

A microeconomics FRQ point is almost always a definition plus a direction: name the concept, then say which way the curve, price or quantity moves and why. Write the definitions below in one sentence each, and always finish with “therefore ...”.

Basic concepts

Scarcity – the condition that wants are unlimited while the resources to satisfy them are limited, which forces choice

Opportunity cost – the value of the next-best alternative given up when a choice is made

Marginal analysis – comparing the additional benefit of one more unit with its additional cost, and acting while the benefit is the greater

Comparative advantage – the ability to produce a good at a lower opportunity cost than another producer

Absolute advantage – the ability to produce more of a good than another producer from the same resources

Production possibilities curve – a curve showing the maximum combinations of two goods an economy can produce when all resources are used efficiently

Supply, demand and welfare

Demand – the quantities of a good buyers are willing and able to buy at each price, other things equal

Supply – the quantities of a good sellers are willing and able to sell at each price, other things equal

Price elasticity of demand – the percentage change in quantity demanded divided by the percentage change in price

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

Producer surplus – the difference between the price sellers receive and the lowest price they would accept

Deadweight loss – the loss of total surplus caused when output moves away from the allocatively efficient quantity

Price ceiling – a legal maximum price; it causes a shortage when set below equilibrium

Price floor – a legal minimum price; it causes a surplus when set above equilibrium

Market failure

- Market failure** – a situation in which a free market allocates resources inefficiently, so total surplus is not maximised
- Externality** – a cost or benefit falling on a third party who is not part of the transaction
- Public good** – a good that is non-rival and non-excludable, so the market under-provides it
- Free-rider problem** – people consuming a non-excludable good without paying, which leaves it under-provided

Production and cost

- Marginal product** – the extra output produced by adding one more unit of a variable input
- Law of diminishing marginal returns** – beyond some point, adding more of a variable input to a fixed input raises output by less each time
- Marginal cost** – the addition to total cost from producing one more unit
- Economies of scale** – falling long-run average total cost as the scale of output increases
- Marginal revenue** – the addition to total revenue from selling one more unit

Market structures

- Perfect competition** – many small firms selling an identical product with free entry and exit, so each is a price taker
- Monopoly** – a single seller of a product with no close substitutes, protected by barriers to entry
- Monopolistic competition** – many firms selling differentiated products with free entry, so each faces a downward-sloping demand curve but earns zero long-run profit
- Oligopoly** – a few large firms whose decisions are interdependent, so each must consider the others' reactions
- Profit maximisation rule** – a firm produces the quantity at which marginal revenue equals marginal cost
- Price discrimination** – charging different buyers different prices for the same good for reasons unrelated to cost
- Allocative efficiency** – producing the quantity at which price equals marginal cost, so total surplus is maximised
- Productive efficiency** – producing at the minimum of average total cost