Top of the 'Blocks'

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'Blocks' are vital to success in Economics exams. They are the chunks of text that you can copy-and-paste into your answers to rapidly boost your grade.

In this guide you will find the ten most important 'blocks' in A Level Economics. To be exam-ready, make sure you can quickly and accurately write these out, drawing the diagrams correctly.

Test yourself regularly to make sure you can excel every time.

Important tips:

- Be clear, precise and concise.
- Identify the start and end of your chain of reasoning and go step-by-step from start to end.
- You should **think** in steps (like bullet points) but you must **write** in full prose in your exams.
- This is Economics, so use Economics keywords.
- Make sure your diagrams are 'ACE' (label your Axes, Curves and Equilibria).

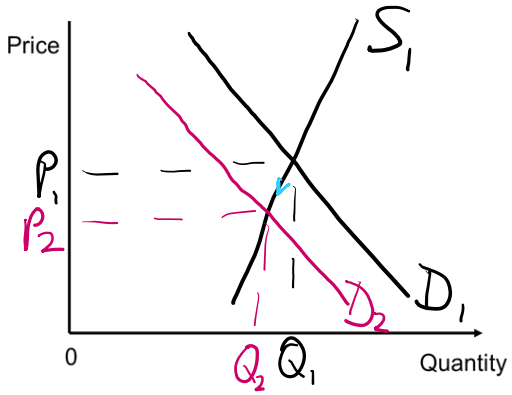
Block 1: Demand and Supply analysis

Use a D&S diagram to analyse the effects of changes that affect D and/or S for a good, considering elasticity.

- Need help? Revisit Demand and Supply flowchart and Demand and Supply questions.

Example: Analyse the effects of a rise in interest rates on the market for houses.

- If there is a rise in interest rates, then the cost of borrowing rises.
- This makes it more expensive for people to repay their mortgages.
- Therefore people will be less able to afford houses, so demand will fall, shifting to the left from D_1 to D_2.



- Therefore there will be a contraction in supply.
- Therefore equilibrium price falls P_1 to P_2 and quantity falls from Q_1 to Q_2.
- Supply of housing is likely to be inelastic because it takes a long time to build. Therefore the fall in demand is likely to lead to a relatively small fall in quantity but a relatively large fall in price.

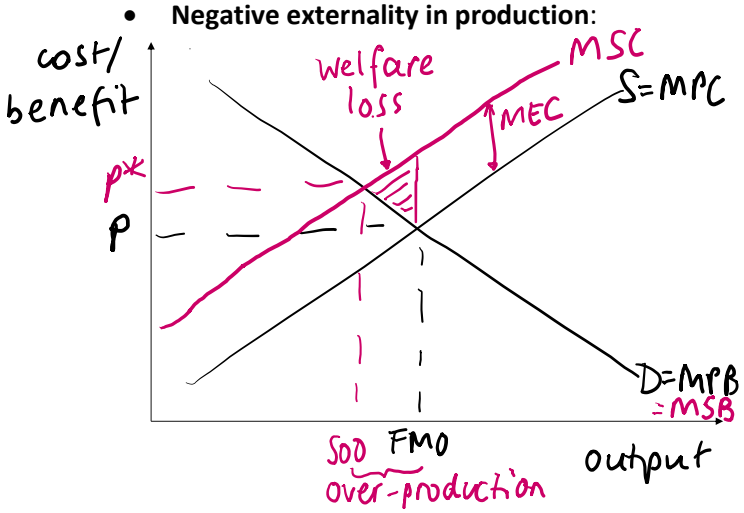
Tips: When there is a shift, use the 'rule of three' – the curve rises/falls, shifts right/left, from D_1 to D_2 / S_1 to S_2.

Power Up: D&S analysis is vital in microeconomics. Be ready to apply this skill to rises or falls in demand and/or supply.

Block 2: Externality analysis

Use an externality diagram to analyse how negative (positive) **externalities in production** (consumption) **cause market failure**

- **Negative externality in production**:



- If left to the free market, buyers and sellers decide how much to demand and supply based on their private preferences. Therefore D=MPB and S=MPC.
- The free market output (FMO) occurs at the output where D=S.
- However, there is a **negative externality in production,** shown by **MEC**.
- This means that the Marginal **Social Cost** is **greater** than the Marginal **Private Cost.**
- (There are no externalities in **consumption** so **MPB=MSB**).
- The social optimal output (SOO) would occur at the output where MSB=MSC.
- Therefore, if it is left to the free market, there would be **overproduction** of the good by **FMO-SOO**.
- Therefore there is a misallocation of resources, shown by the welfare loss.
- Therefore there is a market failure.

Tips: Positive numbers **>** 0. Welfare loss for positive externalities looks like a '>' sign.
Negative numbers **<** 0. Welfare loss for negative externalities looks like a '<' sign.

Power Up: There are four externality diagrams you need to know (negative production, negative consumption, positive production, positive consumption). Lots of the analysis is the same, but the parts shown above **in bold** are the bits that change.

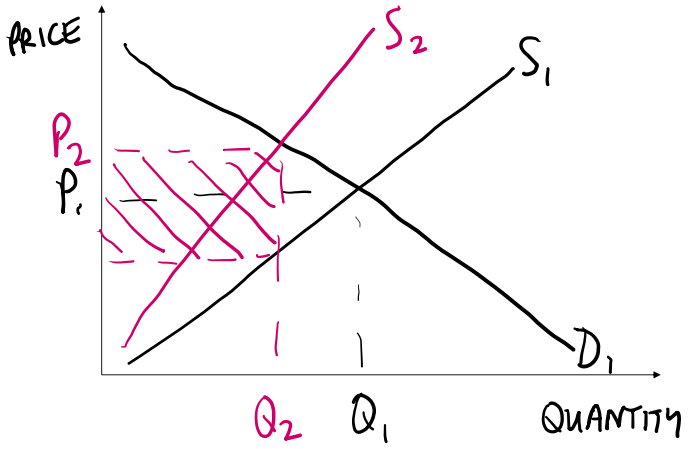
Externality analysis is also useful for merit goods (positive in consumption), demerit goods (negative in consumption) and environmental externalities (negative in production or consumption).

Block 3: Indirect tax

Use a D&S diagram to analyse how an indirect tax aims to correct market failure. Evaluate its effectiveness.

- An indirect tax is a payment from producers to government for producing a good or service.
- An indirect tax leads to an increase in cost of production, so it causes supply to fall, shifting to the left from S1 to S2.

Diagram for an *ad valorem* tax (levied as a percentage of the price)



- The vertical difference between the two curves shows the tax per unit.
- This will cause the price to rise from P1 to P2 and the quantity to fall from Q1 to Q2.
- The shaded area shows the total amount of revenue raised for the government from the tax.
- Since the quantity falls, this can correct market failure in the case of overproduction of a good/service.

Evaluation (example): The extent to which the tax is effective depends on the price elasticity of demand. If the tax is placed on a good with inelastic demand, such as alcohol because it is addictive, then there will be a relatively small fall in quantity. Therefore the tax will be relatively unsuccessful at correcting the market failure. On the other hand, since there is a large rise in price and a small fall in quantity, it will be relatively successful at raising revenue for government.

Other suggestions for **evaluation** (would need to be developed):

- Can 'internalise the externality' for negative production externalities, but it is difficult to place a monetary value on externalities.
- May create unintended consequences – people switch to 'worse' demerit goods / smuggling / black markets.

Tips: When shading the rectangle, the base is the **new** quantity and the height is the **vertical difference** between the supply curves.

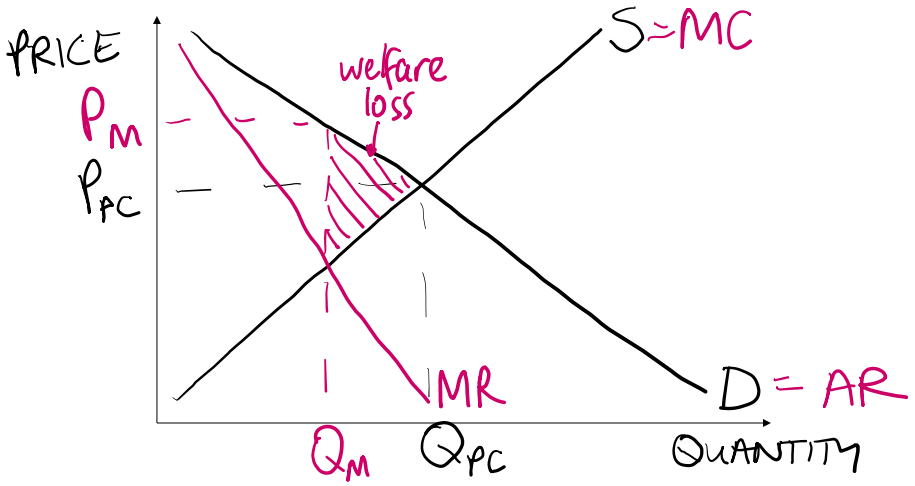
Power Up: The diagram above is for an ad valorem tax; be ready to adapt it for a unit tax (the supply curves are parallel).

Indirect taxes are the opposites of subsidies; be ready to adapt this block to analyse and evaluate subsidies – so many essays in Paper 1 benefit from a paragraph on either taxes or subsidies.

Block 4: PC v Monopoly

Use a D&S diagram to compare PC and monopoly markets and show welfare loss of monopoly

- In a perfectly competitive market, the equilibrium price and quantity occur where Demand is equal to Supply, at price P_{PC} and Q_{PC}.
- If the market becomes a monopoly, then the firm is a price maker. Therefore their Average Revenue is equal to the Demand curve, but their Marginal Revenue is twice as steep.
- Assuming they aim to maximise profits, they will produce where Marginal Revenue is equal to Supply, which is based on their Marginal Cost. Therefore they will produce at the lower quantity of Q_M.
- At that quantity, buyers will pay the higher price of P_M.
- There is a welfare loss shown by the shaded area.
- Therefore there is a misallocation of resources.
- Therefore there is a market failure.



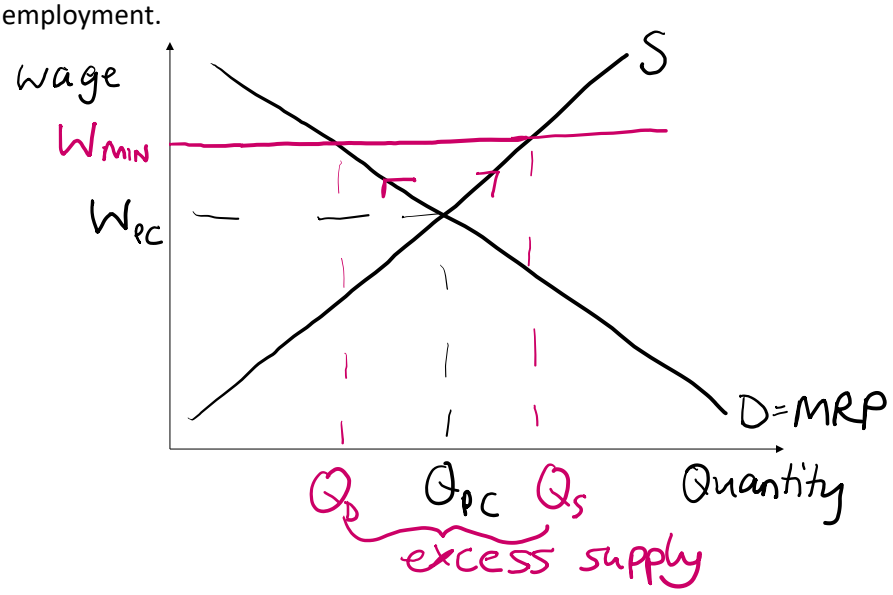
Tips: The MR curve should start at the same place as the AR curve but be twice as steep. A common mistake is to show P_M where S=MR – remember to go up to AR!

Power Up: This block is useful for any essay involving competitive and concentrated markets.

Block 5: Minimum Wage

Use a D&S diagram to analyse the effect of trade union intervention / a minimum wage in the labour market

- In a perfectly competitive labour market, the equilibrium wage and quantity occur where Demand is equal to Supply, at wage W_{PC} and Q_{PC}.
- If a minimum wage is imposed above the equilibrium at W_{MIN}, then there will be an extension in supply to Q_S and a contraction in demand to Q_D.
- This will lead to higher wages at W_{MIN} but quantity will fall to Q_D.
- Furthermore there will be excess supply of $Q_S - Q_D$. In the labour market this is unemployment.



Suggestions for **evaluation** (would need to be developed):

- Minimum wage must be above the equilibrium to have any effect – some occupations would not be affected
- The magnitude of the effects depend on elasticity of demand and supply for labour.
- Increases costs for firms – likely to reduce international competitiveness; costs might be passed on to consumers through higher prices
- The excess supply is likely to lead to other problems (unemployment, undeclared work, social problems, etc.)

Power Up: By changing the y-axis from 'wage' to 'price', this diagram shows a **minimum price** for any good or service. This has been used to reduce consumption of demerit goods (e.g. alcohol in Scotland) and to increase incomes for producers (e.g. agriculture).

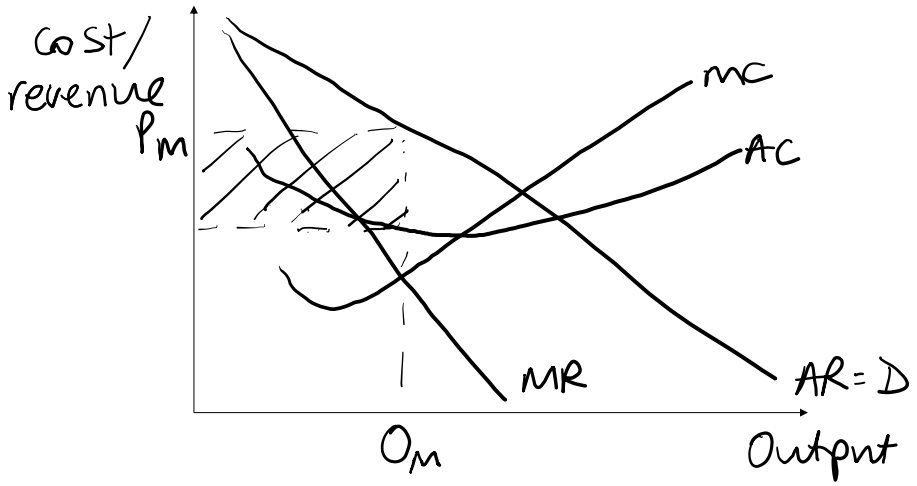
It can be changed to show **maximum price,** which has been used when prices are deemed to be 'too high' (e.g. energy prices, rent prices).

However, economists tend not to like minimum prices (or maximum prices) because they distort the market mechanism and the excess supply (or demand) creates other problems.

Block 6: Monopoly in the LR

Use a cost and revenue diagram to analyse the LR equilibrium for a monopoly.

- A monopoly is a price maker, so their Average Revenue is equal to Demand in the market. Marginal Revenue must start at the same place but be twice as steep.
- We assume they aim to maximise profits, so they produce where MC=MR, which is output O_M.
- For that output, consumers are willing and able to pay price P_M for the good.
- Since AR is greater than AC, the monopoly makes abnormal profits shown by the shaded area.
- At the current level of output, price is not equal to MC, so it is not allocatively efficient.
- At the current level of output, the firm is not producing at the lowest AC, so it is not productively efficient.



Tips: Make sure your MC and AC curves cross at the lowest AC.
A common mistake is to show P_M where MC=MR – remember to go up to AR!

Power Up: This diagram is also the diagram for **Monopoly in the SR** and **Monopolistic Competition in the SR**.

By drawing the curves so that AC=AR at the profit maximising output, it can be turned into the diagram for **Monopolistic Competition in the LR**.

By adding in equilibria where AC=AR, it can be turned into the diagram to show a **contestable** monopoly.

This diagram can also be used to compare objectives of the firm. It already shows output for **profit maximisation**. By adding in equilibria where MR=0 shows **revenue maximisation** and where AC=AR shows **sales maximisation**.

Block 7: Rise in AD

Use an AD&AS diagram to analyse how a rise in AD will affect the four main macroeconomic objectives.

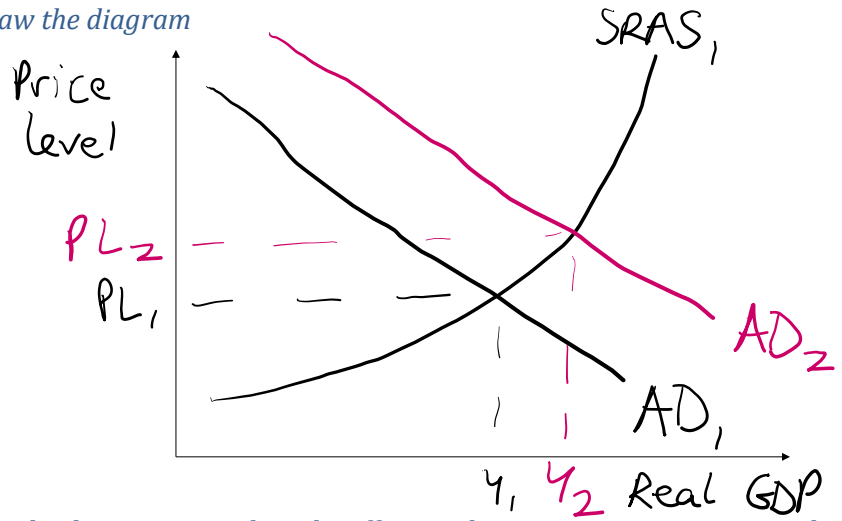
Need help? Revisit AD and AS flowchart and AD and AS questions.

This analysis is for a rise in consumer confidence. Change the words in italics to fit your scenario.

Step 1: first explain the effect(s) on AD, SRAS and/or LRAS

- If there is a rise in *consumer confidence*, this will lead to a rise in *consumption*.
- *Consumption* is a component of AD (AD=C+I+G+X-M), so there will be a rise in AD, so it shifts to the right from AD_1 to AD_2.

Step 2: draw the diagram



Step 3: use the diagram to explain the effect on the 4 main macroeconomic objectives

- Real GDP rises from Y_1 to Y_2.
  - This means that there is more (short run) economic **growth** in the economy.
  - Since the economy is producing more, and labour is a derived demand, it is likely that there would be more demand for labour. Therefore there will likely be less (cyclical) **unemployment.**
- Price level rises from PL_1 to PL_2.
  - This means that there is more (demand-pull) **inflationary pressure.**
  - As the prices of UK goods have risen, they may be less price competitive relative to other countries. Therefore we may export less and import more, so the **trade balance** may worsen.

Tips: *When there is a shift, use the 'rule of three' – the curve rises, shifts right, from AD_1 to AD_2.*

Power Up: AD&AS analysis is vital in macroeconomics. Be ready to analyse a fall in AD.
A rise in AD can be used to show so many ideas in macroeconomics, including:

- Expansionary fiscal policy (Govt. spending rises or taxation falls)
- Expansionary monetary policy (lower interest rates, QE)
- A fall in the exchange rate
- A conflict of objectives
- Demand-pull inflation

Block 8: Rise in LRAS

Use an AD&AS diagram to analyse how a rise in LRAS will affect the four main macroeconomic objectives.

Need help? Revisit AD and AS flowchart and AD and AS questions.

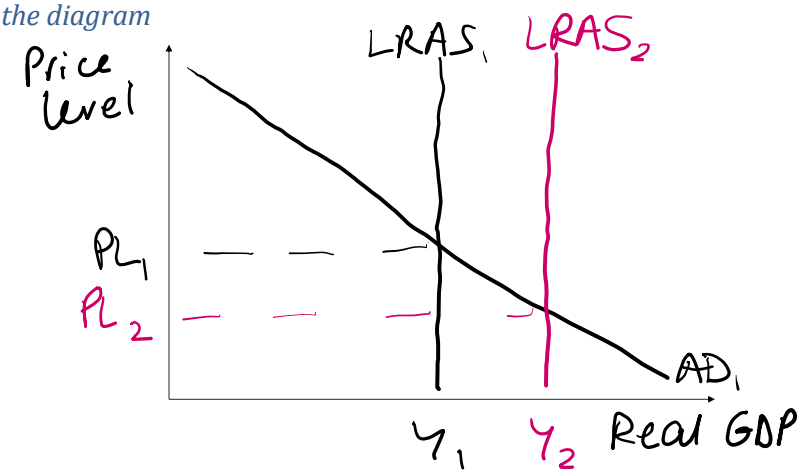
This analysis is for an improvement in education. Change the words in italics to fit your scenario.

Step 1: first explain the effect(s) on AD, SRAS and/or LRAS

If there is an improvement in *education*, this will *improve the human capital of the nation*, leading to an increase in the productive capacity.

This will lead to a rise in Long Run Aggregate Supply, so it shifts to the right, from $LRAS_1$ to $LRAS_2$.

Step 2: draw the diagram



Step 3: use the diagram to explain the effect on the 4 main macroeconomic objectives

- Real GDP rises from Y_1 to Y_2.
  - This means that there is more (long run) economic **growth** in the economy.
  - Since the economy is producing more, and labour is a derived demand, there is more demand for labour. Furthermore, the improved human capital means workers are more productive and more employable. Therefore there will be less **unemployment.**
- Price level falls from PL_1 to PL_2.
  - This means that there is less **inflationary pressure.**
  - As the prices of UK goods have fallen, they may be more price competitive relative to other countries. Therefore we may export more and import less, so the **trade balance** may improve.
- All four objectives have improved, so the improvement in education was very beneficial to the UK economy.

Tips: *When there is a shift, use the 'rule of three' – the curve rises, shifts right, from $LRAS_1$ to $LRAS_2$.*

Power Up: A rise in LRAS can be used to show:

- Supply-side policy
- Anything that causes a rise in the quantity or quality of capital, enterprise, land or labour

Block 9: NICE

Use an AD&AS diagram to analyse how 'Non-Inflationary Continuous Expansion' can be achieved

Need help? Revisit AD and AS flowchart and AD and AS questions.

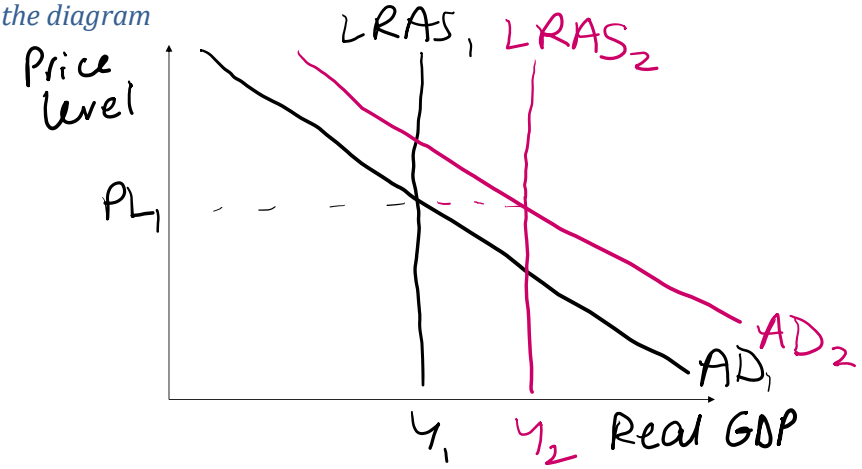
This analysis is for a rise in investment. Change the words in italics to fit your scenario.

Step 1: first explain the effect(s) on AD, SRAS and/or LRAS

If there is a rise in investment, investment is a component of AD (AD=C+I+G+X-M), so there will be a rise in AD, so it shifts to the right from AD_1 to AD_2.

The rise in investment leads to an increase in capital in the economy, therefore there is a rise in the productive capacity. Therefore there is a rise in LRAS, so it shifts to the right from $LRAS_1$ to $LRAS_2$.

Step 2: draw the diagram



Step 3: use the diagram to explain the effect on the 4 main macroeconomic objectives

- Real GDP rises from Y_1 to Y_2.
  - This means that there is more economic **growth** in the economy, both short run and long run.
  - Since the economy is producing more, and labour is a derived demand, it is likely that there would be more demand for labour. Therefore there will likely be less **unemployment.**
- Price level may rise, fall or stay the same depending on the relative size of the shifts of AD and LRAS. On my diagram it remains unchanged at PL_1.
  - This means that **inflation** is relatively stable.
  - Prices are stable, relative to other countries, so there is likely to be little change to the **trade balance**.
- Two objectives have improved and two have not been significantly affected, so the rise in investment was largely beneficial to the UK economy.

Power Up: This diagram can be used to show many ideas in macroeconomics, including:

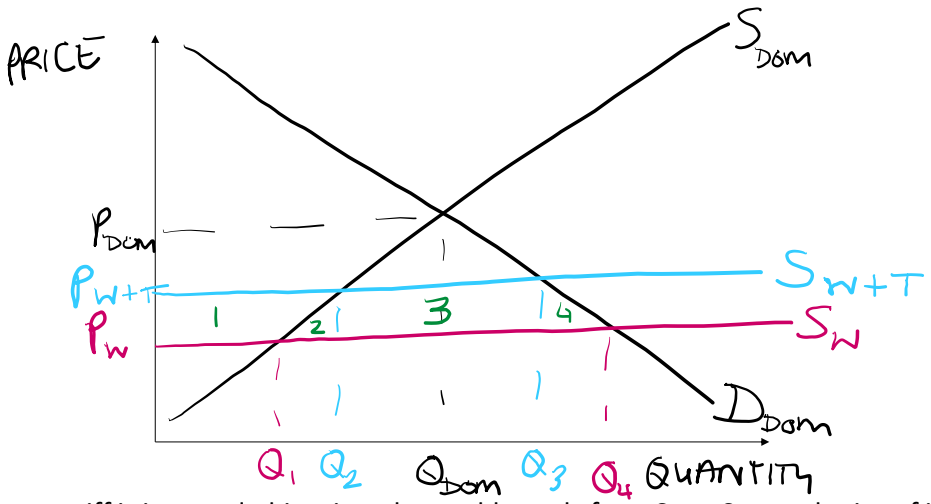
- Supply-side fiscal policy
- A rise in investment (increases both AD and LRAS)
- Inward FDI

Block 10: Tariff

Use a D&S diagram to show the effects of a tariff.

Note: Although this is from **macroeconomic** topic (trade), we need a **microeconomic diagram** because we study the effect of the tariff on the **market for a good/service.**

- If there is no trade, then the equilibrium price and quantity occur where Domestic Demand is equal to Domestic Supply, which is at P_{DOM} and Q_{DOM}.
- When there is free trade, then goods can be imported at the world price P_W. We assume that this country is too small relative to the world market to influence the world price, so the world supply S_W is perfectly elastic.
- The domestic producers produce a quantity Q_1, domestic consumers buy quantity Q_4 and quantity $Q_4 - Q_1$ is imported from abroad.



- When a tariff is imposed, this raises the world supply from S_W to S_{W+T} and price of imports from P_W to P_{W+T}.
- Domestic production increases from Q_1 to Q_2. Domestic buyers buy fewer goods, falling from Q_4 to Q_3. Imports fall from $Q_4 - Q_1$ to $Q_3 - Q_2$.
- Areas 1+2+3+4 show the fall in consumer surplus.
- Area 1 shows the rise in producer surplus for the domestic producers, area 3 is the amount of government revenue gained by the tariff.
- Areas 2+4 are the welfare loss from the tariff.

Power Up: This diagram can be slightly tweaked to show:

- Trade creation
- Trade diversion