

**A-Level Economics Guide**

**How is economics taught at NFS?**

* + 5 lesson per week
	+ Intuitively, graphically and mathematically
	+ Reading case and statistical data
	+ Problem solving to describe likely outcomes
	+ Discussions to prescribe solutions

**What does 100% effort look like?**

* Be on time and engage – every lesson!
* Be equipped and organised!
* Meet deadlines!
* Read, read, read!
* Don’t worry about getting it wrong!
* Never give up!

**What does marking look like?**

* Lots of ‘green pen’ self-assessment in lessons and verbal feedback
* Extended writing and mock assessments are teacher marked, with students improving their work with ‘green pen’ amendments and notes

**What does homework look like?**

* Reading and watching video clips
* Practice questions
* Research

**What is on the learning syllabus and how are you assessed?**

**Learning**

* Microeconomics (supply and demand, market structures, market failure)
* Macroeconomics (inflation, unemployment, growth and government policy instruments)
* Global economics (trade, trade accounts, exchange rates, development)

**Assessment**

* Multichoice questions; mathematical application questions; descriptive and prescriptive essays (final external assessment is 100% examination)

**Summer preparation – Let’s get you started by thinking about 4 KEY PRINCIPLES OF ECONOMICS!**

**Answers can be typed or handwritten and must be ready for your first NFS economics lesson. YOU WILL BE USING YOUR ANSWERS DURING THE LESSON!**

**Principle 1: Do I face trade-offs?**

You may have heard the old saying, “There ain’t no such thing as a free lunch.” Grammar aside, there is much truth to this saying. To get something that we like, we usually have to give up something else that we also like. Making decisions requires trading off one goal against another.

Consider a student who must decide how to allocate her most valuable resource—her time. She can spend all of her time studying economics, spend all of it studying psychology, or divide it between the two fields. For every hour she studies one subject, she gives up an hour she could have used studying the other. And for every hour she spends studying, she gives up an hour she could have spent napping, bike riding, watching TV, or working at her part-time job for some extra spending money.

Consider parents deciding how to spend their family income. They can buy food, clothing, or a family vacation. Or they can save some of the family income for retirement or the children’s college education. When they choose to spend an extra dollar on one of these goods, they have one less dollar to spend on some other good.

When people are grouped into societies, they face different kinds of trade-offs.

One classic trade-off is between “guns and butter.” The more a society spends on national defence (guns) to protect its shores from foreign aggressors, the less it can spend on consumer goods (butter) to raise the standard of living at home. Also important in modern society is the trade-off between a clean environment and a high level of income. Laws that require firms to reduce pollution raise the cost of producing goods and services. Because of these higher costs, the firms end up earning smaller profits, paying lower wages, charging higher prices, or some combination of these three. Thus, while pollution regulations yield the benefit of a cleaner environment and the improved health that comes with it, they come at the cost of reducing the incomes of the regulated firms’ owners, workers, and customers.

Another trade-off society faces is between efficiency and equality. Efficiency means that society is getting the maximum benefits from its scarce resources. Equality means that those benefits are distributed uniformly among society’s members. In other words, efficiency refers to the size of the economic pie, and equality refers to how the pie is divided into individual slices. When government policies are designed, these two goals often conflict. Consider, for instance, policies aimed at equalizing the distribution of economic well-being. Some of these policies, such as the welfare system or unemployment insurance, try to help the members of society who are most in need. Others, such as the individual income tax, ask the financially successful to contribute more than others to support the government. Though they achieve greater equality, these policies reduce efficiency. When the government redistributes income from the rich to the poor, it reduces the reward for working hard; as a result, people work less and produce fewer goods and services. In other words, when the government tries to cut the economic pie into more equal slices, the pie gets smaller.

Recognizing that people face trade-offs does not by itself tell us what decisions they will or should make. A student should not abandon the study of psychology just because doing so would increase the time available for the study of economics.

Society should not stop protecting the environment just because environmental regulations reduce our material standard of living. The poor should not be ignored just because helping them distorts work incentives. Nonetheless, people are likely to make good decisions only if they understand the options that are available to them. Our study of economics, therefore, starts by acknowledging life’s trade-offs.

**Written task 1: Describe an important trade-off you recently faced. (100 words)**

**Principle 2: What is the true cost of a decision I make?**

Because people face trade-offs, making decisions requires comparing the costs and benefits of alternative courses of action. In many cases, however, the cost of an action is not as obvious as it might first appear.

Consider the decision to go to university. The main benefits are intellectual enrichment and a lifetime of better job opportunities. But what are the costs? To answer this question, you might be tempted to add up the money you spend on tuition, books, room, and rent. Yet this total does not truly represent what you give up to spend a year in university.

There are two problems with this calculation. First, it includes some things that are not really costs of going to university. Even if you quit school, you need a place to sleep and food to eat. Room and board are costs of going to college only to the extent that they are more expensive at college than elsewhere. Second, this calculation ignores the largest cost of going to college—your time. When you spend a year listening to lectures, reading textbooks, and writing papers, you cannot spend that time working at a job. For most students, the earnings they give up to attend school are the single largest cost of their education.

The opportunity cost of an item is what you give up to get that item. When making any decision, decision makers should be aware of the opportunity costs that accompany each possible action. In fact, they usually are. University athletes who can earn millions if they drop out of school and play professional sports are well aware that their opportunity cost of attending college is very high. It is not surprising that they often decide that the benefit of a college education is not worth the cost.

**Written task 2: Describe the true cost of you attending NFS 6th Form and studying A Level courses. (100 words)**

**Principle 3: Am I thinking rationally?**

Economists normally assume that people are rational. Rational people thoroughly and purposefully do the best they can to achieve their objectives, given the available opportunities. As you study economics, you will encounter firms that decide how many workers to hire and how much of their product to manufacture and sell to maximize profits. You will also encounter individuals who decide how much time to spend working and what goods and services to buy with the resulting income to achieve the highest possible level of satisfaction.

Rational people know that decisions in life are rarely black and white but usually involve shades of grey. At dinnertime, the question you face is not “Should I fast or eat like a pig?” More likely, you will be asking yourself “Should I take that extra spoonful of mashed potatoes?” When exams roll around, your decision is not between blowing them off and studying 24 hours a day but whether to spend an extra hour reviewing your notes instead of watching TV. Economists use the term marginal change to describe a small incremental adjustment to an existing plan of action. Keep in mind that margin means “edge,” so marginal changes are adjustments around the edges of what you are doing. Rational people often make decisions by comparing marginal benefits and marginal costs.

For example, suppose you are considering calling a friend on your smart phone. You decide that talking with her for 10 minutes would give you a benefit that you value at about £7. Your smart phone service costs you £40 per month plus £0.50 per minute for whatever calls you make. You usually talk for 100 minutes a month, so your total monthly bill is £90 (£0.50 per minute times 100 minutes, plus the £40 fixed fee). Under these circumstances, should you make the call? You might be tempted to reason as follows: “Because I pay £90 for 100 minutes of calling each month, the average minute on the phone costs me £0.90. So a 10-minute call costs £9. Because that £9 cost is greater than the £7 benefit, I am going to skip the call.”

That conclusion is wrong, however. Although the average cost of a 10-minute call is £9, the marginal cost—the amount your bill increases if you make the extra call—is only £5. You will make the right decision only by comparing the marginal benefit and the marginal cost. Because the marginal benefit of £7 is greater than the marginal cost of £5, you should make the call. This is a principle that people innately understand: Smart phone users with unlimited minutes (that is, minutes that are free at the margin) are often prone to making long and light-hearted calls.

Marginal decision-making can help explain some otherwise puzzling economic phenomena. Here is a classic question: Why is water so cheap, while diamonds are so expensive? Humans need water to survive, while diamonds are unnecessary. Yet people are willing to pay much more for a diamond than for a cup of water. The reason is that a person’s willingness to pay for a good is based on the marginal benefit that an extra unit of the good would yield. The marginal benefit, in turn, depends on how many units a person already has. Water is essential, but the marginal benefit of an extra cup is small because water is plentiful. By contrast, no one needs diamonds to survive, but because diamonds are so rare, people consider the marginal benefit of an extra diamond to be large. A rational decision maker takes an action if and only if the marginal benefit of the action exceeds the marginal cost. This principle explains why people use their smart phones as much as they do, why airlines are willing to sell tickets below average cost, and why people are willing to pay more for diamonds than for water. It can take some time to get used to the logic of marginal thinking, but the study of economics will give you ample opportunity to practice.

**Written task 3:** *Thinking at the margin works for business decisions as well. Consider an airline deciding how much to charge passengers who fly standby. Suppose that flying a 200-seat plane across the UK costs the airline £100,000. In this case, the average cost of each seat is £100,000/200, which is £500. One might be tempted to conclude that the airline should never sell a ticket for less than £500. But a rational airline can increase its profits by thinking at the margin. Imagine that a plane is about to take off with 10 empty seats and a standby passenger waiting at the gate is willing to pay £300 for a seat. The marginal cost for this passenger would be the free drink issued as part of the ticket.* **Should the airline sell the ticket? (100 words plus calculations)**

**Principle 4: Do people respond to incentives? Always!**

An incentive is something (such as the prospect of a punishment or reward) that induces a person to act. Because rational people make decisions by comparing costs and benefits, they respond to incentives. You will see that incentives play a central role in the study of economics. One economist went so far as to suggest that the entire field could be summarized as simply “People respond to incentives. The rest is commentary.” Incentives are key to analysing how markets work. For example, when the price of an apple rises, people decide to eat fewer apples. At the same time, apple orchards decide to hire more workers and harvest more apples. In other words, a higher price in a market provides an incentive for buyers to consume less and an incentive for sellers to produce more. As we will see, the influence of prices on the behaviour of consumers and producers is crucial to how a market economy allocates scarce resources.

Public policymakers should never forget about incentives: Many policies change the costs or benefits that people face and, as a result, alter their behaviour. A tax on petrol, for instance, encourages people to drive smaller, more fuel-efficient cars.

That is one reason people drive smaller cars in Europe, where petrol taxes are high, than in the UK, where petrol taxes are low. A higher petrol tax also encourages people to carpool, take public transportation, and live closer to where they work. If the tax were larger, more people would be driving hybrid cars, and if it were large enough, they would switch to electric cars.

When policymakers fail to consider how their policies affect incentives, they often end up facing unintended consequences. For example, consider public policy regarding auto safety. Today, all cars have seat belts, but this was not true 60 years ago. In 1965, Ralph Nader’s book Unsafe at Any Speed generated much public concern over auto safety. Government responded with laws requiring seat belts as standard equipment on new cars.

How does a seat belt law affect auto safety? The direct effect is obvious: When a person wears a seat belt, the probability of surviving an auto accident rises. But that’s not the end of the story because the law also affects behaviour by altering incentives. The relevant behaviour here is the speed and care with which drivers operate their cars. Driving slowly and carefully is costly because it uses the driver’s time and energy. When deciding how safely to drive, rational people compare, perhaps unconsciously, the marginal benefit from safer driving to the marginal cost.

As a result, they drive more slowly and carefully when the benefit of increased safety is high. For example, when road conditions are icy, people drive more attentively and at lower speeds than they do when road conditions are clear.

Consider how a seat belt law alters a driver’s cost–benefit calculation. Seat belts make accidents less costly because they reduce the likelihood of injury or death.

In other words, seat belts reduce the benefits of slow and careful driving. People respond to seat belts as they would to an improvement in road conditions—by driving faster and less carefully. The result of a seat belt law, therefore, is a larger number of accidents. The decline in safe driving has a clear, adverse impact on pedestrians, who are more likely to find themselves in an accident but (unlike the drivers) don’t have the benefit of added protection. At first, this discussion of incentives and seat belts might seem like idle speculation. Yet in a classic 1975 study, economist Sam Peltzman argued that auto-safety laws have had many of these effects. According to Peltzman’s evidence, these laws give rise to fewer deaths per accident but also to more accidents. He concluded that the net result is little change in the number of driver deaths and an increase in the number of pedestrian deaths.

Peltzman’s analysis of auto safety is an offbeat and controversial example of the general principle that people respond to incentives. When analysing any policy, we must consider not only the direct effects but also the less obvious indirect effects that work through incentives. If the policy changes incentives, it will cause people to alter their behaviour.

**Written task 4: Describe an incentive your parents offered to you, in an effort to influence your behaviour. Did it work? (100 words)**