



## Behavioral economics

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# Rational economic decision

In a nutshell, economists assume that the basic motivation driving most people most of the time is a desire to be happy.

This assumption implies that people make choices on the basis of whether or not those choices are going to make them as happy as they can be given their circumstances.

## Rational economic decision making and economic incentives

At the heart of traditional or orthodox demand theory is the assumption that the members of households or consumers always act rationally.



Rational behaviour means people try to make decisions in their self-interest or to maximise their private benefit.

When a choice has to be made, people always choose what they think at the time is the best alternative, which means that the second best or next best alternative is rejected.

# Utility

If people make choices on the basis of what's going to bring them the most happiness, they need a way of comparing how much happiness each option brings.

## Utility

Economists suppose that you can compare all possible things that you may experience with a common measure of happiness or satisfaction, which they call utility.

Two important measures are:

### 1 Total utility

The overall satisfaction that is derived from the consumption of all units of a good over a given time period.

### 2 Marginal utility

The additional utility is derived from the consumption of one more unit of a particular good.

# Law of diminishing marginal utility

To see how marginal utility works, you need to recognise that the amount of utility that a given thing brings usually depends on how much of that given thing a person has already had.

Example:



If you've been really hungry the first slice of pizza that you eat brings you a lot of utility.



The second slice is also pleasant, but not quite as good as the first because you're no longer starving.



The third, in turn, brings less utility than the second.



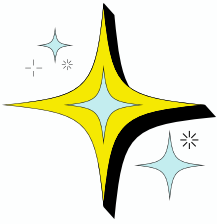
And if you keep forcing yourself to eat, you may find that the 6th slice of pizza actually makes you sick and brings you negative utility.

Economists refer to this phenomenon as diminishing marginal utility.

## Diminishing marginal utility

Each additional, or marginal, piece of pizza brings less utility than the previous piece so that the extra utility, or marginal utility, brought by each successive slice diminishes as you eat more and more slices.

**END OF  
PREVIEW**

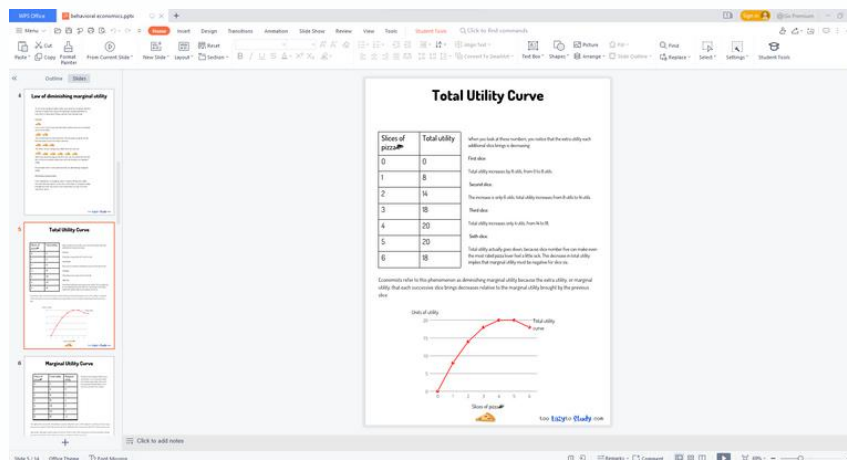


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**Question**

Spain has had one of the highest unemployment rates in Europe. Moreover, 3.5 million of those unemployed had been out of work for at least a year by 2015. The Spanish Government has introduced a range of policy measures, including increased government spending, to reduce unemployment and poverty. It has also tried to help firms make the supply of their products more elastic.

Analyse why price elasticity of supply can differ between products. [6]

Category: Price elasticity of supply

**Answer**

When a questions starts with 'Analyse', the student is required to set out the main points and show how they link and connect.

**Step 1** : Define 'price elasticity of supply' in the introduction.

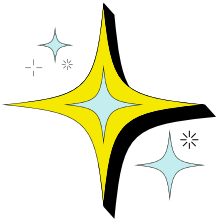
Price elasticity of supply (PES) measures of the responsiveness of quantity supplied to a change in price.

The formula for PES is as follows :

$$\frac{\% \text{ change in quantity supplied}}{\% \text{ change in price}}$$

% change in price.

Supply is price elastic (i.e. PES > 1) if producers can quite easily increase supply without a time delay when there is an increase in the price of the product. Supply is price inelastic (i.e. PES < 1) if firms find it difficult to change production in a given time period when the market price changes.



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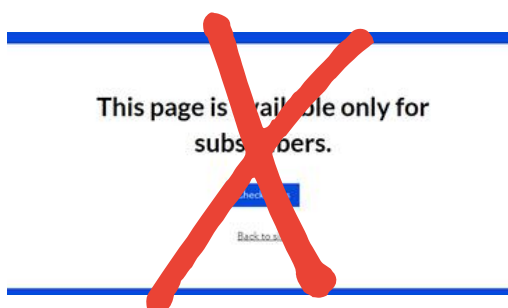
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### Economics notes

Category: Economic growth

#### Actual economic growth

Actual economic growth is the annual percentage increase in national output, which typically fluctuates in accordance with the trade cycle.

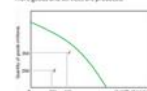
Actual growth in the long run is determined by two factors:

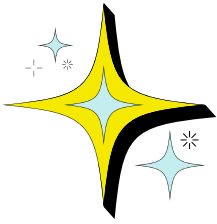
1 The growth in potential output (in other words the aggregate supply)

2 The growth in aggregate demand (AD)

A production possibility curve (PPC) diagram can be used to show economic growth resulting from greater use of existing resources.

The economy is initially producing at point X. Then the production point increases to point Y and more goods and services are produced.





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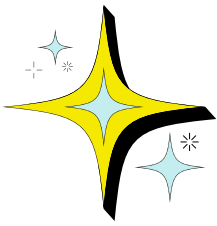
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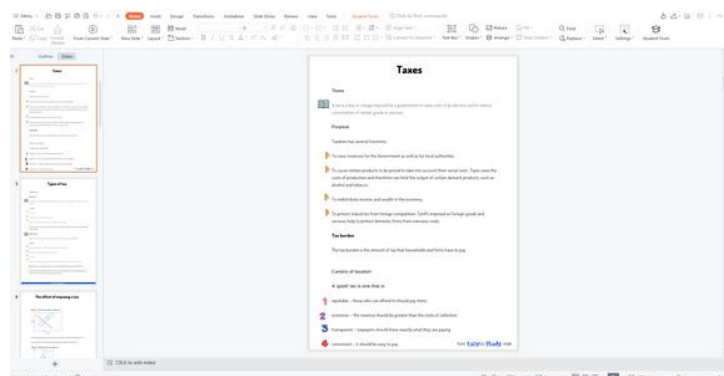


# FREQUENTLY ASKED QUESTIONS

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  - At the end of each section, you can even create your own mindmaps!



2. We know writing economics essays can be a struggle, especially during an exam, during which time is limited.

- That's why we've structured every essay in an optimal way and broke every essay down into headings and paragraphs. We've even included tips and marking scheme comments!

**Tip:** Generally, AQA exam questions are accompanied by an extract (although we have not included it here for simplicity). To score higher marks, refer back to the data (facts and figures) given in the extract, when writing your essay! Note that in this question you are asked to 'explain TWO factors'. In this case, it's a good idea to break your essay into two parts: Factor 1 and factor 2. (Step 1: Define 'demand' in the introduction)

Demand refers to both the willingness and the ability of customers to pay a given price to buy a good or service. There are several factors which could lead to an increase in the demand for bus travel in the future.

(Step 2: Explain TWO factors which could increase the demand for bus travel)

**Factor 1:** A change in tastes or social norms will increase the demand for bus travel.

Today, travelling by bus has the image of being unpleasant, unreliable and for the 'lower class'. However, more awareness is being raised about air pollution, climate change and CO<sub>2</sub> emissions. People in the future may perceive bus travel as being more ecologically and economically efficient. Furthermore, with the introduction of smart lanes and electric buses, the experience of travelling by bus will improve with time. These factors will encourage people to take the bus.

If more people become aware that travelling by bus is environmentally friendly, more people will opt for bus travel to reduce their carbon footprint. The demand for bus travel will increase. The effect of an increase in demand for bus travel can be shown using a diagram. The diagram below shows the demand and supply curves of bus travel.

