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## Economics Revision

# AS Economics

# Factors causing a change in Price

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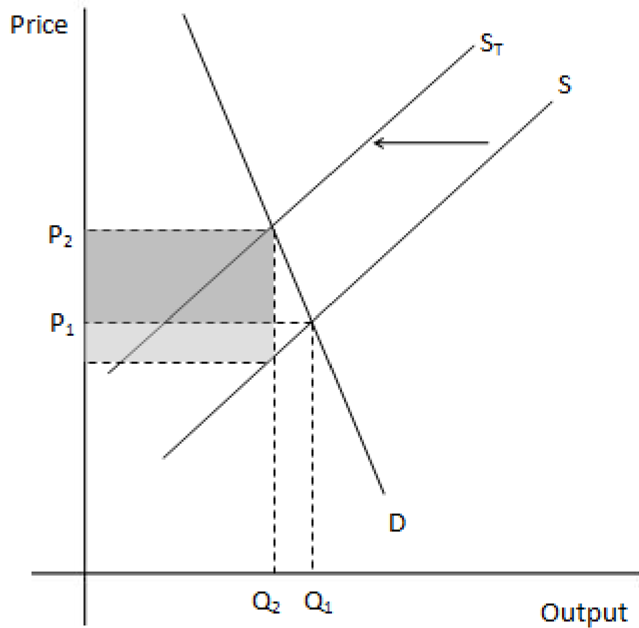
**Indirect taxation:**

Increased PED → increased effectiveness of tax in reducing use of good.

Inelastic:

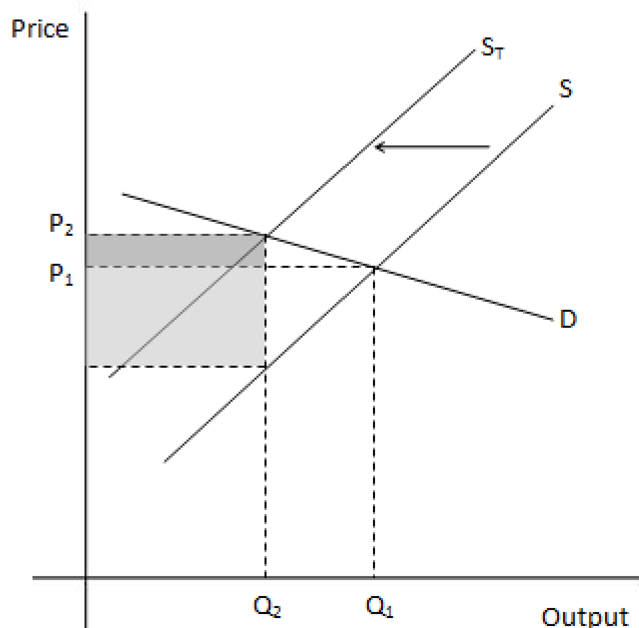



There is a low fall in quantity.

Tax revenue is high.

The consumer incidence, i.e. the tax burden of the consumer (the darker shaded area) is greater than the producer incidence (the lighter shaded area), i.e. less of the tax burden can be passed onto the producer.

Elastic:

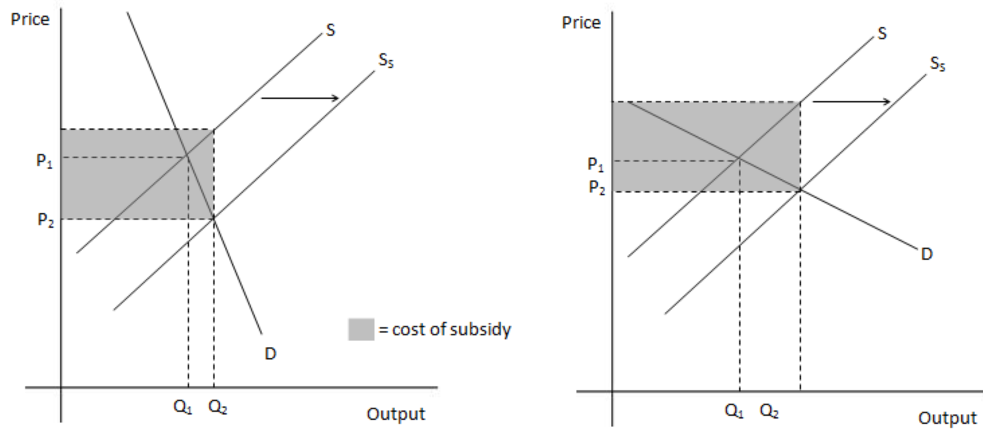



There is a greater fall in quantity demanded than with inelastic demand.

Tax revenue is lower.

The producer incidence is greater than the consumer incidence, i.e. less of the tax burden can be passed onto the consumer.

Subsidies are more effective with price elastic goods, but the cost of the subsidy is greater:

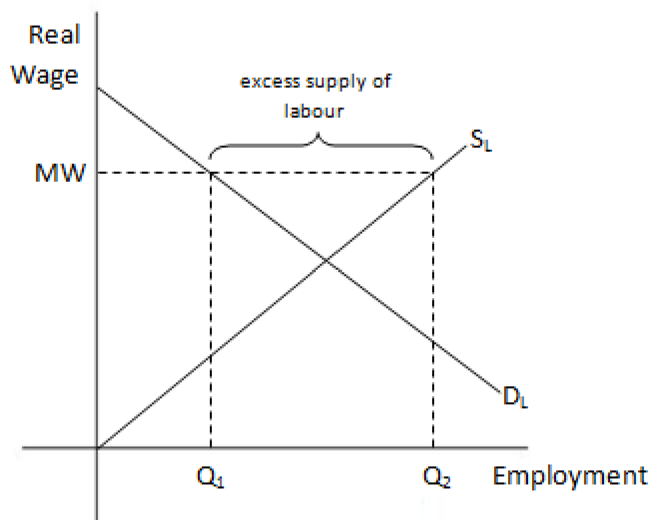


## Labour Market

Labour is a factor of production – if the economy is in a boom more labour is required. It has derived demand (demand for labour is a result of demand for the good it produces). Price of labour – wages.

The equilibrium of employment is therefore where the demand for labour is equal to the supply of labour.

### Minimum Wage




Causes excess supply – 'real wage' unemployment.

Reduces the mobility of labour – government over-rides the price mechanism and distorts the functions of price.

Trade unions are another cause of imperfection and labour immobility – they force the real wage above the equilibrium, causing the same inefficiencies and unemployment as the minimum wage.

## Housing Market

### Demand for Housing

Rising standards of living – increased demand for housing – income elasticity of demand for housing is positive.

Most homeowners have a mortgage – have to pay back interest to the bank on top of the original loan.
Therefore a decrease in the interest rate may increase the demand for housing.

Speculation can also affect the housing market – economy doing well – taking out a large mortgage isn't risky – downturn in the economy might lead to a downturn in the housing market as banks and consumers are less prepared to lend and borrow.

### Supply of housing

Price inelastic in the short run and medium term – takes time for the market to respond to increased demand due to time lags between deciding to build more houses and their completion.
Limited availability of land also restricts supply.

### Effect

House prices increase significantly if there is increasing demand due to inelasticity of supply – may prevent first time buyers from getting on the 'housing ladder'.

Fall in confidence → decrease in demand and a large fall in house prices.

Rental market – opposite direction to the homebuyers market and are substitutes to an extent.
Fall in confidence – some people put off buying and rent.
Increase in confidence – people buy instead of renting.

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## Commodities Markets

### Demand for Oil

Oil – necessary for the production of goods and for fuel – derived demand and is price inelastic. Surge in demand for oil has occurred as countries like China and India have experienced high economic growth.

### Supply of Oil

Non renewable resource – amount supplied depends on a variety of factors:

- Changes in costs of drilling and refining oil.
- Wars destroying oil fields.
- Discovery of new oil sites.

Etc. add volatility to the market. This is made worse by speculators – trade on future prices of oil to make money.

Oil will be purchased if it is believed that there will be an increase in price in the future and sold if it is believed that the price is going to fall.

OPEC – controls fluctuations in oil prices – restricts supply when the price of oil is too low (to shift the supply curve leftwards) and releases supply when it is too high (shift rightwards) – oil prices are kept within set boundaries.
BUT this system relies on the oil producing countries having enough oil to release when prices are too high – if supply is restricted beyond their control, they will not be able to reduce prices.
OPEC can contribute to price volatility by such intervention, particularly as demand is price inelastic.

Price mechanism – ensures that scarce resources are allocated efficiently – as oil becomes increasingly scarce, higher prices are to be expected. This may in time lead to the development of alternative fuels which are more environmentally friendly and consumers demanding less oil and switching to cheaper and 'cleaner' substitutes.

## Agricultural Markets

- Often suffer from price fluctuations – external shocks such as weather and disease.
- Government may intervene with a buffer stock scheme – ensures that producers get enough income each year and therefore have an incentive to keep supplying to the market even after a bad harvest. Consumers also benefit from steady prices.
- (See Government Intervention)
- Buffer stock schemes have disadvantages – high start up and administration costs, government needs enough resources to always be in a surplus of the good, cost of storage, perishable food leads to waste, reliant on there not being too many good or bad harvests in succession, producers may also catch onto the fact that if they keep overproducing the government will always buy up the surplus.