



Economic systems

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The Free Market

The free-market economy



The free market economy is an economy where all economic decisions are taken by individual households and firms and with no government intervention.



Price mechanism

In a free-market economy, decisions on how resources are to be allocated are usually taken by the price mechanism.

The price mechanism determines the production, utilization of resources, and pricing.

This means that the forces of demand and supply determine:

- ▶ what goods and services will be produced,
- ▶ how they will be produced
- ▶ for whom will they be produced

Prices act to indicate the likely market value of particular resources.

The price mechanism works as follows.

1 2

Prices respond to shortages and surpluses.

- 1 Shortages result in prices rising.
- 2 Surpluses result in prices falling.

The Free Market Pros and Cons

Pros

1

Increased efficiency

The profit motive encourages producers to be more efficient. Competition between firms keeps prices down and acts as an incentive to firms to become more efficient. The more efficiently firms can combine their factors of production, the more profit they will make.

2

Consumer wishes

The more firms there are competing, the more responsive they will be to consumer wishes.

3

Innovation

Innovation is promoted because it provides a competitive edge.

4

Functions automatically

There is no need for costly and complex bureaucracies to coordinate economic decisions.

Cons

1

Merit goods will be under-produced and demerit goods will be over-produced.

2

Public goods cannot be provided by the free market because of their two characteristics, non-diminish ability and non-excludability.

3

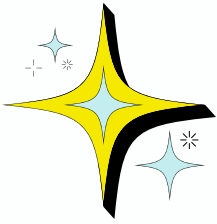
Lack of competition and high profits may remove the incentive for firms to be efficient.

4

Power and property may be unequally distributed.

5

The practices of some firms may be socially undesirable. For example, a chemical works may pollute the environment.

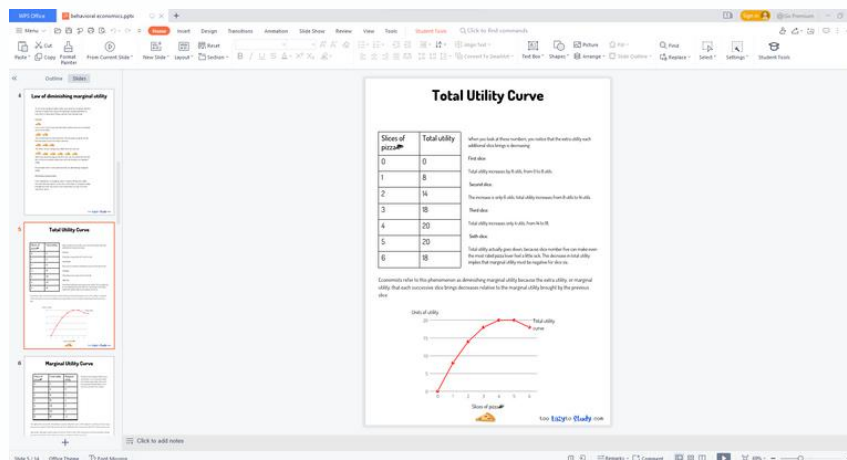


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Question

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.

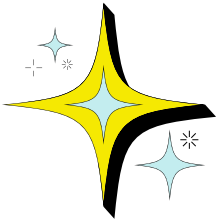
Price elasticity of supply (PES) measures of the responsiveness of quantity supplied to a change in price.

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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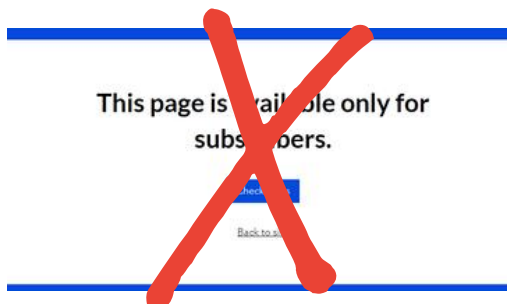
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Economics notes

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.

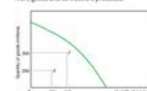
Actual growth in the long run is determined by two factors:

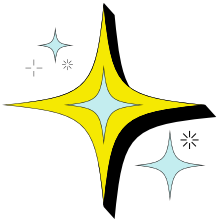
1 The growth in potential output (in other words the aggregate supply)

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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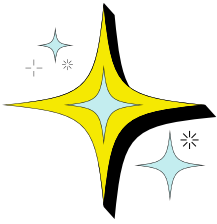
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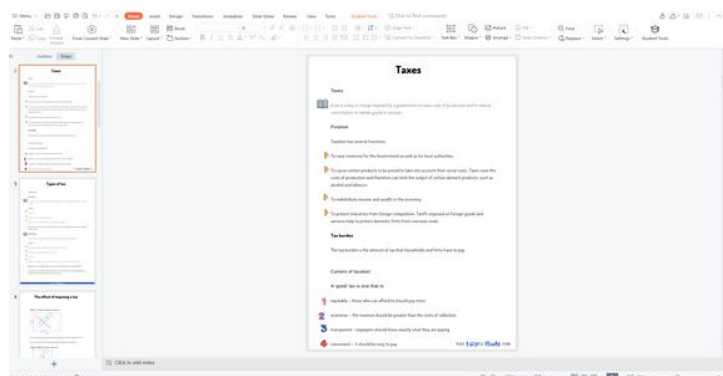


FREQUENTLY ASKED QUESTIONS

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1. We've put ourselves in the mind of a student when making the economics notes.
- We know that reading large paragraphs of economic theory can be well... boring. That's why we've made our note templates as clear and concise as possible. Every student is unique, and so should be their notes! That's why we've made it possible to edit them.
 - 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 CO₂ 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.

