

Economics questions open with a definition mark more often than any other subject on this site, and the mark is for precision: the right nouns, the right condition, and the ceteris paribus clause where the theory needs it.

Basic economic ideas

Scarcity – unlimited wants set against limited resources, which forces choice

Opportunity cost – the benefit forgone from the next best alternative when a choice is made

Ceteris paribus – all other factors held constant, so the effect of one variable can be isolated

Free good – a good with no opportunity cost, because it is not scarce

Production possibility curve – a curve showing the maximum combinations of two goods an economy can produce with all resources fully and efficiently employed

Positive statement – a statement of fact that can be tested against evidence

Normative statement – a statement of opinion or value judgement, containing words such as should or ought

Demand, supply and elasticity

Effective demand – the quantity consumers are willing AND able to buy at a given price in a given period

Law of demand – as price rises, quantity demanded falls, ceteris paribus

Movement along a demand curve – a change in quantity demanded caused by a change in the good’s own price

Shift in demand – a change in demand at every price, caused by a determinant other than the good’s own price

Price elasticity of demand – the responsiveness of quantity demanded to a change in price: percentage change in quantity demanded divided by percentage change in price

Income elasticity of demand – percentage change in quantity demanded divided by percentage change in income; negative for an inferior good

Cross elasticity of demand – percentage change in quantity demanded of one good divided by percentage change in the price of another; positive for substitutes, negative for complements

Price elasticity of supply – percentage change in quantity supplied divided by percentage change in price; greater in the long run when factors are mobile

Consumer surplus – the difference between what consumers are willing to pay and what they actually pay

Producer surplus – the difference between the price producers receive and the minimum they would accept

The price system and market failure

Market failure – where the free market fails to allocate resources efficiently, so welfare is not maximised

Externality – a cost or benefit falling on a third party not involved in the transaction

Negative externality of production – where marginal social cost exceeds marginal private cost, so the market overproduces

Merit good – a good which is under-consumed because consumers undervalue its private benefit, and which also creates positive externalities

Public good – a good that is non-rival and non-excludable, so the free market fails to provide it – the free-rider problem

Allocative efficiency – where price equals marginal cost, so resources are allocated to the goods consumers value most

Productive efficiency – producing at the lowest point on the average cost curve, so output is made at least cost

Government failure – where government intervention creates a net welfare loss, often through unintended consequences or information failure

Maximum price – a legal ceiling set BELOW equilibrium, which creates excess demand

Minimum price – a legal floor set ABOVE equilibrium, which creates excess supply

The firm and market structure

Fixed cost – a cost that does not vary with output in the short run

Marginal cost – the addition to total cost from producing one more unit

Law of diminishing returns – as more of a variable factor is added to a fixed factor, the marginal product of the variable factor eventually falls

Economies of scale – the fall in long-run average cost as the scale of output rises

Perfect competition – many buyers and sellers, a homogeneous product, perfect information and free entry and exit, so each firm is a price taker

Monopoly – a single seller with high barriers to entry; in Cambridge terms, a firm with more than 25% of the market

Oligopoly – a market dominated by a few firms, with interdependent decision-making

Normal profit – the minimum return needed to keep a firm in the industry; it is a cost of production

Supernormal profit – profit above normal profit, earned when average revenue exceeds average cost

Natural monopoly – an industry where economies of scale are so large that one firm can supply the whole market at lower cost than several

Macroeconomics	
Gross domestic product in a given period	– the total value of goods and services produced within a country
Real GDP	GDP – GDP adjusted for inflation, so it measures a change in output rather than in prices
Economic growth capacity	– an increase in real GDP; potential growth is an increase in productive capacity
Inflation	– a sustained rise in the general price level
Deflation inflation	– a sustained FALL in the general price level; disinflation is a fall in the RATE of inflation
Demand-pull inflation aggregate supply	– inflation caused by aggregate demand rising faster than aggregate supply
Cost-push inflation aggregate supply left	– inflation caused by a rise in the costs of production, shifting aggregate supply left
Unemployment seeking it	– people of working age who are without work, available for work and actively seeking it
Cyclical unemployment	– unemployment caused by a lack of aggregate demand in a downturn
Structural unemployment or location and the jobs available	– unemployment caused by a mismatch between workers' skills
Balance of payments of the world in a period	– a record of all transactions between residents of a country and the rest of the world in a period
Current account deficit transfers exceeds exports	– where the value of imports of goods, services, income and transfers exceeds exports
Fiscal policy	– the use of government spending and taxation to influence aggregate demand
Monetary policy	– the use of interest rates and the money supply to influence aggregate demand
Supply-side policy	– policy aimed at increasing the productive capacity of the economy by improving incentives, skills or competition
Multiplier caused it	– the ratio of the final change in national income to the initial change in injection that caused it
Terms of trade	– the ratio of an index of export prices to an index of import prices, times 100
Comparative advantage another country	– the ability to produce a good at a lower opportunity cost than another country
Protectionism domestic producers	– the use of tariffs, quotas and subsidies to restrict imports and shield domestic producers