

# Economics Year 1 Micro

## Theme 1 Close the Gap



# Markets and Market Failure



# Nature of Economics

What does ceteris paribus mean? *Why is it important to economics?*

What is a positive statement? *Provide 2 Examples*

What is a normative statement? *Provide 2 Examples*

Which 3 questions does the study of economics seek to answer?

What does 'scarcity' mean?

What is meant by a 'renewable resource'?

What is meant by a 'non-renewable resource'?

What is the Economic Problem?

What are the 4 factors of production? *What is the Reward for Each factor and provide at least 1 Example of Each*



Define Opportunity Cost

Why do opportunity costs exist?

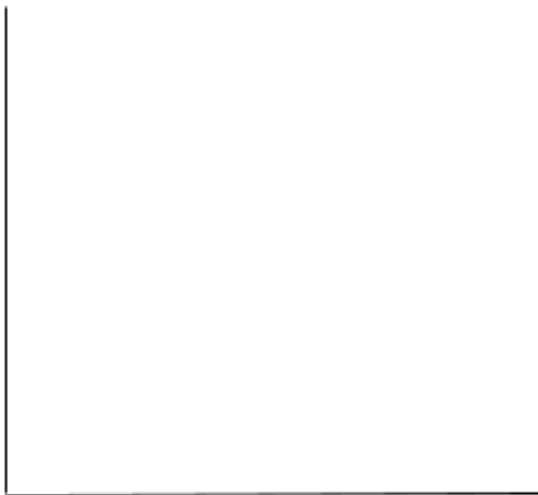
Give an example of an opportunity cost for a consumer

Give an example of an opportunity cost for a firm

Give an example of an opportunity cost for a Government

Define Production Possibility Frontier/Curve?

Draw a PPF Curve and identify the following:



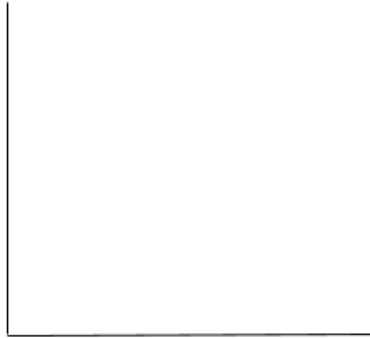
- a point on the PPF which is unattainable at the current level of technology
- a point on the PPF where the allocation of resources is efficient
- a point on the PPF where the allocation of resources is inefficient

Define Capital Goods

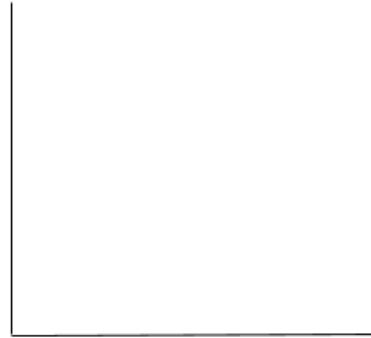
Define Consumer Goods



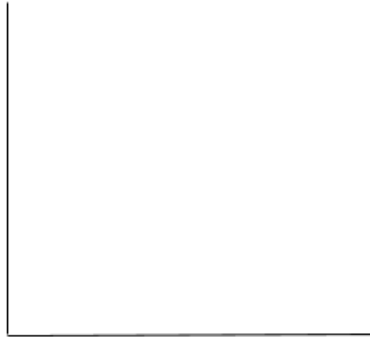
Illustrate actual economic growth on a PPF diagram



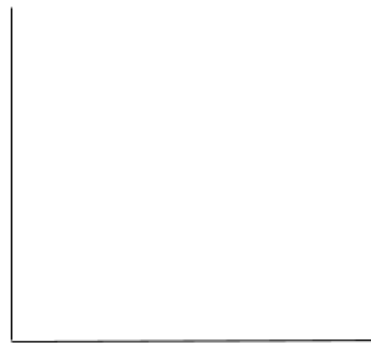
Illustrate potential economic growth on a PPF diagram



Illustrate opportunity cost on a PPF



Illustrate the effects of an improvement in technology in the production of Capital Goods



Explain 2 causes of an outward shift in the PPF

Explain 2 causes of an inward shift in the PPF

Explain why we would not want 100% of our production to be on capital goods

Explain why we would not want 100% of our production to be on consumer good



What is specialisation?

How does the division of labour result in higher output?

How might the division of labour result in higher quality?

How might specialisation result in lower costs?

Give 4 disadvantages of specialisation in a firm

Explain each of the 5 functions of money



Which economist is associated with free market economies?

What is a free market economy?

How are the 3 fundamental questions of economics answered in a free market?

Give 3 advantages of a free market economies

Give 4 disadvantages of free market economies

Which economist is associated with command economies?

What is a command economy?

How are the 3 fundamental questions of economics answered in a command economy?

Give 4 advantages of command economies

Give 3 disadvantages of command economies

What is a mixed economy?

How are the 3 fundamental questions of economics answered in a mixed economy?

What is the role of the state in a mixed economy?



# How Markets Work

## Rational Decision Making

What is utility?

What do consumers seek to maximise?

What do firms seek to maximise?

What is irrational behaviour?

Explain 3 reasons why agents may behave irrationally

## Demand

What is demand?

Explain 3 reasons the demand curve is downward sloping

What causes a movement in demand (extension or contraction)



Illustrate an extension in demand



Illustrate a contraction in demand



Illustrate an increase in demand



Illustrate a decrease in demand



What factors can cause a shift in demand? (As illustrated above)

What is the law of diminishing marginal utility?



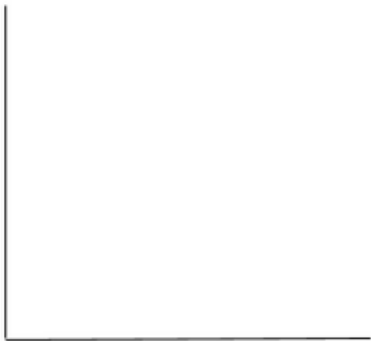


# Supply

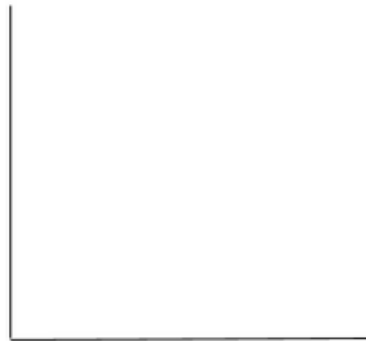
What is supply?

Explanation 3 reasons the supply curve is upward sloping

What causes a movement in supply (extension or contraction)

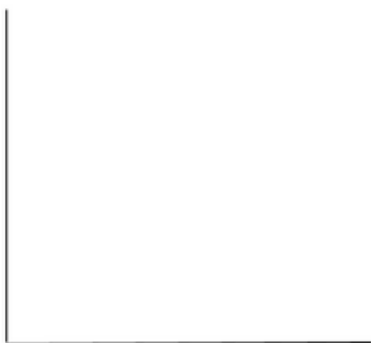


Illustrate an extension in demand

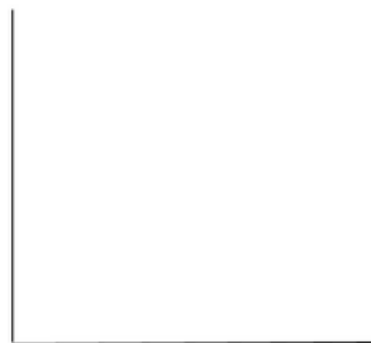


Illustrate a contraction in demand

Illustrate an increase in supply



Illustrate a decrease in supply



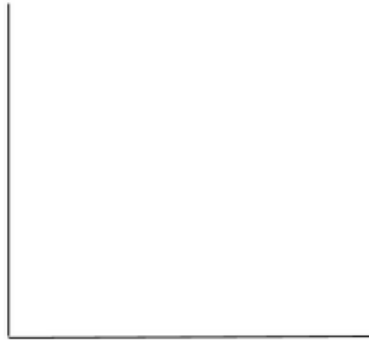
What factors can cause a shift in supply? (As illustrated above)



## Price Determination and Price Mechanism

Define Equilibrium?

Illustrate equilibrium price and quantity of a product



What is a shortage? What is it also known as?

Illustrate how a shortage occurs



What is a surplus? What is it also known as?

Illustrate how a surplus occurs





Explain the 3 functions of the price mechanism

## Consumer and Producer Surplus

Define Consumer Surplus

Define Producer Surplus

Illustrate Consumer Surplus



Illustrate Producer Surplus



What happens ?	Price Increase	Price Decrease
Consumer Surplus		
Producer Surplus		



## Elasticity - PED

What is the definition of price elasticity of demand?

Give the formula for PED

What is meant by 'price elastic demand'? (what is the effect?)

What values would constitute 'price elastic demand'?

What is meant by 'price inelastic demand'?

What values would constitute 'price inelastic demand'?

What is meant by 'perfectly price elastic demand'?

What values would constitute 'perfectly elastic demand'?

What is meant by 'unit elastic demand'?

What value would constitute 'unit elastic demand'?



Price Elastic



Price Inelastic



Perfectly Price  
Inelastic



Perfectly Price  
Elastic



Explain how each of the following influence the PED of a Product

Substitutes

Percentage of Income

Luxury or necessity

Addictiveness/habitual behaviour

Time

What happens top revenue when?	Price Inelastic	Price Elastic
Price Increase		
Price Decrease		



## Elasticity - XED

What is the definition of cross price elasticity of demand?

Give the formula for XED

What is the definition of substitute goods?

What values of XED would constitute a substitute? (what about weak and strong?)

What is the definition of complementary goods?

What values of XED would constitute complementary goods? (what about weak and strong?)

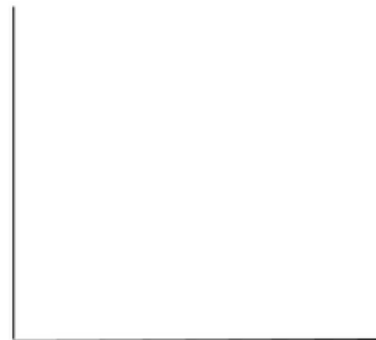
What would an XED of 0 indicate?

Draw two diagrams illustrating a complement and a substitute (think carefully when labelling the axis)

Complement



Substitute





## Elasticity - YED

What is the definition of income elasticity of demand?

Give the formula for YED

What is the definition of an inferior good? (what is the relationship between income and demand?)

What values of YED would constitute an inferior good?

What is a normal good? (What is the relationship between income and demand?)

What values of YED would constitute a normal necessity good?

What values of YED would constitute a luxury good?



## Elasticity - PES

What is the definition of price elasticity of supply?

Give the formula for PES

What is meant by 'price elastic supply'? (what is the effect?)

What values would constitute 'price elastic supply'?

What is meant by 'price inelastic supply'?

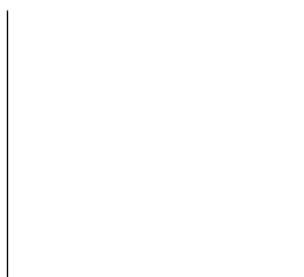
What values would constitute 'price inelastic supply'?

What is meant by 'perfectly price elastic supply'?

What values would constitute 'perfectly elastic supply'?

What is meant by 'unit elastic supply'?

What value would constitute 'unit elastic supply'?



Price Elastic



Price Inelastic



Perfectly Price  
Inelastic



Perfectly Price  
Elastic





Explain how each of the following influence the PES of a Product

**B**arriers to entry

**R**aw Materials

**I**nventories

**T**ime

**S**pare capacity

What is the relevance of the elasticities to businesses?

PED is relevant because?

YED is relevant because?

XED is relevant because?



# Market Failure

What is the definition of market failure?

## Externalities

Define Externalities

Define External Benefit **Provide 3 examples**

Define External Cost **Provide 3 examples**

Define Social Benefit ( include the formula for social benefits)

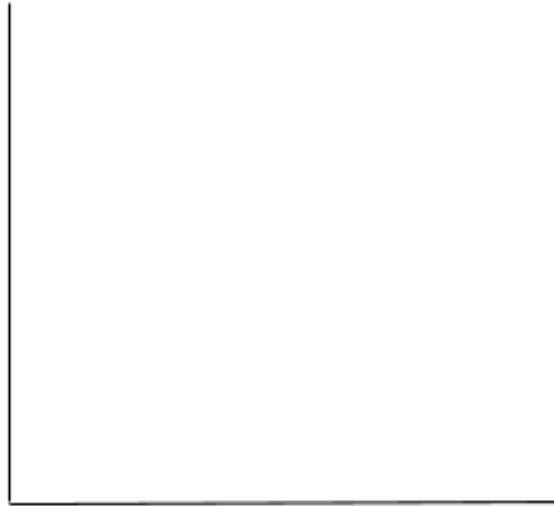
Define Social Costs (include the formula for Social Costs)

Define Negative Production Externality - what does it lead to? **Provide 3 examples**



Draw a Negative Production Externality Include the following:

Socially Optimal Equilibrium, Free Market (Private) Equilibrium, Over/Under Production, Over/Under Valuation, Welfare Loss



Define Positive Consumption Externality - what does it lead to? Provide 3 examples

Draw a Positive Consumption Externality Include the following:

Socially Optimal Equilibrium, Free Market (Private) Equilibrium, Over/Under Production, Over/Under Valuation, Welfare Loss





## **Public Goods**

What is meant by the term 'Public Good'?

What are the conditions that need to be met to be a Public Good?

What is the name of the good which displays only one of the conditions

What is non-excludability? Use an example in your answer

What is non-rivalry? Use an example in your answer

What is the free rider problem?

Are public good under or over produced in the free marker? Why?

Give a reason why governments may choose not to provide public goods

## **Information Failure**

What is information asymmetry?

Why is this a form of market failure?

What is adverse selection?

What is moral hazard?



# Government Intervention and Government Failure

## Indirect Taxes

What is a tax?

What is the difference between an indirect and a direct tax?

What are the two types of indirect tax?

Give 3 reasons why government might want to tax a product

Draw a specific tax. Using letter notation, show:

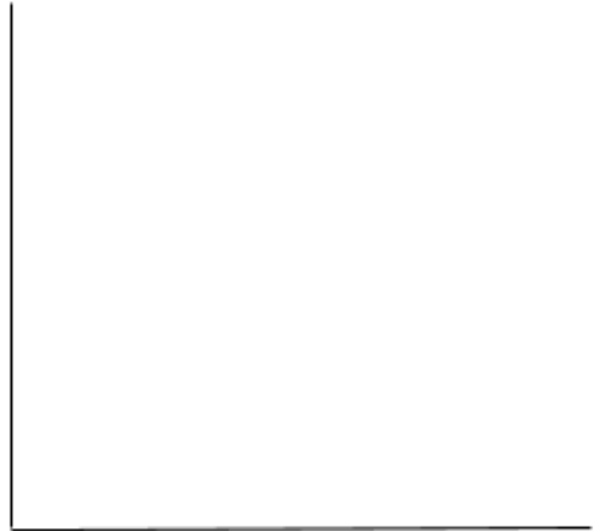
- a. Original price
- b. Original quantity consumed
- c. New price to consumers
- d. New price to producers
- e. Tax per unit at new equilibrium
- f. producer tax incidence
- g. consumer tax incidence
- h. government revenue
- i. deadweight loss





Draw a Ad Valorem tax. Using letter notation, show:

- a. Original price
- b. Original quantity consumed
- c. New price to consumers
- d. New price to producers
- e. Tax per unit at new equilibrium
- f. producer tax incidence
- g. consumer tax incidence
- h. government revenue
- i. deadweight loss



Explain using a chain of analysis how a tax works? (think through the steps and what order does it need to be in)

Explain how taxes can be used to 'internalise an externality'

Explain 2 benefits of indirect taxes over other forms of intervention to correct a market failure

Give 2 disadvantages of indirect taxes over other forms of intervention to correct a market failure



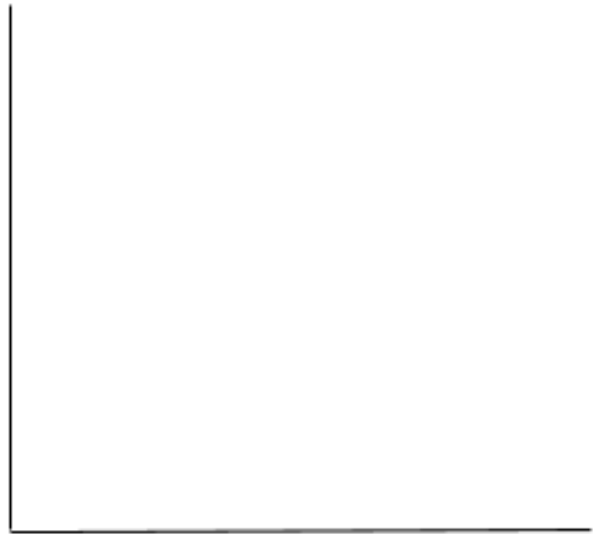
## Subsidies

What is a subsidy?

Give 2 reasons why governments may wish to subsidise a product

Draw a subsidy diagram. Using letter notation, show:

- a. Original price
- b. Original quantity consumed
- c. New price to consumers
- d. New price to producers Subsidy per unit
- e. Producer benefit
- f. Consumer benefit
- g. government cost
- h. deadweight loss



Explain using a chain of analysis how a subsidy works? (think through the steps and what order does it need to be in)

Explain 2 benefits of subsidies over other forms of intervention to correct a market failure

Explain 2 disadvantages of subsidies over other forms of intervention to correct a market failure



## Minimum Prices

What is a minimum price?

What is a guaranteed minimum price?

Explain 2 reasons why a government may wish to put a minimum price on a product

Draw an unguaranteed minimum price diagram. Using letter notation, show:

- a. Original price
- b. Original quantity consumed
- c. Original consumer welfare
- d. Original producer welfare
- e. New price
- f. New quantity demanded
- g. New quantity supplied
- h. Surplus/Shortage
- i. New consumer welfare
- j. New producer welfare



Explain 2 benefits of (unguaranteed) minimum prices over other forms of intervention to correct a market failure

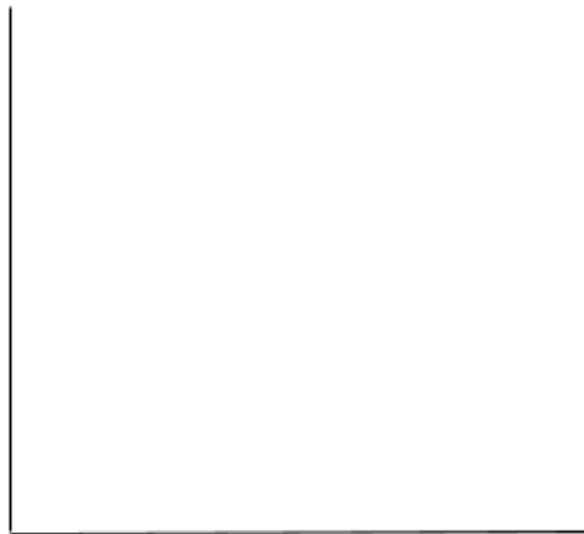
Explain 2 disadvantages of (unguaranteed) minimum prices over other forms of intervention to correct a market failure





Draw a guaranteed minimum price diagram. Using letter notation, show:

- a. Original price
- b. Original quantity consumed
- c. Original consumer welfare
- d. Original producer welfare
- e. Original revenue
- f. New price
- g. New quantity demanded by consumer
- h. Quantity bought by government
- i. New quantity supplied
- j. Surplus/Shortage
- k. New consumer welfare
- l. New producer welfare
- m. New revenue from consumers
- n. New total revenue
- o. Cost to government



Explain a benefit of guaranteed minimum prices over unguaranteed minimum prices

Explain a disadvantage of guaranteed minimum prices over unguaranteed minimum prices



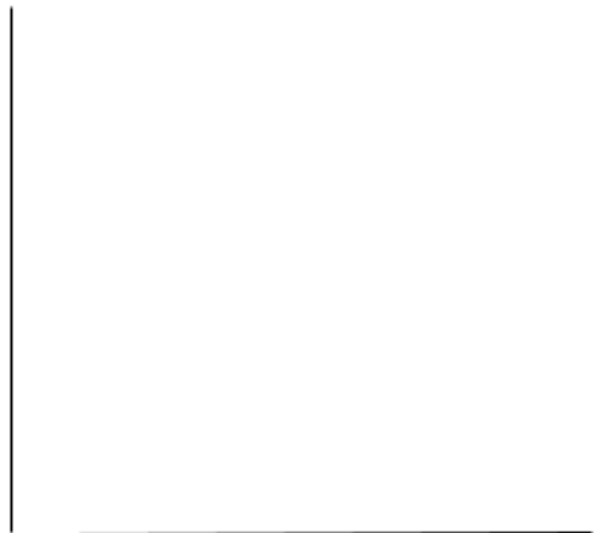
## Maximum Prices

What is a maximum price?

Explain 2 reasons why a government may wish to put a maximum price on a product

Draw an unguaranteed minimum price diagram. Using letter notation, show:

- a. Original price
- b. Original quantity consumed
- c. Original consumer welfare
- d. Original producer welfare
- e. New price
- f. New quantity demanded
- g. New quantity supplied
- h. Surplus/Shortage
- i. New consumer welfare
- j. New producer welfare



Explain 2 benefits of maximum prices over other forms of intervention to correct a market failure

Explain 2 disadvantages of maximum prices over other forms of intervention to correct a market failure



## **State Provision**

How is state provision funded?

Explain 3 reasons why the government might want to provide goods

Explain 2 benefits of state provision.

Explain 2 disadvantages of state provision



## **Information Provision**

In what forms might the government provide information?

Explain 2 benefit of information provision

Explain 2 disadvantages of information provision

## **Regulation**

What is regulation?

What forms might regulation take?

Explain 2 benefits of Regulation



\ Explain 2 disadvantages of Regulation

## **Government Failure**

What is meant by 'government failure'?

Explain 3 causes of 'government failure'

Explain 3 examples of government failure in the UK