

# **Key Definitions for Economics A Level Years 1 & 2**

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**For OCR Students**

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**\*Any terms 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.**

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## Microeconomics

### Scarcity and Choice

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- 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)

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- 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

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- 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

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- 4    **Enterprise (Entrepreneurship)**                      The risk-taking role undertaken by owners of a business as they combine other FoPs in the pursuit of profit

*Additional Information*  
A key FoP in a market economy (a specialised form of labour)

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5	<b>Investment (for Sustainable Growth) (I)</b>	<p>Spending by firms on new capital stock or repair of existing stock (per period)</p> <p><i>Additional Information</i>          Not to be confused with saving, which is what people do when they buy stocks &amp; 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)</p>
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6	<b>Depreciation (of Capital)</b>	<p>The rate at which capital loses value over time</p> <p><i>Additional Information</i>          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)</p>
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7	<b>Opportunity Cost (O/C)</b>	<p>The value (benefit) of the next best preferred option foregone</p> <p><i>Additional Information</i>          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)</p>
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8	<b>Production Possibility Frontier (or Curve) (PPF)</b>	<p>The combinations of two goods which an economy is capable of producing using all its resources in the most efficient way</p> <p><i>Additional Information</i>          Also known as production possibility curve (PPC); 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</p>

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- 9 **Productive Efficiency** 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 – term 75)
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- 10 **Specialisation** Where a factor of production is devoted to a specific job in the production process
- Additional Information*  
e.g. labour can specialise (your Economics teacher probably doesn't sing professionally or teach French), land usually has a specialist use (Bordeaux vineyards are not used for car manufacture or even pea growing); if resources specialise in what they have a comparative advantage in, this enables larger scale production and there are significant efficiency gains (enabling an economy to move towards its production possibility frontier): mass production methods for car manufacture become possible etc.
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- 11 **Division of Labour** Where labour specialises in the performance of a particular part of the production process
- Additional Information*  
Is a form of specialisation (an economy of scale); made famous in Adam Smith's 'Wealth of Nations' (1776) with his example of pin making & its different stages of production