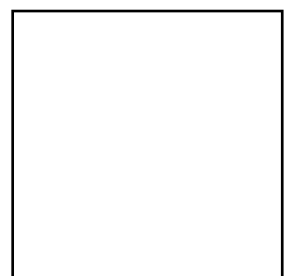
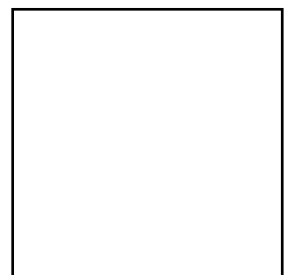
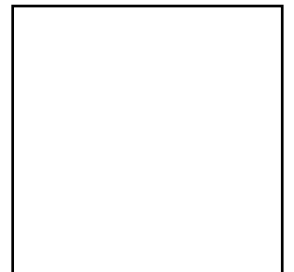


Nelson Thornes  
Distance Learning

# AS Economics

Steve Margetts



Nelson Thornes

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# Introduction



Welcome to the AS Economics distance learning pack! Each of these units will guide you through all of the knowledge you need for your exams. You will sit two exams in the summer:

Unit 1 Economics: Markets and Market Failure

Unit 2 Economics: The National Economy

Each exam is worth 50% of the AS (this means it is also worth 25% of the final A Level). They are both 1 hour 15 minutes long and consist of two sections:

Section A: 25 compulsory multiple choice questions *(25 marks)*.

Section B: two optional data-response questions are set; you must answer one *(50 marks)*.

You will have lots of questions to answer as you work through the chapters; if unsure about any of the answers it is essential that you ask your tutor for help and guidance.

I wish you all the best.

Steve Margetts

June 2010



---

# Module 1 Markets and Market Failures

## Unit 1 The Economic Problem

---

### Learning objectives

By the end of this unit, you should be able to:

- Explain the principles of scarcity, needs and infinite wants, and the economic problem.
- Explain opportunity cost.
- Identify the four factors of production and the factor payments associated with them.
- Outline the economic objectives of a variety of economic agents.
- Analyse the role of prices in a free market economy.
- Explain how a production possibility boundary can be used to demonstrate opportunity cost and productive and allocative efficiency.
- Distinguish between inward and outward shifts of the production possibility boundary.
- Distinguish between positive and normative statements.

### Definitions

You should complete the following definitions in your glossary before starting this unit:

- Allocatively efficient
- Capital
- Consumer goods
- Consumers
- Economic agent
- Economic goods
- Economic problem
- Economic Resources
- Enterprise
- Entrepreneur
- Factor owners

- Factors of Production
- Free goods
- Incentive
- Increasing opportunity costs
- Infinite wants
- Interest
- Investment goods
- Labour
- Land
- Needs
- Normative economics
- Opportunity cost
- Positive economics
- PPB
- Production Possibility Boundaries
- Productively efficient
- Profit
- Rationing
- Rent
- Scarcity
- Signalling
- Utility
- Wages
- Wants

**In order to complete the activities in Unit 1.1 students must read Chapter 1 of the recommended textbook:**

***AQA AS Economics* by Jim Lawrence, Alasdair Copp and Steve Stoddard, published by Nelson Thornes.**

## Introduction

The main purpose of economic activity is the production of goods and services to satisfy consumers' needs and wants, and thereby to improve economic welfare. The consumption and production of goods and services is not limited to those sold in shops and over the internet, they also include housework, DIY and the benefits you get from the natural environment.

## Scarcity

### Activity 1



There are only a limited amount of resources on the planet; these can be described as scarce or finite resources.

- 1 Give some examples of scarce resources:

These scarce resources are called economic goods. Not all resources are scarce, these are called free goods.

- 2 Give an example of a free good.

In reality nearly all goods are economic goods; clean air was often quoted a free good as it could be used without worrying about scarcity. Increased pollution has led to many economists questioning whether air is in fact a free good.

## Needs and infinite wants

### Activity 2



There are a number of things humans need to survive, these are our basic needs.

- 1 What are your basic needs for survival?
- 2 Would you be happy only owning these things?

People are not satisfied if only their basic needs are met, they would rather enjoy a higher standard of living; this is because we all have an unlimited number of wants.

- 3 What are your unlimited wants?

## The economic problem

The fact that resources are scarce and our wants are infinite gives lead to the basic economic problem. How do we allocate the limited resources so that society can receive the maximum benefit? Your own point of view will affect how you answer this question. There are three basic questions that need to be answered in order to solve the economic problem:

1. What should we produce given the scarce resources available?
2. How should we produce it?
3. For whom should it be produced? Who is going to receive the goods and services once they have been produced?

Economics attempts to answer these questions.

## Opportunity cost

An economic agent is any person or group that makes decisions within an economy, for example consumers, firms, governments etc. Due to the existence of the economic problem, economic agents are forced to make choices regarding what to do with their limited resources.

You have £40: do you spend it on a t-shirt or a night out? Does the government spend £100 million on weapons or building a hospital? Should your school buy 10 computers or 50 chairs? A rational economic agent will choose the option that gives them the greatest amount of satisfaction (economists call this utility).

The opportunity cost is the satisfaction (or utility) you lose from not being able to have your second choice (the next best alternative), examples of opportunity cost are:

- If you spend £40 on a night out, the opportunity cost will be the t-shirt.
- If the government spends £100 million on weapons, the opportunity cost will be building a hospital.
- If a school decides to buy 10 computers, the opportunity cost will be 50 tables.

### Activity 3



- 1 Give three examples of opportunity cost. Use the same terminology and phrasing as above.

Economic goods will have an opportunity cost as they are scarce and cannot be used for two different things at the same time. Free goods have no opportunity cost.

## Economic resources (factors of production)

There are many different resources in the world; economists group them into four factors of production:

### Capital

This includes all of the machinery, buildings, machines etc. used in the production of goods and services. Capital also includes the money that firm have and use.

## Activity 4



- 1 Think of an economic agent (individual, business, government etc.) and provide examples of capital that it uses.

### Enterprise

This is carried out by entrepreneurs who:

- Think of original ideas or improve upon what is already in the marketplace.
- Get the business up and running by organising the other three factors of production.
- Take risks with their own money and the financial capital of other investors.

## Activity 5



- 1 Can you think of any entrepreneurs and the businesses that they have started?

### Land

Confusingly, land is not just the ground that is built on, but includes all of the natural resources as well. Land is divided into two different types:

- Non-renewable resources
- Renewable resources

## Activity 6



- 1 Give some examples of both non-renewable and renewable resources.

### Labour

This includes the workforce in the economy. Every worker possesses different skills and qualities we – measure this in human capital.

## Activity 7



- 1 Explain how it possible to increase an individual's human capital.

There is an easy way of remembering the different factors of production – CELL:

Capital

Enterprise

Land

Labour

The owners of factors of production can sell or loan them and receive payments – these are called factor incomes:

- The payment for capital is interest
- The payment for enterprise is profit
- The payment for land is rent
- The payment for labour is wages

The factors of production can be bought and sold in factor markets. These will be discussed in far greater detail later in the year.

## Activity 8



- 1 Can you think of any examples of markets where factors of production are bought and sold?

## Economic objectives of individuals, firms and government

Different economic agents will have varying objectives. We make the assumption that each economic agent will act in its own interest. Often these interests will be competing.

### Consumers

Unfortunately, you and I only have a limited amount of money therefore we have to make decisions about how to spend it. When faced with a decision about how to spend money consumers will opt for the good or service that gives them the most utility (satisfaction).

Economic theory assumes that people act rationally and attempt to maximise their own welfare.

## Activity 9



- 1 Explain why people give to charity if they behave rationally.

## Workforce

Workers will want higher wages, better job security and improved working conditions.

## Activity 10



- 
- 1 Identify any other things that employees may want from their employers.

We often assume that workers will want to maximise the wages that they earn.

- 2 Is money always the most important consideration for workers? Explain your answer.

---

### Businesses

Economists assume that most businesses are profit maximisers (profit = revenue – costs). This is because they are owned by individuals who want to maximise the return on their investment.

## Activity 11



- 
- 1 What other objectives might a business have? Provide examples.

## Factor owners

The owners of the factors of production will want to maximise the payment they receive. This is in comparison to firms who will wish to minimise costs, they will only be prepared to pay what the factor of production is worth in the production process.

## Governments

The government is the elected representative of the consumers, therefore it should simply act on behalf of the people.

# Activity 12



1 Why might the decisions a government make not be universally accepted by the whole population?

2 Can you think of any recent government decisions that have been particularly controversial?

The government has to decide whether to intervene in the economy. Governments of different countries will make different decisions, for example, healthcare in the UK is provided free of charge, whilst a system of private healthcare operates in the USA.

Do you know of any other areas of the economy in which different countries' governments have made different decisions about how to solve a problem?

## The role of prices and profits in a free market economy

Prices and profits are used as signs in the economy to consumers and firms – this process is known as the price mechanism. Decisions made by consumers and firms are based upon the prices and profits available in a particular market. Prices and profits have three main functions in an economy:

Rationing – we know that resources are scarce, but consumer wants are infinite. Prices are used to help determine how these scarce resources will be allocated



# Activity 14



- 
- 1 How do you think consumers will react to the signal that prices have increased?
  - 2 How do you think firms will react to the signal that prices and therefore potential profits have increased?

- 
- Incentive – the price acts as an incentive for the consumers and firms in the market. Low prices are incentive for buyers to purchase more goods.

# Activity 15

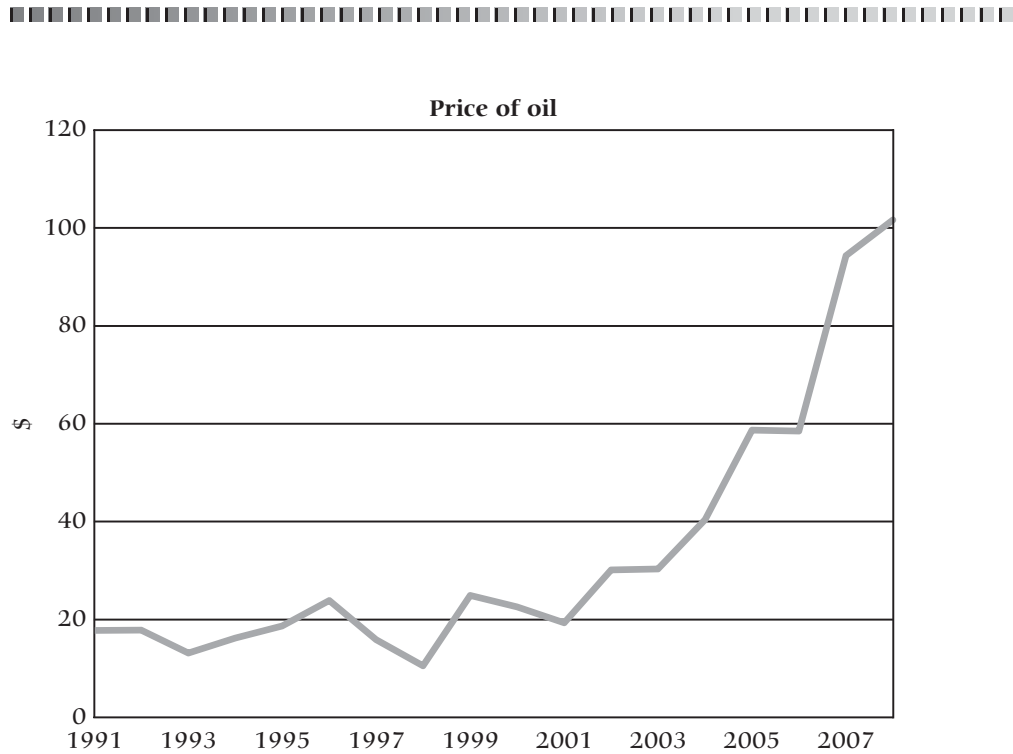


- 
- 1 If the price of a good decreases, what will happen to the amount of utility gained per pound spent relative to other goods?
  - 2 What will happen to the number of goods you can buy per pound if the price goes up?
  - 3 How will that affect the incentive to buy that good?

**Changing prices will also impact the incentives for firms supplying the market.**

1. What will happen to the incentive to supply if the price falls?
2. What will happen to a firm's demand for factors of production if there is an increase in the price of the good it sells?
3. What may happen to firms in a market if the price of the good stays low for a prolonged period of time?
4. After this happens what might happen to the price? Explain your answer.

**Activity  
16**



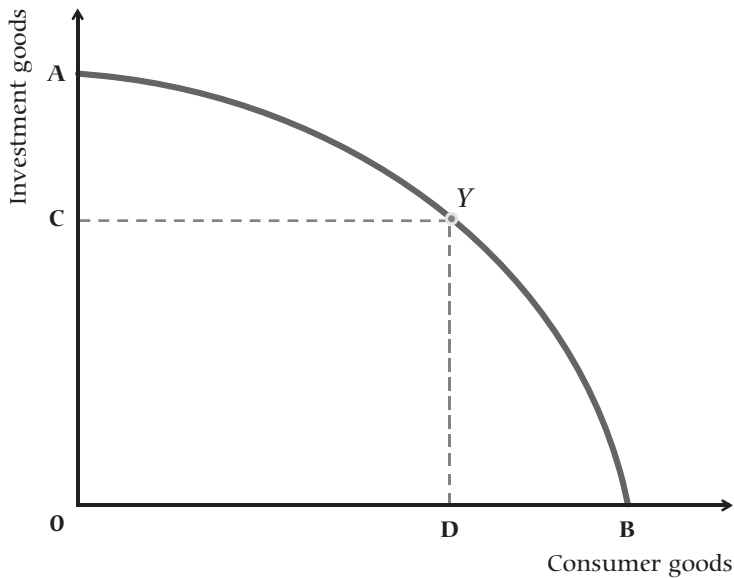
- 1 Describe the changes in the price of oil from 1991 to 2007.
  
  
  
  
  
  
  
  
  
  
- 2 How would the increase in the price of oil ration the quantity available amongst consumers?



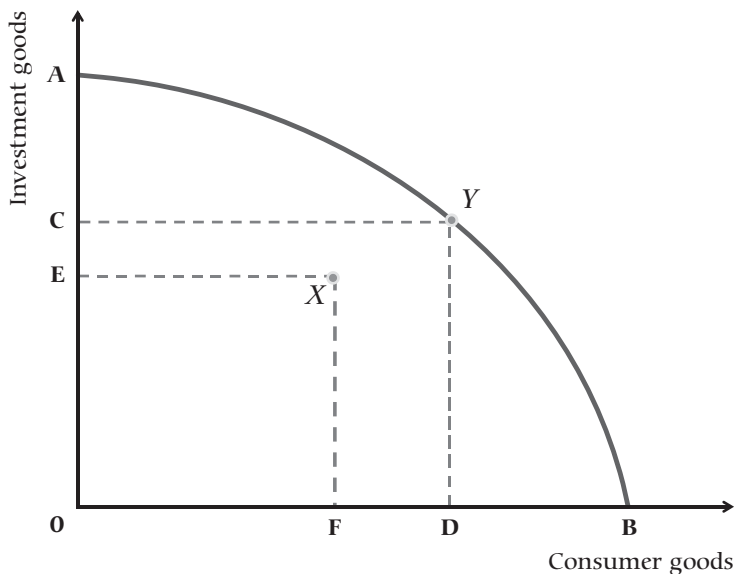
## Production possibility boundaries (PPB)

The PPB demonstrates the concepts of choice and opportunity cost. If we assume that a country can only produce investment and consumer goods, the diagram below shows a PPB that demonstrates a menu of choices for the economy of what it is able to make. For example, it could produce:

- OA investment goods, or
- OB consumer goods, or
- OC investment goods and OD consumer goods.



If the economy is producing at any point inside the PPB, such as point X, it is not producing as efficiently as it could, because it could increase production of consumer goods and investment goods with the resources it already has. It is not possible to produce at any point outside of the PPB.



## Activity 17

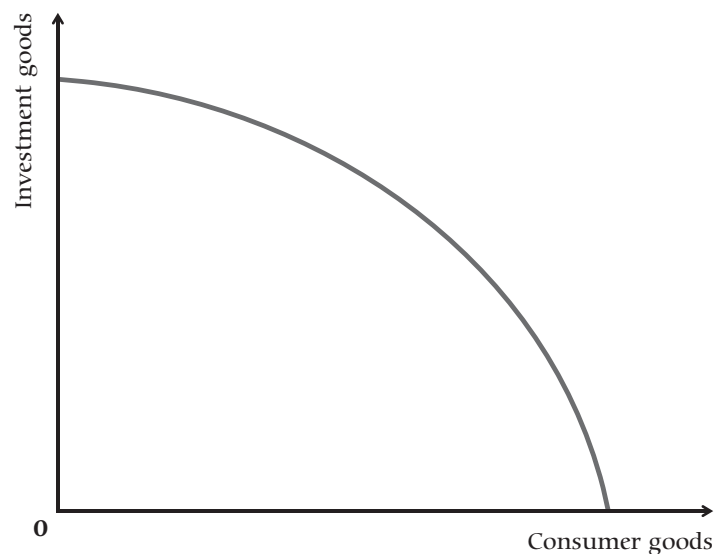


- 1 How many more consumer goods and investment goods could the country produce if it moved from point X to Y (which is on the PPB)?

If an economy is producing at any point on the PPB, such as Y, it is using all of its resources efficiently. This means the economy is producing as much as it can, given the present levels of technology and productivity, and the amount of factors of production it has. Any point on the PPB is said to be productively efficient, as every firm in the economy is producing at their lowest possible costs. If a firm were not operating at its lowest possible costs, then it would be wasting resources and therefore the economy would not be on the PPB.

Any point on the PPB is also allocatively efficient as it is not possible to make somebody better off without making somebody else worse off.

## Activity 18

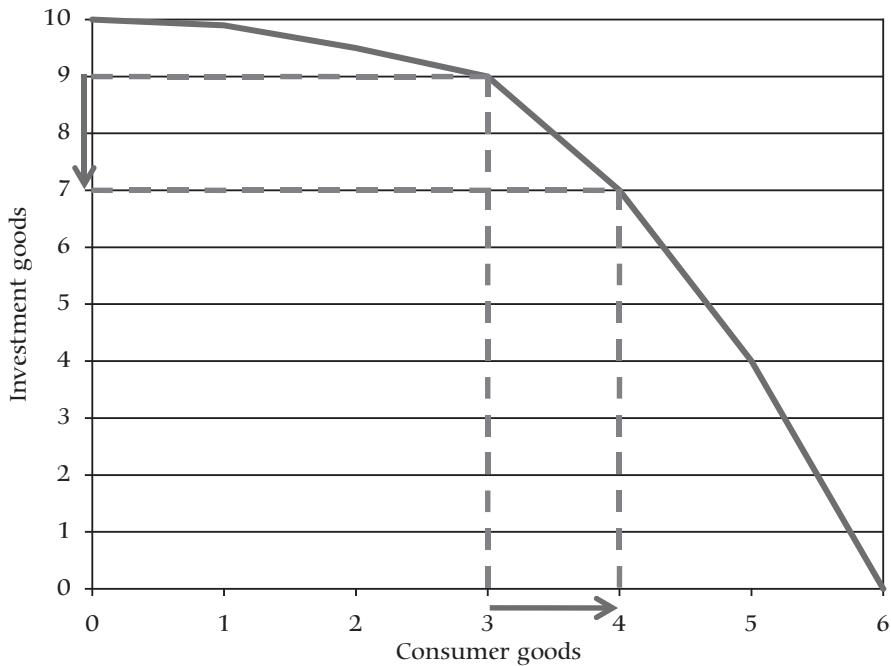


On the diagram above label the following:

- 1 Point A – is allocatively efficient
- 2 Point B – there is unemployment in the economy
- 3 Point C – is productively efficient and only investment goods are produced
- 4 Point D – is not allocatively efficient and the economy is producing more consumer goods than investment goods.

## Opportunity cost and the PPB

If a country wanted to increase its production of consumer goods, it would have to sacrifice the production of some investment goods. Therefore we can say the opportunity cost of producing more consumer goods is investment goods.



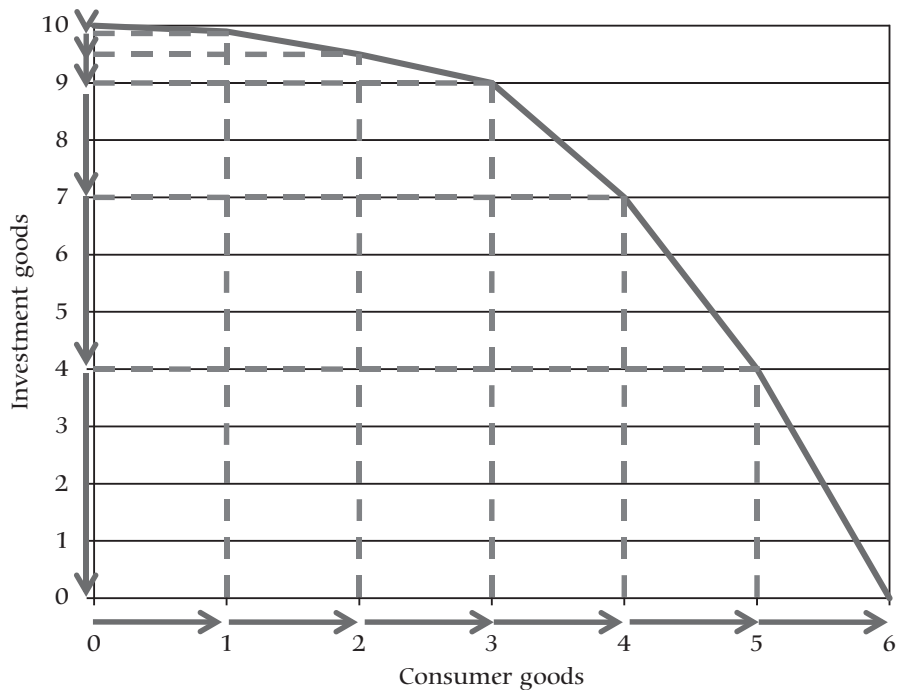
The country is presently producing 3 units of consumer goods and 9 units of investment goods. It wants to expand output of consumer goods to 4 units. What is the opportunity cost of this increase in production?

It is also possible to demonstrate the concept of increasing opportunity costs using a PPB. This means that as a country wants to produce more and more of one good it has to give up increasing amounts of the other good. The table below provides the figures for an economy; a PPB has been drawn based upon this data.

### Activity 19



Consumer goods	Investment goods
0	10
1	9.9
2	9.5
3	9
4	7
5	4
6	0



Assume the economy is presently only producing investment goods. In order to produce the first unit of consumer goods only 0.1 units has to be given up. The opportunity cost of the second unit of consumer goods has increased to 0.4.

1 Complete the table below by calculating the opportunity cost for each extra unit of consumer goods produced.

Consumer goods	Opportunity goods
1	0.1
2	0.4
3	
4	
5	
6	

2 What is happening to the opportunity cost of producing more and more consumer goods?



Increasing opportunity costs occur because the factors of production have different properties.

## Activity 20



- 1 Identify further ways that factors of production have varying qualities:

- Capital, e.g. machinery is better equipped to produce one good rather than another one.
- Land, e.g. land differs in quality in different parts of the country.
- Labour, e.g. people have different skills and varying levels of human capital.

If the opportunity costs were constant the PPB would be a straight line. It is because of increasing opportunity costs that the PPB is bowed outwards.

### Shifts of the PPB

As you know, a nation is unable to produce outside of the PPB. A nation is able to shift its PPB to the right (so that it can produce a greater amount of goods) in one of two ways:

- Firstly, by increasing the quantity of factors of production available for production, e.g. by increasing the number of workers or factories.

## Activity 21



- 1 Outline some examples of how the quality of factors of production could be improved.

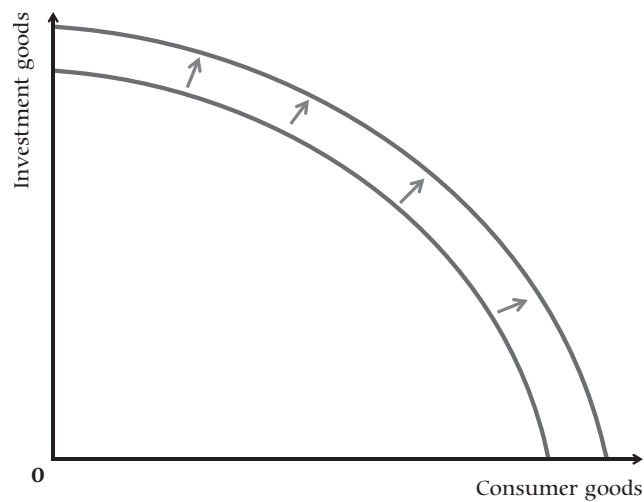
- Secondly, by increasing the quality of factors of production available for production

# Activity 22

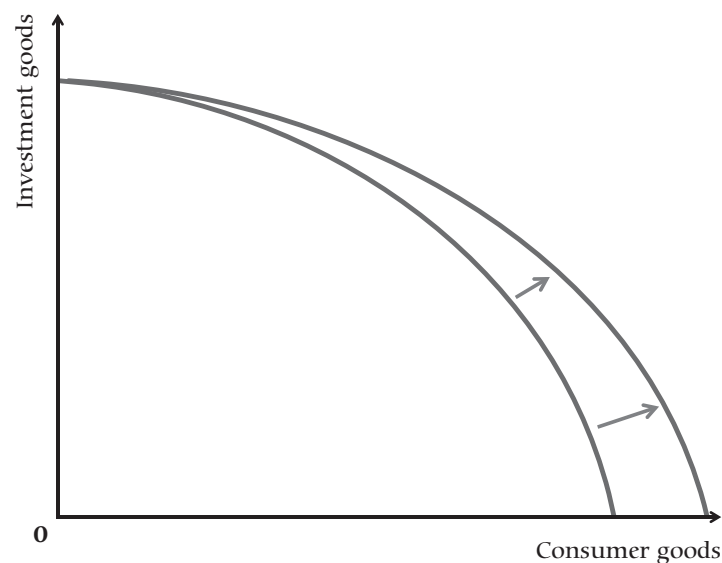


- 1 Outline some examples of how the quality of factors of production could be improved.

An outward shift of the PPB is shown below:



If the increase in the quality or quantity of factors of production only affected one of the two products, we would see a shift in the PPB as below.



## Activity 23



- 1 Which of the two goods have seen an improvement in the quantity or quality of factors of production that produces them?

- 2 Analyse any factors or events that could shift the PPB inwards.

## Positive and Normative Economics

Positive economics deals with scientific or objective explanations and statements about the economy – they are facts and cannot be argued with. For example, it is possible for me to state that ‘in the case of normal goods an increase in the price will lead to a decrease in the quantity demanded’.

Normative economics attempts to describe the economy through value judgements – these are opinions and can be debated. For example, ‘all debt held by developing nations should be cancelled’.

## Activity 24



Positive and normative statements can be made about anything.

- 1 Give two examples of a positive statement on any subject you wish.

2 Give two examples of a normative statement on any subject you wish.

3 Now write two positive and normative statements that are economics related.



## Self-assessment: 1.1 The economic problem

At the beginning of this unit we identified a number of learning objectives, how confident are you that they have been achieved?

Explain the principles of scarcity, needs and infinite wants, and the economic problem.



Explain opportunity cost.



Identify the four factors of production and the factor payments associated with them.



Outline the economic objectives of a variety of economic agents.



Analyse the role of prices in a free market economy.



Explain how a production possibility boundary can be used to demonstrate opportunity cost and productive and allocative efficiency.



Distinguish between inward and outward shifts of the production possibility boundary.



Distinguish between positive and normative statements.



### Action plan for completing knowledge

Area of concern	Action plan for improvement

# Assignment

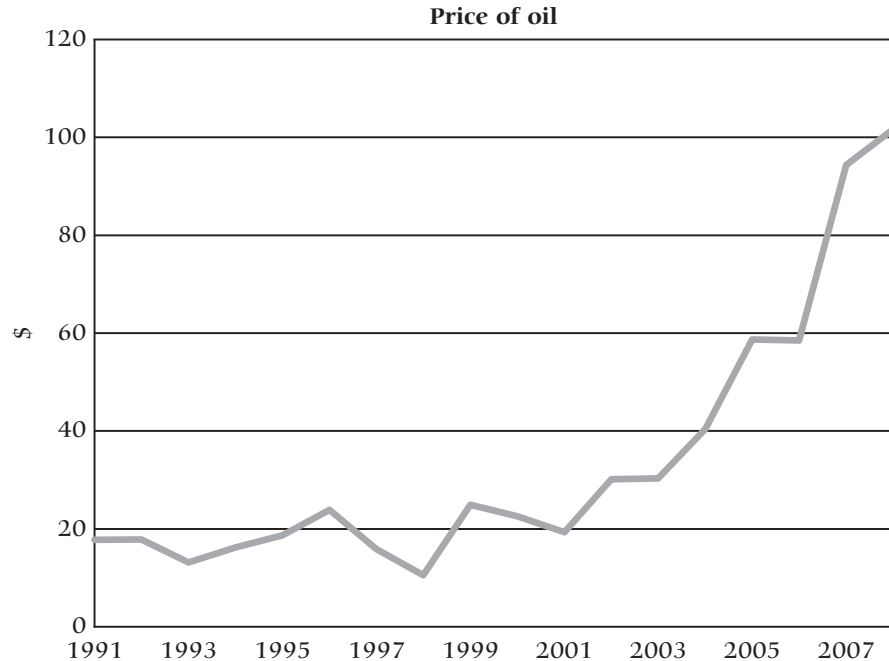
## 1.1



Total for this question: 50 marks

Study Extracts A, B and C, and then answer all parts of the question which follows.

### Extract A: The price of oil per barrel.



### Extract B: Three trillion dollar war

President Bush and his advisers had the normative view that there would be a quick and inexpensive conflict in Iraq. However, the only war in our history which cost more was the Second World War, when 16.3 million US troops fought in a campaign lasting four years, at a total cost (in 2007 dollars, after adjusting for inflation) of about \$5 trillion (that's \$5 million million, or £2.5 million million). With virtually the entire armed forces committed to fighting the Germans and Japanese, the cost per troop was less than \$100,000 in 2007 dollars. By contrast, the Iraq war is costing upward of \$400,000 per troop. 5

America has spent over \$845 billion on military operations, reconstruction, embassy costs, enhanced security at US bases, and foreign-aid programmes in Iraq and Afghanistan. In 2008 costs are projected to exceed \$12.5 billion a month for Iraq alone, up from \$4.4 billion in 2003, and in Afghanistan the total is \$16 billion a month. 10

In the UK, Gordon Brown set aside £1 billion for war spending. As of late 2007, the UK had spent an estimated £7 billion in direct operating expenditures in Iraq and Afghanistan (76 per cent of it in Iraq). 15

Source: Adapted from Joseph Stiglitz and Linda Bilmes, 2008, *The Three Trillion Dollar War*.

### Extract C: The Iraqi economy: from shocks to take-off?

There are four reasons that provide a measure of optimism for the Iraqi economy at the moment.

First, the command economy was dismantled, and private initiative is emerging. A stock market operates three days a week, and 45 banks and companies are listed and traded by Iraqis and, since August, by foreigners 5

as well. The economy is growing. According to the IMF, the Iraqi economy is projected to grow at 7% in 2008 after a somewhat anaemic growth in 2007.

Second, foreign currency reserves are rising and so is the Iraqi legal tender, the dinar, which now trades at about 1,200 to the dollar, after trading at 2,000 or more dinars to the dollar before the invasion. More importantly, it is a convertible currency. The central bank auctions dollars regularly to meet market demand without any restriction. 10

Third, oil production is increasing. Oil export has recently reached the pre-invasion level of 1.8 million barrels per day, and the ministry of oil forecasts an export level of 2.0–2.1 million b/d by the end of the year. Subsidy on oil products, other than kerosene, used for cooking and lighting, has been abolished. Private fuel imports have been liberalized, and many of the long lines for gasoline are gone. Efforts are under way to expand and upgrade existing refineries in Iraq, which will ensure fuel supplies to power broad economic growth. 15 20

Fourth, inflation has been brought under control, thanks to the tightening of monetary policy and the appreciation of the dinar—along with the maintenance of fiscal discipline and measures to reduce fuel shortages.

Source: *The Iraqi Economy: From Shocks to Take-off?* 25/2/2008, Dr. Nimrod Raphaeli, The Middle East Research Media Institute

## Questions

- 1 Define the term 'normative economics'. (Extract B, line 1) (5 marks)
- 2 Using Extract A, identify the main trends in the price of oil over the period shown. (8 marks)
- 3 Extract B refers to the fact that the USA and UK have spent \$845 billion and £7 billion respectively on military operations in Iraq and Afghanistan. Explain the term 'opportunity cost' and explain the decisions faced by the US and UK governments prior to going to war in Iraq and Afghanistan. (12 marks)
- 4 Extract C addresses why the Iraqi economy may take-off in the future. Using the data and your economic knowledge, evaluate how the war in Iraq has impacted the production possibility of its economy. (25 marks)



# Module 1 Markets and Market Failures

## Unit 2 Demand in the Market

### Learning objectives

By the end of this unit, you should be able to:

- Distinguish between wants and effective demand.
- Explain why the demand curve is downward sloping.
- Explain the relationship between price and quantity demanded.
- Identify how utility will affect the price consumers are prepared to pay and, therefore, the quantity demanded.
- Outline how changes in price lead to movements along the demand curve.
- Analyse the factors that will cause the demand curve to shift.
- Explain composite demand.
- Explain derived demand.

### Definitions

You should complete the following definitions in your glossary before starting this unit:

- |                     |                        |
|---------------------|------------------------|
| ■ Birth rate        | ■ Individual demand    |
| ■ Commodity markets | ■ Inferior good        |
| ■ Complement        | ■ Inverse relationship |
| ■ Composite demand  | ■ Market demand        |
| ■ Consumer          | ■ Normal good          |
| ■ Contraction       | ■ Opportunity cost     |
| ■ Demand            | ■ Rational             |
| ■ Demand curve      | ■ Rationing            |
| ■ Derived demand    | ■ Signal               |
| ■ Effective demand  | ■ Substitute good      |
| ■ Extension         | ■ Utility              |
| ■ Immigrant         | ■ Utils                |
| ■ Incentive         | ■ Wants                |

In order to complete the activities in Unit 1.2 students must read Chapter 2 of the textbook *AQA AS Economics* (Nelson Thornes).

## Introduction

Demand is the quantity of a good or service that customers want to buy. We all may want a brand new Ferrari, speedboat and a mansion on a private island, but we cannot all afford them. Our wants become a demand when we have the money to back up our desires. This is called effective demand, in other words, what customers are prepared and able to buy at a particular price.

## The shape of the demand curve

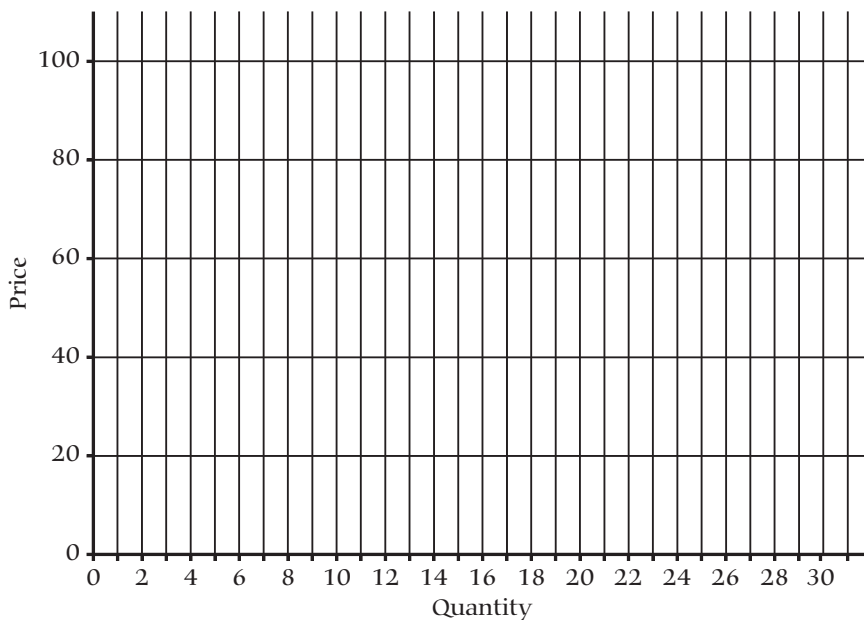
### Activity 1



Think about how many 500ml bottles of Coca Cola you would buy in a month at prices between 20p and £1. Complete the table below.

Price of a bottle of 500ml Coca Cola	Your quantity of effective demand
100	
80	
60	
40	
20	

- Now use the chart below to plot your results. Draw a line of best fit and label it 'Demand'.



- In what direction does the demand curve slope?

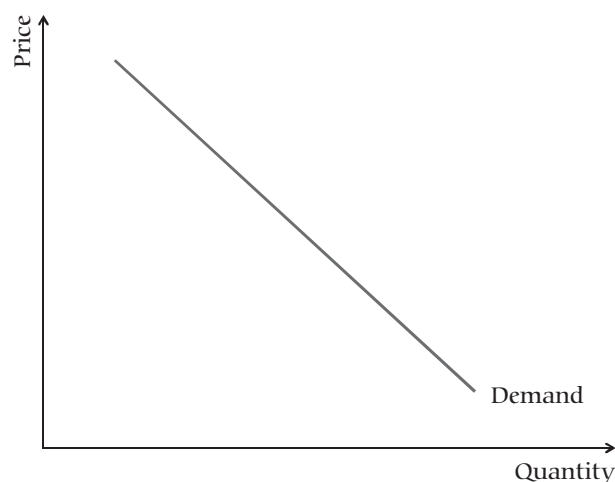
We call it a demand curve even though it may be straight.

3 Describe the relationship between price and quantity?



I expect that your demand curve is downward sloping; this means that there is an inverse relationship between the price of a good and the quantity demanded. An increase in the price will lead to a fall in the quantity demanded, while a decrease in the price will lead to a rise in the quantity demanded.

The curve you have drawn is known as an individual demand curve. If you were able to add up all of the individual demand curves for a particular good in an economy, we would call it a market demand curve.



The market demand curve also shows an inverse relationship between price and quantity.

## Activity 2



- 1 Explain why an increase in price will lead to a fall in the quantity demanded. Use as many of the following terms in your answer as possible: utility, opportunity cost, rational, rationing and consumer.

Another way of explaining why the demand curve is downward sloping is to calculate how much satisfaction you get from consuming increasing quantities. If the amount of utility from consuming a good falls, a rational consumer would only be prepared to pay a lower price. Utility is measured in utils – the higher the number of utils, the greater the satisfaction.

### Activity 3



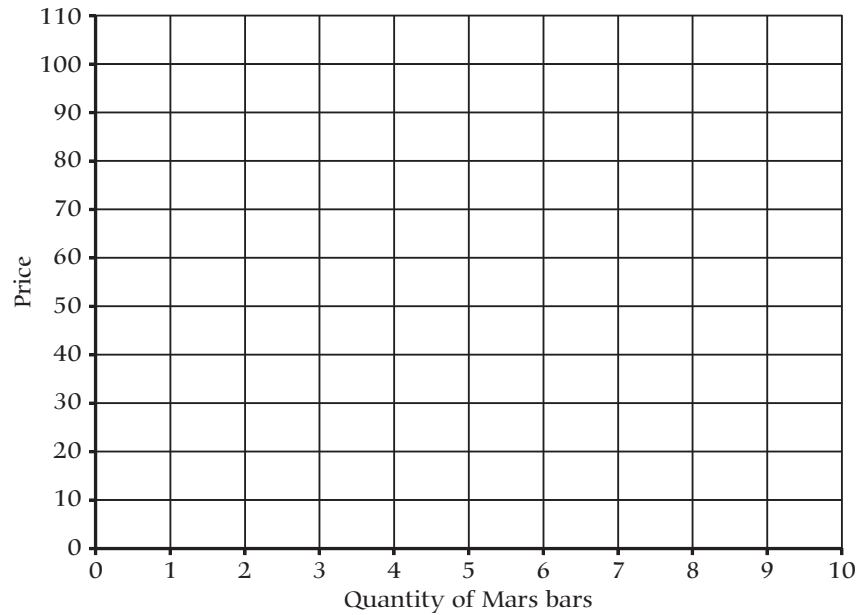
For the sake of this exercise assume that you like Mars bars.

- 1 Complete the table below by writing down how much satisfaction each additional Mars bar gives you. I have stated that the first Mars bar gives you 100 utils of satisfaction – how much will the 2nd, 3rd, 4th etc. yield? It is possible that you may get negative satisfaction from a Mars bar. How much would you be prepared to pay for the satisfaction you have gained?

Mars bar number	Utils of satisfaction you get from eating it	Price you would be prepared to pay for it (p)
1	100	p
2		p
3		p
4		p
5		p
6		p

Mars bar number	Utils of satisfaction you get from eating it	Price you would be prepared to pay for it (p)
7		p
8		p
9		p
10		p

2 Now plot the price and quantity on the chart below and draw a line of best fit. Label the result as 'demand'.



3 What is the shape of the demand curve you have drawn here?

4 How does it compare to the shape of the demand curve when you determined your demand based upon price rather than the amount of satisfaction you would receive?



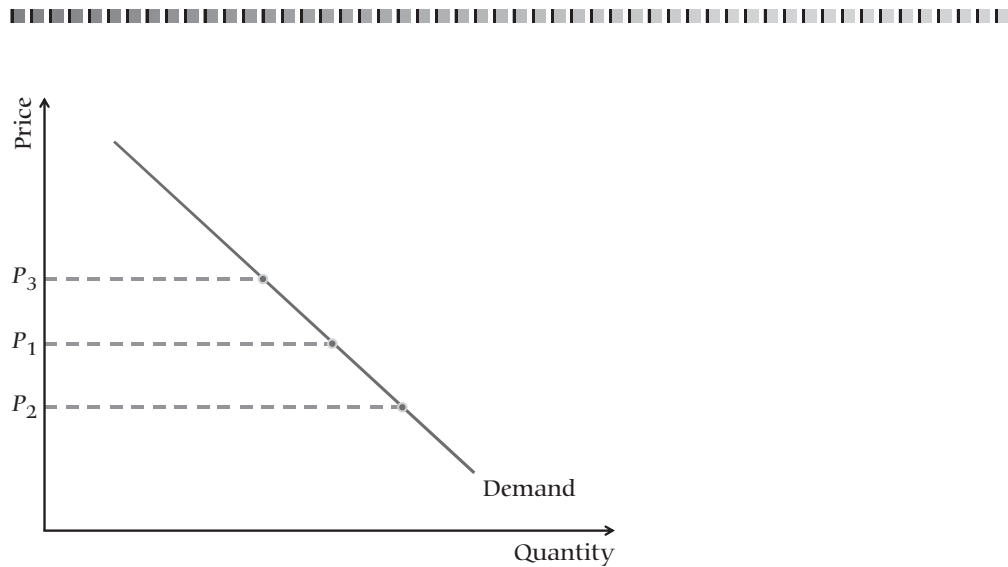
It is possible to calculate how many Mars bars you will purchase by checking the price in a shop. Assuming the price is below what you're prepared to pay for one chocolate bar, you will keep consuming until the satisfaction you receive is worth less than the price Mars are charging. For example, if the satisfaction you will get

from the fourth Mars bar is worth 40p and the Mars bar costs 50p you wouldn't buy it. If the price a shop charges is above what you are willing to pay for one Mars bar then, as a rational consumer, you will not demand any Mars bars.

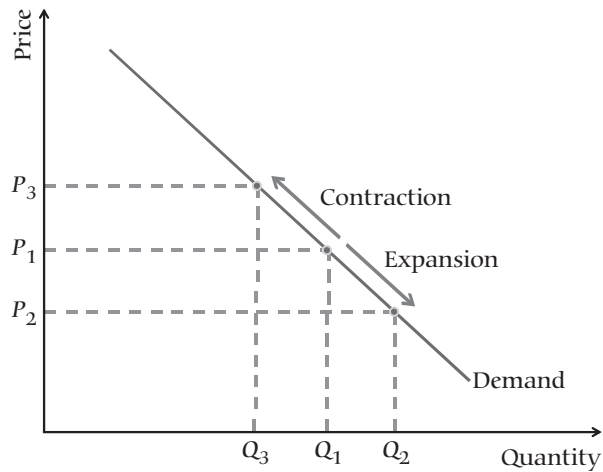
## Movements along the demand curve

Any change in price will cause a movement along the demand curve. An increase in price will lead to a contraction in demand, whilst a decrease in price will cause an extension in demand.

### Activity 4



- 1 Would a decrease in price from  $P_1$  to  $P_2$  lead to a contraction or an extension demand?
- 2 Would an increase in price from  $P_1$  to  $P_3$  lead to a contraction or an extension demand?
- 3 What would you expect to happen to the quantity demanded after the price decreases from  $P_1$  to  $P_2$ ?
- 4 What would you expect to happen to the quantity demanded after the price increases from  $P_1$  to  $P_3$ ?



The above diagram shows how an increase in price from  $P_1$  to  $P_3$  will cause the quantity to fall from  $Q_1$  to  $Q_3$ . Conversely, a fall in price from  $P_1$  to  $P_2$  leads to the quantity increasing from  $Q_1$  to  $Q_2$ .

### Shifts in the demand curve

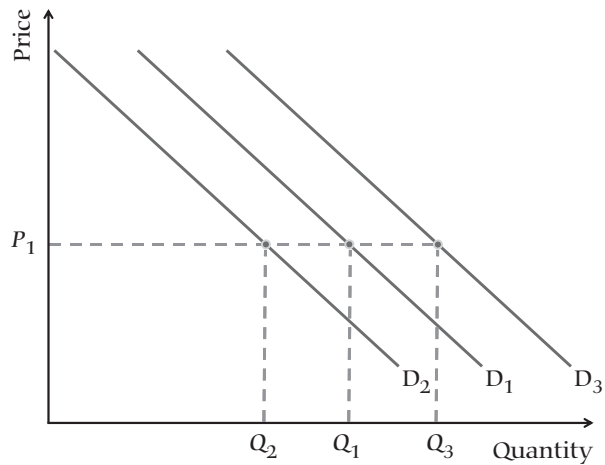
A change in price will lead to a movement along the demand curve, whilst a change in any other factor could cause a shift in demand.

## Activity 5



- 1 What factors could lead to your demand for Coca Cola to shift? You are not allowed to say price as that will simply lead to a movement along your demand curve.





We can see what will happen when there is a shift in demand in the diagram above. This shows what will happen to the quantity demanded if the price stays the same.

## Activity 6



- 1 What will happen to the quantity demanded at a price of  $P_1$  when demand decreases, in other words, demand shifts to the left?

- 2 What will happen to the quantity demanded at a price of  $P_1$  when demand increases, in other words, demand shifts to the right?

Some of these factors will lead to your demand for Coca Cola shifting to the right and others will cause it to shift to the left.

- 3 Complete the table below with examples of what might cause the shift in demand for Coca Cola.

Factors that shift demand to the left	Factors that shift demand to the right



There are a number of general factors highlighted by economists that will lead to a shift in the demand curve.

### Changes in income

When incomes go up there will also be an increase in demand for most goods.

**Activity**  
**7**

When a demand rises for a product after an increase in income, we call the good or service a normal good.

- 1 List some examples of normal goods.

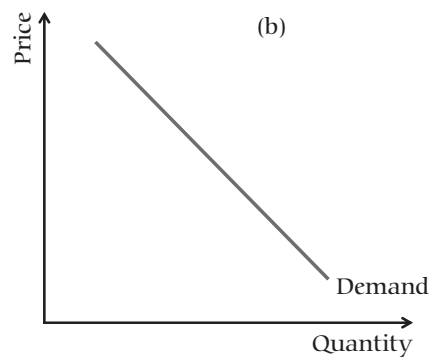
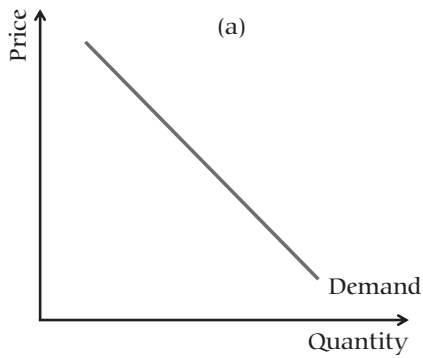


There are also some goods, known as inferior goods, which will see a decrease in demand for them after a rise in income.

- 2 Can you identify some examples?

Use the diagrams below to show how demand would shift if there was:

- a. An increase in income and the product was a normal good.
- b. An increase in income and the product was an inferior good.



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### The price of substitute goods

If the price of a rival product, known as a substitute good, decreases then demand for the initial good will fall. For example, a decrease in the price of Pepsi will lead to a decrease in demand for Coca Cola.

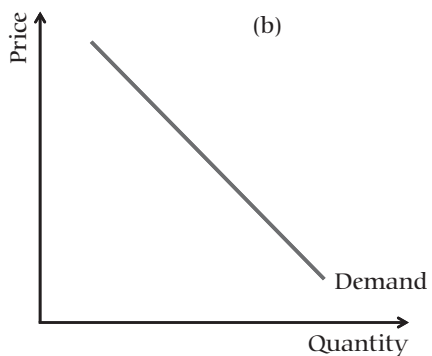
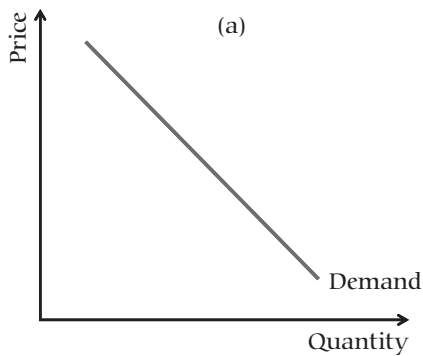
## Activity 8



- 
- 1 Can you think of other examples of substitute goods?

Use the diagrams below to show how demand would shift if there was:

- a. A fall in the price of a substitute good.
- b. An increase in the price of a substitute good.



## The price of complement goods

If the goods are complements, then a fall in the price of one good will lead to an increase in demand for the other. For example, if the price of PlayStation 3 were to fall, we would expect to see an increase in the demand for PlayStation 3 games.

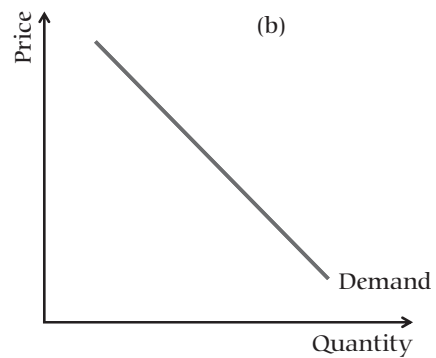
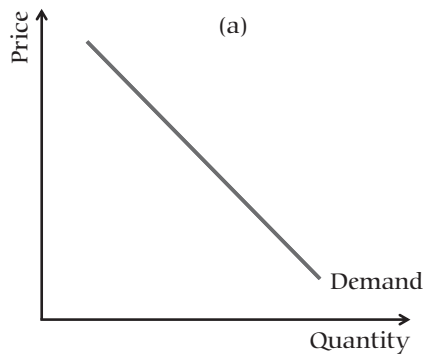
### Activity 9



- 1 Can you think of other examples of complement goods?

Use the diagrams below to show how demand would shift if there was:

- a. A fall in the price of a complement good.
- b. An increase in the price of a complement good.



## The population

An increase in population is likely to lead to an increase in demand.

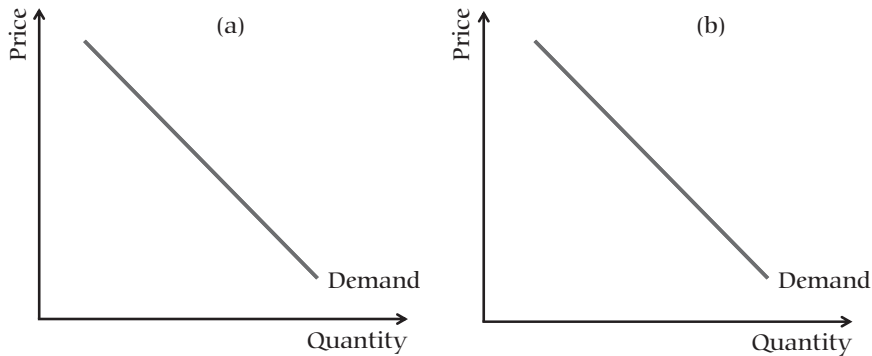
### Activity 10



- 1 Why has the UK seen an increase in its population in the past few years?

Use the diagrams below to show how demand would shift if there was:

- a. A fall in the birth rate.
- b. An increase in the number of immigrants from Eastern European nations that have recently joined the European Union.



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## Advertising and publicity

Advertising aims to influence customer decisions.

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### Activity 11

- 1 Explain why consumers are likely to be influenced by advertising and publicity.

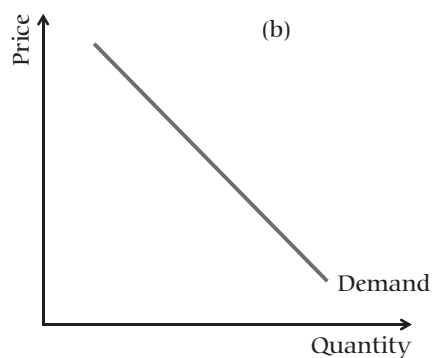
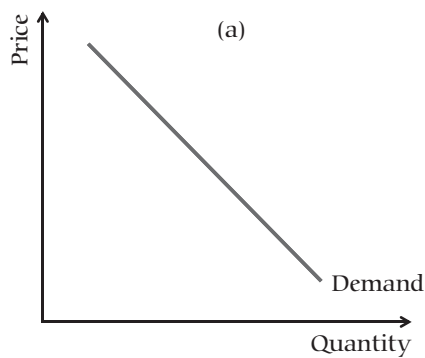
- 2 Will all advertising and publicity always lead to the demand curve shifting to the right?

Explain your answer and provide examples if possible.

- 3 Have there been any examples of particularly successful advertising campaigns that have led to the demand curve shifting significantly to the right?

Use the diagrams below to show how demand would shift if there was:

- a. Lots of poor publicity in the newspapers about the product. Consider, for example, the release of Dasani water by Coca Cola.
- b. A new advert is shown on the television and it is very popular – people email it to one another and it is heavily featured on YouTube. Consider, for example, the gorilla advertising Cadbury.



## Changes in fashion

Goods and services will frequently move an out of fashion.

### Activity 12

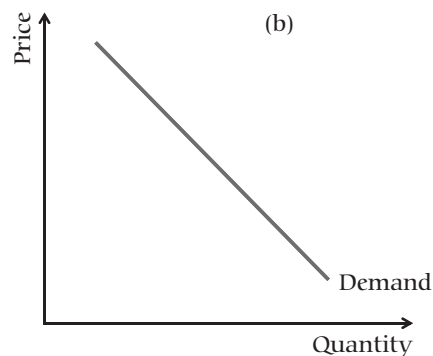
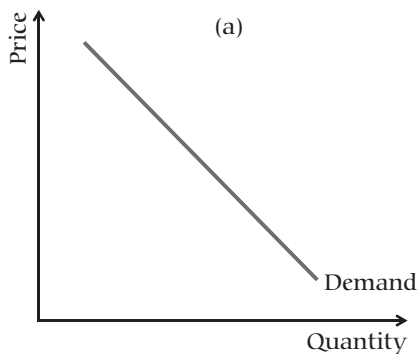


- 1 Are there any goods that are particularly fashionable at the moment?

- 2 What would you expect to happen to the demand curve for those products?

Use the diagrams below to show how demand would shift if:

- The product suddenly became very fashionable.
- The good was so unfashionable, even your Gran wouldn't wear it.





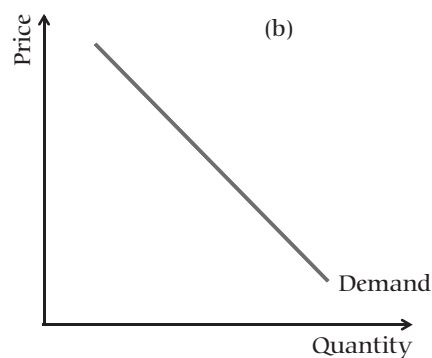
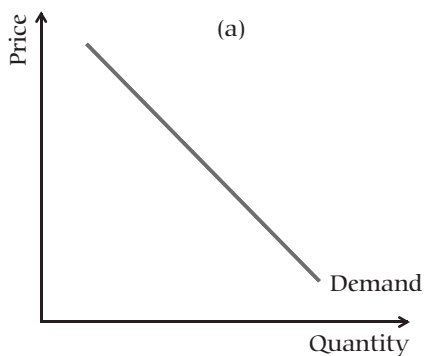
# Activity 14



- 1 Are there any other goods that are affected by weather?

Use the diagrams below to show how demand would shift:

- For ice cream during a particularly hot summer.
- For holidays in the UK during a very hot summer.



## Changes in the law

The law can impact the level of demand dramatically as certain goods or services are made illegal or compulsory.

# Activity 15

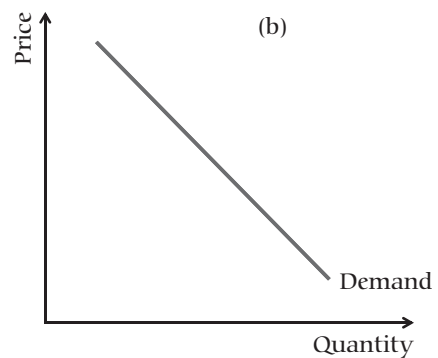
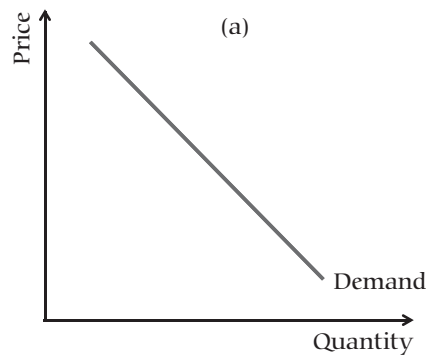


- 1 Can you think of anything that has been banned recently? What has been the impact on the demand of that product?

- 2 Can you think of anything that has been made compulsory recently? What has been the impact on the demand of that product?

Use the diagrams below to show how demand would shift:

- a. For handguns after they were made illegal in the UK.
- b. For child car safety seats after their use was made compulsory in the UK.



### Uncertainty over future prices

Many commodity markets, such as oil and gas, are affected by what traders think will happen to prices in the future.

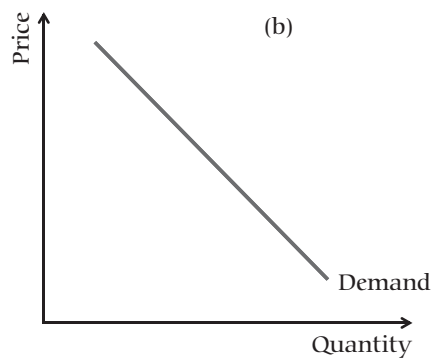
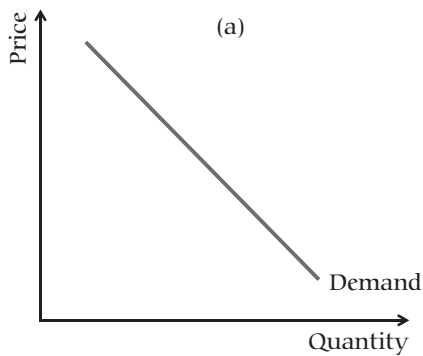
# Activity 16



- 1 Can you think of any other markets that will be affected by changes in demand if people expect prices to change in the future?

Use the diagrams below to show how demand would shift if:

- People expected house prices to increase in the future.
- Investors expected the price of shares to fall in the future.



## Composite demand

This applies when a good is demanded for two or more distinct uses, for example, steel is used in the production of cars and ships.

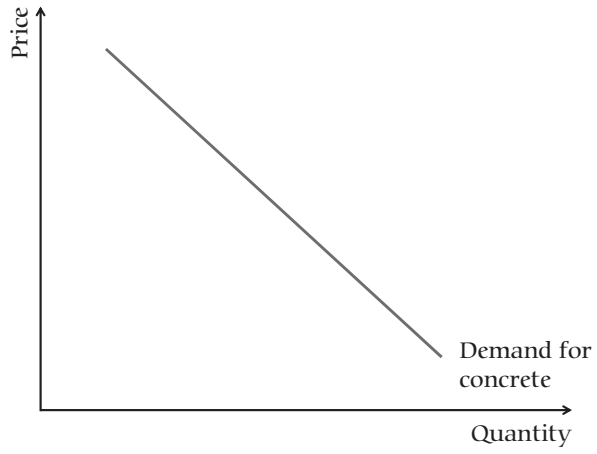
# Activity 17



- 1 Can you think of any other products that have composite demand, in other words, they are demanded for more than one use?



- 2 On the diagram below show the effect on the demand curve for concrete of an increase in demand for building skyscrapers in China.



## Self-assessment: 1.2 Demand in the market

At the beginning of this unit we identified a number of learning objectives, how confident are you that they have been achieved?

Distinguish between wants and effective demand.



Explain why the demand curve is downward sloping.



Explain the relationship between price and quantity demanded.



Identify how utility will affect the price consumers are prepared to pay and, therefore, the quantity demanded.



Outline how changes in price lead to movements along the demand curve.



Analyse the factors that will cause the demand curve to shift.



Explain composite demand.



Explain derived demand.



### Action plan for completing knowledge

Area of concern	Action plan for improvement

**Assignment**

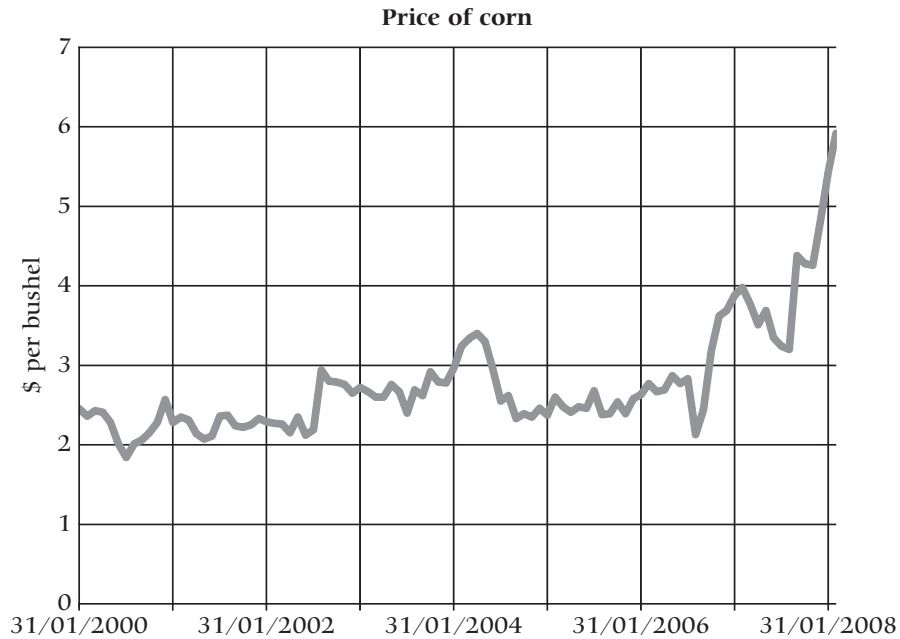
**1.2**



Total for this question: 50 marks

Study **Extracts A, B, C and D**, and then answer **all** parts of the question which follows.

**Extract A: The price of corn per bushel.**



**Extract B: Cheap no more**

In early September 2007 the world price of wheat rose to over \$400 a tonne, the highest ever recorded and twice the average of the past 25 years. In May it had been around \$200. Normally, sky-high food prices reflect scarcity caused by crop failure, however, these record prices are due to two demand factors.

One is increasing wealth in China and India. This is stoking demand for meat in those countries, in turn boosting the demand for cereals to feed to animals. Higher incomes in India and China have made hundreds of millions of people rich enough to afford meat and other foods. In 1985 the average Chinese consumer ate 20kg (44lb) of meat a year; now he eats more than 50kg. China's appetite for meat may be nearing saturation, but other countries are following behind: in developing countries as a whole, consumption of cereals has been flat since 1980, but demand for meat has doubled. 5

Two, ethanol is the dominant reason for this year's increase in grain prices. It is used as a biofuel and a big expansion of the ethanol programme in 2005 explains why prices started rising in the first place. 15

Source: adapted from 'Cheap no more', Gerrit Buntrock, 6/12/2007, *The Economist*.

**Extract C: Tortilla Protests**

Tens of thousands of workers and farmers protested against the high cost of tortillas and other food staples. Tortillas, which are made from grain, are subject to a government agreed price limit of about 35 cents a pound. This is about 40 percent higher than the price three months earlier and contrasts with the 4 percent increase in the minimum wage, which is still less than \$5 a day. However, in some areas, prices have risen to 45 cents a pound. 5

Source: adapted from 'Thousands in Mexico City Protest', Elisabeth Malkin, 1/2/2008, *International Herald Tribune*

## Extract D: Alternatives to oil

The industrialised world stands aghast at the prospect of rising oil prices. Paying more for oil means increases in the price of almost everything that drives the rich economies. But the benefit of the present oil price hikes could be to focus attention on the possibility of a world far less dependent on oil. What are the alternatives?

5

**Coal?** Before oil's supremacy, coal was king. It was the bedrock of the Industrial Revolution in Europe and North America. There are enormous reserves of coal available, but it does give off large quantities of the gases which are causing climate change, especially carbon dioxide (CO<sub>2</sub>) and sulphur dioxide (SO<sub>2</sub>).

**Nuclear?** Some people still pin their hopes on nuclear power, which makes far less of a contribution to global warming (though it is not entirely neutral).

10

**Renewable fuels?** Some are tried and tested, like hydro-electric power. Wind and wave power have promise, as do biofuels based on grain. Solar power is coming on by leaps and bounds. Many motor manufacturers believe the future lies in fuel cells or hydrogen.

15

**Conservation?** And there is what supporters are fond of calling 'the fifth fuel' – energy conservation.

Source: adapted from 'Alternatives to oil', Alex Kirby, 8/9/2000, [bbc.co.uk](http://bbc.co.uk) accessed 3/3/2008

## Questions

- 1 Define the term 'scarcity' (Extract B, line 3). (5 marks)
- 2 Using Extract A, identify the main trends in the price of corn over the period shown. (8 marks)
- 3 Extract B refers to the growth in demand and the price of grain. Extract C looks at the impact of these price increases in Mexico. Using the term 'derived demand' and demand diagrams analyse why rising grain prices has led to an increase in the price of tortillas in Mexico. (12 marks)
- 4 Extract D analyses the possible alternatives to oil given the background of rising oil prices. Using the data and your economic knowledge, evaluate what might happen to the demand for oil over the coming decade. Evaluate the impact of substitute goods. (25 marks)

