depending on the type of merit good) ● Lower prices encourage those on low income to consume the good as its more affordable ● talk about underconsumption?? ● Lowers cost of production to producers - incentives the production. Resolves underproduction of merit good. Moves closer to socially optimum level This closer to allocatively efficient...maximise welfare	Against ● Opportunity cost to the government in times of austerity ● Determining size of subsidy is often difficult ● Consumption will not increase with a decrease in price if the PED of the good or service is inelastic as this means it's unresponsive to changes in price ● Firms may misuse the subsidy and not increase supply ● Is the subsidy a one-off payment ?
Alternative: Provide information: since it's a merit good, you should provide more information so everyone knows	

the benefit of it

Discuss whether implementing regulations is the most effective method to correcting market failure arising from de-merit goods?	
Definitions: De-merit good Regulations Market Failure	
For ● If aimed at producer it, it can be in the form of a limit on how much they can supply on a yearly basis increasing their cost of production **thus supply shifts left (supply shifting left diagram).** ● Can be aimed at consumers or producers, the regulation could be that you have to be 18 to smoke cigarettes (demerit good) this **decreases demand shifting it left (demand** ● **shifting left diagram** ● Use one...either at producers or suppliers! ● It solves market failure by solving solving overproduction of the good...etc	Against ● enforcing and monitoring the regulation requires a lot of money thus creates opportunity cost ● often very difficult to get the size of the regulation correct ● If something is going to be banned, it automatically creates a black market, which is not controlled at all, thus may not be effective ● Alternatives: ● information provision ● Indirect taxes
Conclusion	

Discuss whether using information provision is the most effective method to correcting market failure arising from demerit goods
Definitions: ● information provision ● market failure ● demerit good

FOR	**AGAINST**
● Information provision would shift demand	● consumers just ignore information ● level of information - how is it being

LEFT as it makes consumers aware of the real costs of consuming the good. Meaning they REDUCE consumption ● Make consumers aware of how consumption of the good is more harmful than realised ● corrects asymmetric information ● How it solves market failure...solves overconsumption...market closer to allocative efficiency...increasing welfare etc	spread? ● A few billboards here and there wont do anything ● A nationwide campaign will. ● requires a lot of money creates opportunity cost ● Other methods such as partial bans or regulations with fines may be more effective as it is more direct and gets the message across to consumers. ● Long term solution, less effective in the short run

Identify two characteristics of a 'public good'

- non rivalry -consumption by one does not affect the consumption of others
- non excludability- individuals cannot be excluded from the consumption

Identify one possible example of a positive externality arising from education. Explain why this is a positive externality

Students receive a better job as a private benefit this benefits a third party such as the UK as it means a faster growing economy which is the external benefit.

Demand:

- incomes rising - good becomes more affordable (as consumers have more to spend?), if the good is a normal good then when incomes rise so does the demand for the good according to YED (think that would be 3 marks)
- Increase advertising
- Fashion/Tastes
- price of substitutes increase therefore consumers switch to cheaper alternative, so the demand for that good increases and it's become more affordable, so demand increases (please tell me if I've done anything wrong or if this is not worth 3 marks)
- Future price changes, if the good price is to rise in the future thus it is more sensible and convenient to purchase the goods now whilst it is still cheaper.

Supply:

- supply will increase if there is a decrease in costs of production. e.g. packaging costs reduced.
- I'm gonna rewrite the above point:
- If there was a fall in the cost of raw materials it would lead to a lower cost of production, as a result a firm has a greater incentive to supply as it can make more profit therefore supply increases

- it will also increase if there is an advancement of technology
- subsidies lower total costs of production for firms so they become more willing to supply as they can now afford to

---

Elasticities	**Relevance AND appropriate comments** Blue - *Evaluative Points*
PED	• If it is elastic then lower the price hence the quantity demanded will rise by a greater than a proportionate amount thus generating greater revenue • if inelastic then a higher price will decrease quantity demanded by a less than proportionate amount thus generating greater revenue • But the figures are estimates. They change over time and are only valid for the time at which the data was taken • Price is not the only factor that determines demand as well.
PES	• Shows the responsiveness of the Quantity Supplied to a change in Price. • If the elasticity is elastic, , then if there's a rise in price of the goods, the business should increase the quantity supplied. • Overtime, the factor production is adjustable hence the PES becomes elastic from inelastic
XED	Shows the responsiveness of Demand for one product, to a change in Price of another product. • If **positive**, then signifies the products are substitutes to each other • If **negative**, then the products are complementary goods • The closer the figure is to "0" the weaker the substitutes or complementary good is. The closer to "1" then its a strong substitute or complementary good • Firms can reduce the price of complementary goods in order to increase the demand for another good (e.g. decrease the price of tennis balls → increase demand for tennis rackets) • If a competitor increases the price of a substitute good, the rival firm can expect to see a rise in QD of their good • Figures can change over time
YED q4	• Business can use figures generated to plan, if it knows what is going to happen with income. If a business knows a boom is coming up or a recession, they could plan in stocks/ plan in production/ employment levels. based on expected future incomes. • GOOD EXAMPLE PAGE 8 MS • Again, Data are only estimates…

General Questions:

For L4 on tradeable permits can you say if demands lowers and shifts left then it's not correcting market failure and 1 firm could buy up a lot of permits thus concentrating pollution in 1 spot? anyone?

erms i wouldn't suggest doing that L4 points- just go for the simple ones - u dont get more marks for a more complex idea
OKAY thanks can u remind me of some other L4 points?thanks

enforcing and monitoring costs - requires a lot of money & resources - creates opp cost - could it be used elsewhere? nice 1

difficulty in getting the size of permits - what if it's too much?nice2 market failure still occurs

what if the number of permits is too low?

would another point be that **countries that aren't in europe may still pollute thus making our firms uncompetitive due to high cost**s
yeah !! avoiding the permit
another 1...should the tradable permit policy be applied internationally? if not then firms can just move to other countries and pollute their → global warming yes sounds like a good point thanks
so all these points could achieve 18/18?
If firms are being forced to reduce pollution, they may also become less efficient reducing overall productivity in the economy.

(hey so is how it works and how it solves mf different diagrams?) oh ok !! so i wouldn't draw the diagram with no shifts just explain how it works i think i might draw it just so i don't get confused lol

for 'how it works' its just talking about how it solves neg ext- no need for diagrams examiners not bothered

this is how i would go about achieving 18/18 on TP
Definitions - how it works - how it solves market failure - two negatives - alternative - compare - judgement
what could an alternative be like regulations and taxes for polluting?
subsidies: could give subsidies to firms for research and development into cleaner fuels to reduce pollution
regulations: limit on how much they can produce (similar to TP) but they can't buy permits so its better. Set fines so that they have an incentive to reduce their pollution to prevent being fined.

jus another points on TP: a negative you could mention::

if it already is applied internationally then rich countries can buy permits off poorer countries thus pollution still exists in high amounts. i fucking like that idea

if you do an alternative point later 2 is more then enough

What are some common example of positive and negative externalities??

- Smoking can lead to private cost such as cancers and other smoking-related illnesses and overall the social cost is the strain applied on the NHS and also the need to derived tax revenue into the NHS department when the money could have directed into more useful project such as infrastructure or education
- Chewing gum particularly the therapeutic benefits people teeth and health (e.g. fresher breath). Thus can repeat NHS point, less strain in the dental department.

Can someone tell me the business relevance of PES. It is favourable to have an elastic PES because then firms can react to market changes. This means that if there is a price rise in the future, they can cash in on it by increasing supply. Similarly, if prices fall, they can quickly move resources away from such products and into other products where there is a positive relationship.
It is also good for firms to be able to look at their competitors PES estimates so they can see how other firms will react to changes in price.

Right what is the hardest thing in f581 in peoples opinion?

Ight. Anything else I should know about it?
Is that enough for the 8 marks? Do calculations, say elastic/inelastic. say its unreliable, etc. ?
Oh okay. I will do.
Yeah I would say it varies along supply curve. Changes over time ceteris paribus. Whack it all down and hope for the best.

Ceteris Paribus - refers to all the things assumed to be constant or equal.

- **With elaboration in your comment points such as size, you can potentially gain 3 marks along with well a detailed answer.**

e.g it will depend on much supply increases - if it was larger this would lead to a larger increase in price and quantity - probably get u 2 marks

merit goods - goods that have more private benefits that consumers actually realise- they are generally under-consumed and underproduced in the free market right and DEMERIT are just opp of this?cool cheers ya

Yes. and underprovided because the public don't realise the benefits

Guys, if you saw this question in the exam, what would have you answered?

4. (a) Explain two reasons why a manufacturer might increase its production of chewing gum. - banter - maybe if there is an in the price of chewing gum in the market, if pes is elastic they can increase supply to cash in on the increased revenue available.

what makes supply inelastic

- no stock of goods
- no spare capacity
- time - if the good requires a lot of time to make (growing fruit)
- demand greater than supply? (not sure tbh) ok thanks :)
- if the good is perishable then its inelastic as it can't be stored long

From YED how do you know if something is a luxury good? - positive figure elastic greater than 1 indicates normal good if it's greater than 1 it's a luxury good

Wait so whats the difference between normal and luxury if there both positive and larger than 1

not much really just that if incomes rise there would be a greater rise for luxury goods and inferior good is q.d goes down with increased incomes?ok yes

NORMAL GOOD - +VE AS INCOMES RISE, DEMAND RISE.
INFERIOR GOOD - -VE AS INCOMES RISE, DEMAND FALLS

Essay plans

Discuss whether education should be provided by the private sector or the public sector (18)
Plan:

Define: privatisation - The transfer of ownership of property or businesses from a government to a privately owned entity

Public,

- Left in free market, it would be a merit good ie under consumed and underprovided
- Free market doesn't take positive externalities into consideration when the price is set. - However if the government were to subsidise education it would be very hard to estimate the correct size of subsidy to implement as it is hard to estimate the size of an externality. Potentially case government failure if cost of govt intervention exceeds benefits generated
- Education generate positive externalities, enable labour to become more productively efficient due to gain in more and new skills and qualification etc

- Rationing of price mechanism would mean that poor are not able to afford it (get priced out) in private. Morally this is bad as it is depriving children from education - increased income inequality. BUT if placed in the private sector it might motivate those with lower incomes to work harder to afford education for their children - this could drive up efficiency. And if it remained compulsory (combine it with regulation) for children to be educated, education providers will receive more / guaranteed (due to enforcement of education) profit allowing them to be more productive - I know it's harsh but you have to show all the sides of the argument in an essay

Private,

- produce efficiency due to the competition within the market (Avoids X-inefficiency of public sector due to profit motive)
- Firms will compete which may result in specialisation. This will result in greater output of education (such as different subjects etc) and higher quality (of teaching).
- If run by the government there would be no profit incentive and so would not try to be
- There is an opportunity cost for the government - the funds could be spent on other merit goods/goods, like the NHS or police, that produce positive externalities - The significance of this depends on the government's current fiscal position and whether they can afford to increase their spending or not

Explain two reasons why education is not a 'public good'

- there are a limited number of places in schools (ie limited supply) so rivalous to some degree - there's "competition" for school places as there's more demand for school places, in certain schools, than there is supply
- Some school are excludable as they are in expensive locations to live so people are excluded from them as they can't afford to live there. Also private schools are payed-for so are price excludable.

Whenever a question on public goods come up think "no diminishable?" non rivalrous?

Exam Techniques

Be concise and plan your essay

Supply/Demand Comment marks:

- magnitude of supply shift (go on to explain to get elaboration marks)
- When only demand shifts to the right, you will get 1 mark if you say depends on the elasticity of supply. Vice versa for only supply shifting, say it depends on the elasticity of demand.

- magnitude of demand shift (same)
- we assume ceteris paribus - there could be other factors
- PED/PES (talk about PED if supply changes → opposites)
- **TRY TO EXPLAIN EACH COMMENT MARK TO INCREASE YOUR CHANCE OF GETTING THE MAXIMUM MARKS AVAILABLE FOR COMMENT SECTION**

Government intervention policies	Goods	Criticisms
Regulation	• get the message across directly to firms • non-market based solution of correcting market failure	• cost of policing • although there are fines, if these are not high enough then firms may still break the rules. • it can force some firms to migrate away - bad for overall economy • If fines are too high it will encourage firms to take risks especially if the risk of detection is low.
Tradeable permit pollution	• level is set exactly by government • encourages firms to reduce pollution as they can sell the unused permits for profit • Where demand increases, price increases due to supply being completely inelastic and vice versa • Perfect example of the polluter pays principle	• hard to monitor • may cause firms to decrease efficiency in order to reduce pollution • hard to estimate how many permits to have
Taxation	• provide revenue for the government • revenue can be used to fund the policing costs to help prevent govt failure.	• hurts the poor - could be priced out (regressive nature of the tax) • has to be the same size as externality or -> government failure • cost of policing/collection
Provision of information	• can help to get the message across directly. • enable consumers to make decision that maximise their welfare	• People can simply ignore the information • depends on size of info campaign - a few ads here and there wont do much… • COST
Subsidy	• helps reduce cost of prod - > decrease price -> less underconsumption • if it refers to positive externalities then it generates more positive externalities	• it has a significant cost to the government - opportunity cost. • the funds could be spent elsewhere • has to be right size - size of externality.

60 marks 1 hour 30 minutes

Advice to spend 40 minutes in section A

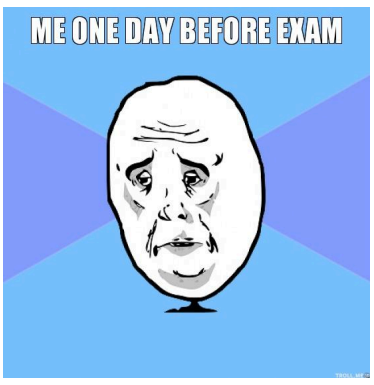
50 minutes in section B (includes 5 mins essay plan)

Last year 2014 national average mark of essay is 9

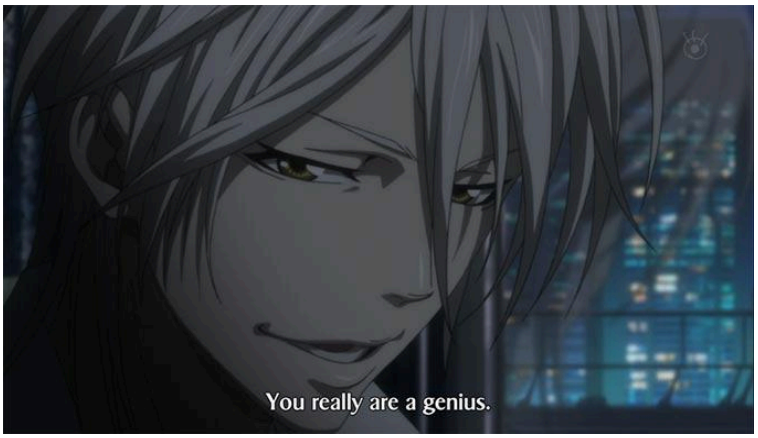
General feedback!

TSR name	How confident you are for the exam, 10 completely confident and to 1 not confident
KhamZ_98	9 - i wrote the private/public essay above and most of the tradeable permits question. Feel free to ask any questions But OCR can do whatever the hell they want.
Slenderman	8 - I need to go over the diagrams, definitions and I should be fine.
anndz3007	9 - i feel quite confidence, will try to write those 4 essays about regulation, subsidy,permit,provision today
Makashima	8 - The exam might do some weird shit then I am going to cry but I fairly know the stuff also need to relook the government intervention policies
BigFreakyGinger	7- Fairly confident, may be resting on my laurels a bit too much. I think I am actually procrastinating by watching the thread on this exam...
Al	8 - need to go over definitions and a few diagrams
Gelion	7-8 - It just depends on the questions they will give us basically...
Justfly	8-9 - confident on most things - sceptical about an essay on state provision though, other then that I think I can tackle any question.
	Doc not editable xD thus no more entry within this survey

< this is u in the exam>



what does makashima looks like!
this is me:



Really wish you guys the best of luck! Do your best!