Key Definitions for Economics A Level Years 1 & 2

For AQA Students

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Contents

***Any terms or chapters in the book that are prefixed by an asterisk (*) are definitions for year 2 of the A-Level and are not a necessity for the AS (Year 1) examination.**

Markets and Market Failure

Economic Methodology and the Economic Problem

1	**Scarcity**	Where wants for a product (or factor of production) exceed amount available (where demand exceeds supply at zero price) *Additional Information:* Supposedly inevitable consequence of man's innate desire to have more (unlimited wants); leads to need for rationing system like prices (very scarce goods have higher prices). Goods can be classified either economic goods (i.e. scarce) or free goods (not scarce, e.g. air)
2	**Factor of Production** (FoP)	A productive resource *Additional Information:* 4 types: land (all natural resources e.g. forests fish, oil, soils & land area), labour (by quantity & quality: skills etc), capital & enterprise
3	**Capital** (K)	Man-made aids to production *Additional Information:* e.g. machine (iMac) or building; often confused with 'financial capital', which relates to a sum of money
4	**Enterprise (Entrepreneurship)**	The risk-taking role undertaken by owners of a business as they combine other factors of production in the pursuit of profit *Additional Information:* A key factor of production in a market economy (a specialised form of labour)

5	**Investment (I)**	Spending by firms on new capital stock or repair of existing stock (per period) *Additional Information:* Not to be confused with saving, which is what people do when they buy stocks & shares (think of this as financial investment); net I = gross I - depreciation (= addition to firms' capital stock per period: enabling PPF to shift out); N.B. gross I = total firms' I spending (this is the item in the Aggregate Demand equation)
6	**Depreciation**	The rate at which capital loses value over time *Additional Information:* Occurs due to wear and tear or through technological obsolescence; means gross investment must exceed depreciation for the capital stock to increase (to shift PPF out next year)
7	**Opportunity Cost (O/C)**	The value (benefit) of the next best preferred option foregone *Additional Information:* e.g. i. O/C (for a parent) of having a child could be the holidays (s)he would have been able to go on instead, ii. O/C (for UK) of increased UK consumption this year is the increased consumption next year (that would have been possible from boosting investment today)
8	**Production Possibility Frontier (PPF)**	The combinations of two goods which an economy is capable of producing using all its resources in the most efficient way *Additional Information:* Also known as production possibility curve or boundary; shows O/C: moving from inside to on PPF carries no O/C; moving around PPF involves giving up 1 good for the other; PPF is curved out from origin

9	**Productive Efficiency (AS Level)**	Where production in an economy occurs when all factors of production are fully utilised and are producing output with the minimum of factor inputs currently feasible *Additional Information:* Maximised at all points on the production possibility frontier (PPF); however, whilst this should produce goods at their cheapest possible prices (since unit costs are at a minimum), it may involve producing the wrong combination of goods to match consumer demands e.g. points at each end of a PPF are productively efficient but are unlikely to suit society, which is likely to prefer some of each (see allocative efficiency – 116, see also 115)
10	**Positive Economics**	The study of propositions which can be verified (proved or disproved) by data from the real world *Additional Information:* e.g. inflation is 2% in UK
11	**Normative Economics**	The study of propositions which cannot be verified by data from the real world and require value judgments *Additional Information:* e.g. inflation should be reduced (usually normative statements include the words ‘should’ or ‘ought’)
	***Individual Economic Decision Making**	
12	***Rationality**	The notion that economic agents make decisions that best promote their perception of what is in their own (selfish) best interest and adjust their behaviour in the light of experience *Additional Information:* This used to be the standard assumption that underpinned standard economic models; however, behavioural economics has revealed how human behaviour can be irrational at times; in 'Thinking Fast and Slow' (2011) Kahneman explains how rational calculations require time ('thinking slow') but that many choices we make are more impulsive ('thinking fast') and therefore can be manipulated by others (e.g. marketing experts) and may not always deliver the best results for individual decision-makers