Economics Key Terms: Section 1

The Basic Economic Problem

Wants	Desires for goods and services. Our wants are limitless - the more we have the more our wants continue to increase.	Economic Good	A product which requires resources to produce it and therefore has an opportunity cost.
Resources	Factors used to produce goods and services.	Free Good	A product which does not require any resources to make it and so does not have an opportunity cost
The economic Problem	Unlimited wants exceeding finite resources.	Capital/ Capital Goods	NOT MONEY - like in business. Man-made (manufactured) goods that are not wanted for their own sake, but so that they can be used in the production of other goods /services, e.g. offices, factories, machinery, railways and tools. AKA producer goods. Mobility of capital depends on the physical ease with which something can be moved (geographical), e.g. a dock or mine is fixed to a place, a photocopier isn't, and if it can be used for different purposes (occupational), e.g. the dock cannot change purpose, but a photocopier can be used by different organisations and business sectors. Quantity of capital is dependent on investment. Quality of capital can improve with advances in technology
Scarcity	A situation where there is not enough to satisfy everyone's wants.	Labour	Human effort used in producing goods and services. Also known as human capital. Geographically mobility: housing prices, family ties, children's education, lack of job info, work visas restrictions, etc. Occupationally mobile: level of transferable skills, e.g. unskilled, trained in a very specific job etc. Quantity: number of workers (size/age of population, retirement/school leaving age, attitude to female employment) and the hours (average working day, full/part-time, overtime, holidays, illness) they can work. Quality: training, education, healthcare and experience.
Factors of Production	The economic resources of land, labour, capital and enterprise. In the short-term there is likely to be at least one fixed factor of production, generally it is capital.	Land	Gifts of nature available for production, e.g. physical land, the vegetation on the land, the sun and rain Most land is occupationally mobile, so a field can be use for farming or building, and a tree for fuel or benches. Land in the traditional sense is geographically immobile. Land in its wider meaning can be moved a certain extent, e.g. diverting a river, or moving wildlife. Quantity of physical land does not change much over time, but land in its wider sense can change quite significantly, e.g. depletion of rainforests, fishing stocks, use of oil. Renewable resources e.g wind are replenished by nature. Quality of land depends on pos or neg human impact.

Enterprise	Risk bearing and key decision making in business. Risk can be minimised through insurance, but ultimately most of the risk (and rewards) lie with the entrepreneur. Enterprise is the most mobile factor of production (both occupationally and geographically) - the skills needed to be an entrepreneur apply to all industries. Quantity increases with better education systems, tax systems and regulations, Also necessity of entrepreneur e.g. the rise of 'kitchen table' businesses during times of recession. Quality of enterprise will increase with education, training, healthcare and experience	Labour Force	People in work and those actively seeking work.
Consumer Goods	Goods and services brought by households for their own satisfaction.	Productivity	The output per factor of production in an hour.
Occupational Mobility of factors of production	**Capability of changing use.** Land: A tree can be used for housing or furniture Labour: dependent on skills, education, training etc. Capital: a mine cannot change uses, a van can Enterprise: a successful entrepreneur should be able to work in any field. Immobility can lead to market failure	Labour Productivity	Output per worker per hour.
Geographical Mobility of factors of production	**Capability of moving from one location to another.** Land: a field cannot move, wildlife can Labour: depends on housing, family, schools, information, visas etc. Capital: a dock cannot move areas but machinery can Enterprise: a successful entrepreneur should be able to operate well in any country.	Output	Goods and services produced by the factors of production.
Depreciation (capital consumption)	The value of capital goods that have worn out or become obsolete.	Investment (gross investment)	Spending on capital goods. Gross investment is total spending on capital goods.

Net Investment

Gross investment — depreciation
Negative net investment is where capital goods have become obsolete or depreciating at a faster rate than the money being invested in capital goods.

Production Possibility Curve 2

A point inside the curve means all resources are not being used to their full capacity.
A point outside of the curve means what may be produced in the future.
Movements along the curve show the opportunity cost of one decision over another.
A shift 'out' in the curve means there is an increase in the quality or quantity of resources, so more can be produced.
A shift 'in' means there is a decrease in the quality or quantity of resources, so less can be produced.
Capital goods Vs consumer goods - macro economy
Product X Vs product Y - micro economy

Quality of factors of production

How good.
Land: pollution, fertiliser etc.
Labour: training, education, healthcare, experience etc.
Capital: investment/depreciation
Enterprise: training, education, healthcare, experience.

Quantity of factors of production

How many.
Land: physical land changes little, renewable resources will replenish naturally, non-renewable resources will diminish. some renewable resources will become non-renewable if exploited too much.
Labour: working population, age of retirement/ school leaving, women in work etc.
Capital: level of investment
Enterprise: political environment, taxes, education, need, regulation.

Factors Influencing Demand for Capital Goods

- Price of capital goods
- price of other factors of production
- profit levels
- corporation tax
- consumer income
- interest rates
- confidence levels
- advances in technology

Opportunity Cost

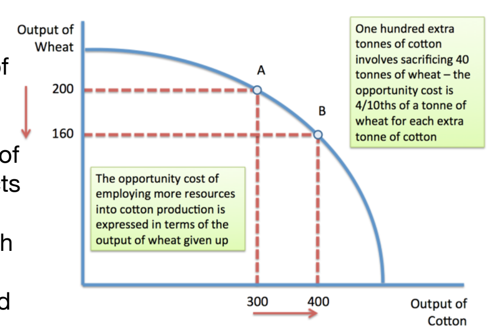
The best alternative forgone.
It influences the decision making of:
consumers
workers
producers
government

Factors influencing Demand for Land

- Productivity of land, e.g. fertile = higher rates
- Prime locations, near customer/consumer
- Near resources/infrastructure etc.

Production Possibility Curve 1

A curve that shows the max output of two types of products and combination of those products that can be produced with existing resources and technology.
(picture Turor2u)



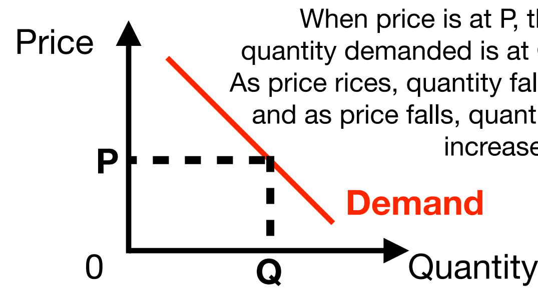
Labour-intensive Vs Capital-intensive Production

Labour
Pros: can be cheaper in some countries; not worth buying machinery for small scale production; consumers demand high quality/custom-made over mass-production; workers are more flexible in where and how they work than machinery; labour give feedback and can improve over time.
Capital
Pros: Advances in tech can make capital goods cheaper and more productive than labour; can produce more uniform products; don't have to negotiate with them; can breakdown and need to be maintained, but do not become ill or take time off.

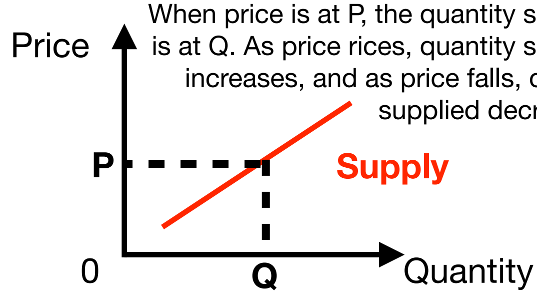
Economic Key Terms: Section 2

The allocation of resources

Microeconomics	The study of the behaviour and decisions of households and firms, and the performance of individual markets (e.g. fast-food, or car industry)	Private Sector	Firms owned by shareholders and individuals. Aims: maximise profit growth (including staying in business if a start up) increase market share maximise sales Sometimes they aim to benefit the community and workers too, e.g. co-ops, 1800s Quaker businesses (Bourneville and Lever Brothers)
Macroeconomics	The study of the whole economy (e.g. countrywide employment rates, GDP etc.). The macroeconomic is made up of all the microeconomies.	Economic system	The institutions, organisations and mechanisms that influence economic behaviour and determine how resources are allocated. There are three main economic systems: **planned, mixed** and **market.**
Market	An arrangement which brings buyers into contact with sellers.	Planned (Command) economic system	An economic system where the government makes the crucial decisions on what to produce, how to produce it and who receives it (through controlling how much people are paid and what the prices are). Land and capital are state-owned and resources are allocated by **directives.**
Economic Agents	Those who undertake economic activities and make economic decisions, including: households (buyers, consumers, savers, workers), firms (producers, employers, buyers) and governments (producers, taxers, regulators, buyers).	Directives	State instructions given to state-owned enterprises (SOE)s.
Mixed Economic System	**An economy in which both the private and public sectors play an important role.** Both the price mechanism and the gov't decide the use of resources, so as to get the best out of the planned and market economic system (but it can fail). **Benefits of private sector:** choice, efficiency, incentives **Benefits of state intervention**: take into account externalities; can encourage use of merit good and dissuade use of demerit; ensures the production of unprofitable necessary goods; can prevent consumer exploitation & help vulnerable groups; gov't may plan ahead further than a private co.; and minimise inequality.	Market (Free Enterprise) Economic System	An economic system where consumers determine what is produced, resources are allocated by the **price mechanism** and land and capital are privately owned. Government intervention is minimal, and those with the most money have the biggest influence on what is produced. Competition leads to lower prices, better quality and greater choice for customers, it can also lead to greater company efficiency. Potential competition means it is easy for firms to enter or leave the industry. In theory, the customer is king when deciding what will be made. The free market can also be applied to the labour market,

Price Mechanism	**The way the decisions made by a household and firms interact to decide the allocation of resources.** The price mechanism rations out products when the supply falls short of demand by pushing up prices until market equilibrium is restored.	Supply	**The willingness and ability to sell a product.**
Capital-intensive	**The use of a high proportion of capital relative to labour.**	Market equilibrium	**A situation where demand and supply are equal at the current price.** Disequilibrium is where supply and demand are not equal at the current price.
Labour-intensive	**The use of a high proportion of labour relative to capital.**	Market Demand	**Total or aggregate demand for a product:** Calculated by adding up each individual's demand at the different prices. This calculation is called **aggregation** of market demand.
Demand	**The willingness and ability to buy a product.**	Aggregation	The addition of individual components to arrive at a total amount.
Demand Curve	Must be fully labelled, large and clear enough to read and explained by accompanying text. When price is at P, the quantity demanded is at Q. As price rices, quantity falls, and as price falls, quantity increases. 	Extension in demand	A rise in the quantity demanded caused by a fall in the price of the product itself. Also known as an 'expansion in demand' or 'an increase in the quantity demanded', and all indicate that this is because of a change in the price of the product.

Change(s) (shifts) in Demand	Due to a change in the 'conditions of demand', such as warm weather on the jumpers market, or climate change awareness on the car market. The only thing that can cause a movement along a demand curve is a change in the price of the product itself. Anything else that causes demand to change would be shown by a shift. Causes include: **weather, expectation of future events, changes in income, changes in price of related products, ad campaigns, changes in population and changes in fashion and taste.**	Contraction in Demand	**A fall in the quantity demanded caused by a rise in the price of the product itself.** AKA 'a decrease in the quantity demanded'.
Increase in Demand	A rise in demand at any given price, causing the demand curve to shift to the right.	Normal goods	A product who has a positive relationship with income, so whose demand increases when income increases and decreases when income falls. E.g. luxury holidays.
Decrease in Demand	A fall in demand at any given price, causing the demand curve to shift to the left.	Inferior goods	A product who has a negative relationship with income, so whose demand decreases when income increases and increases when income falls. E.g. own brand tinned tomato sauce as people switch to the branded version.
Substitute	A product that can be used in place of another.	Complement	A product that is used together with another product.
Ageing population	An increase in the average age of the population.	Birth rate	The number of live births per thousand of the population in a year.

Market Supply	**Total supply of a product.** Not the amount produced as some of the supply may have come from stored produce, and so of the produce may be stored for later supply. Calculated by adding up each individual companies' supply at the different prices. This calculation is called **aggregation** of market supply.	Extension in Supply	A rise in the quantity supplied caused by a rise in the price of the product itself.
Supply Curve	Must be fully labelled, large and clear enough to read and explained by accompanying text. When price is at P, the quantity supplied is at Q. As price rices, quantity supplied increases, and as price falls, quantity supplied decreases . 	Change(s) (shifts) in Supply	Changes in supply conditions causing shifts in the supply curve. E.g. good weather increasing harvest. Causes include: changes in costs of production, improvement in technology, taxes, subsidies, weather, health of livestock, price of other products, disasters, wars, new sources of the same product, or depletion of the same product. Change in price leads to extension/contraction, every other change will lead to a shift.
Contraction in Supply	A fall in the quantity supplied by a fall in the price of the product itself.	Increase in Supply	A rise in supply at any given price, causing the supply curve to shift to the right.
Decrease in Supply	A fall in supply at any given price, causing the supply curve to shift to the left.	Unit Cost	The average cost of production. It is calculated by dividing total cost by output.
Improvements in technology	Advances in the quality of capital goods and methods of production	Taxes	A payment to the government. Direct taxes: taxes on the income and wealth go individuals and firms, e.g. income tax Indirect taxes: taxes on goods and services, e.g. VAT

Subsidy

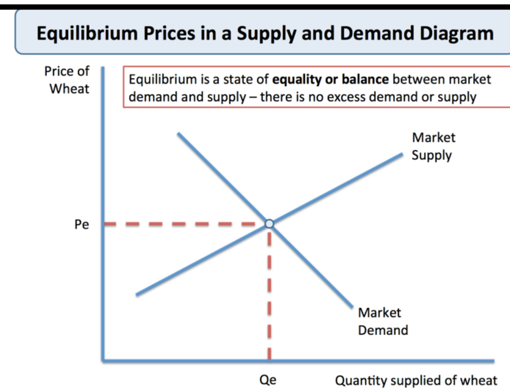
A payment by a government to encourage the production or consumption of a product.

Can be used as a form of trade protection, or to promote merit goods.

Excess Demand

The amount by which demand is greater than supply.
(See disequilibrium)

Equilibrium Price
(tutor2u image)



Effect of Changes in Demand

Increase in Demand = excess demand = rise in Price and then an extension in Supply.

Decrease in demand = excess supply = drop in price and a contraction in the supply curve,

Excess Supply

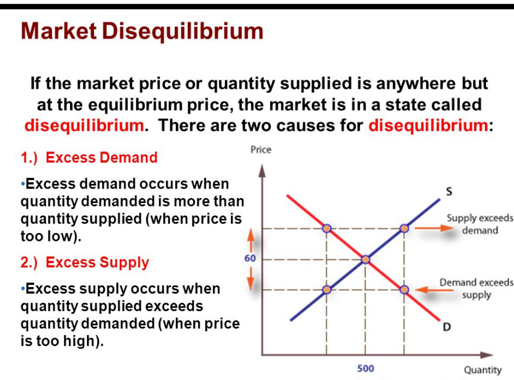
The amount by which supply is greater than demand.
(See disequilibrium)
Movement from disequilibrium to equilibrium should be shown on a S&D curve with arrows illustrating the movement.

Effect of Changes in Supply

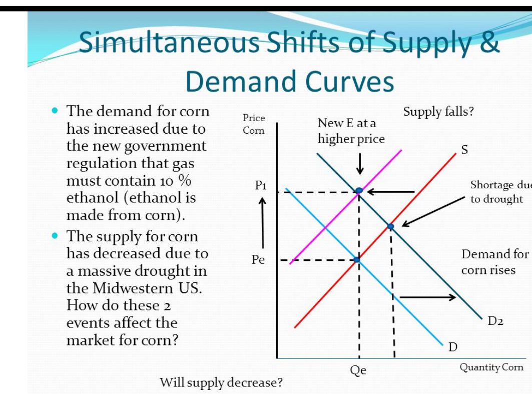
Find picture P69

Increase in S = decrease in P and then an extension of D.

Disequilibrium
(slideplayer.com)



Changes in Supply and Demand
(slideplayer.com)



Price Elasticity of Demand (PED)

A measure of the extent to which the Q Ded changes as a result of a change in P.

PED = Percentage change in quantity demanded / Percentage change in price

OR

PED = %ΔQD / %ΔP

[%ΔQD = change in D / original Q Ded X 100) [%ΔP = change in P / original P X 100)

A minus answer = a rise in P, & a resulting drop in D, and + = ↓P, ↑D. The number says how much demand will extend or contract with price changes. E.g.-2, means a 1% change in P = 2% change in D, 1 = 1%Δ in P = 1%Δ in D, 4 = 1%Δ in P = 4%Δ in D.

Elasticity of Demand

When the quantity demanded changes by a greater percentage than the change in price.
Price sensitive - a small change in price makes a bigger change in demand, e.g. Carling larger - highly substitutable with minimal brand loyalty. A drop in price will attract customers from the competition, increasing demand.
(Inelastic: ↑Δ in P = ↑ total rev. Elastic: ↑Δ in P = ↓ total rev.)
A shallow demand curve, heading towards the horizontal.
(PED more than 1, ignoring sign)

Inelasticity of demand

When the quantity demanded changes by a smaller percentage than the percentage change in price. Only when demand is perfectly inelastic will demand not change with price.

Price insensitive - a raise in price makes a minimal change in demand, e.g. milk or bread - a basic that is not easily substitutable. A drop in price will not make people buy much more as you can only consume so much.
(Inelastic: ↑Δ in P = ↑ total rev. Elastic: ↑Δ in P = ↓ total rev.)
Steep demand curve , heading towards the vertical
(PED is less than 1, but greater than 0, ignoring the sign)

PED and Decision Making

Change in P is one of the biggest influences on demand.
When D is elastic customers get better quality (if close subs) and cheaper prices.
↓ P = ↑ D, but possibly not by enough to ↑ total revenue.
An ↑ in D will make **D** more **inelastic;** The more everyone wants a dachshund, the more insensitive to P demand becomes - who wouldn't pay £1tn for Bernard?
Making a product more distinctive (giving it a USP - unique selling point) makes a product more price inelastic, and gives the producer more power to up the prices.
As P ↑, D becomes more elastic.
Taxing is a way to artificially raise P & reduce consumption.

Determinants of Price Elasticity of Demand

- substitutes (close subs = elastic D in response to Δ in P, no sub = inelastic D)
- % of income (Y) spent on product / %Δ in P of a cheap item Vs a dear one (small % of Y = inelastic/10% on £1 = small impact, D stays up, 10% on £1000 = big impact, D falls; elastic) - Items become more elastic the higher P.
- Product necessity (inelastic) / luxury (elastic)
- Product addictive (inelastic) or not (elastic)
- Whether purchase can be postponed (elastic)
- how market is defined (narrow definition = many subs = elastic), tea Vs PG Tips
- time period under consideration (+time = elastic)

Price Elasticity of Supply (PES)

A measure of the responsiveness of the quality supplied to a change in price.

$$\text{PES} = \frac{\text{Percentage change in quantity supplied}}{\text{Percentage change in price}}$$

OR

$$\text{PES} = \frac{\%\Delta QS}{\%\Delta P}$$

$[\%\Delta QS = \frac{\text{change in QS}}{\text{original Q Sed}} \times 100)$ $[\%\Delta P = \frac{\text{change in P}}{\text{original P}} \times 100)$

The higher the figure, the more responsive (elastic) S is to P.
A PES of 3.7 means a 1% rise in P = a 3.7% extension in S, And a PES of 0.5 means a 1% rise in P = a 0.5% extension in S.
When PES = >1, S is **elastic**. When PES = <1, S is **inelastic**

Perfectly Elastic Demand

(https://www.tutor2u.net/economics/reference/price-elasticity-of-demand)

Perfectly Elastic Demand (Ped = infinity)

If the co-efficient of PED = infinity, then demand is perfectly elastic – there is one price at which consumers are prepared to pay

- If demand for a product is **perfectly elastic**, a change in market supply (shown on the right as an outward shift of supply) will not lead to any change in the equilibrium price. This demand curve applies to highly **competitive markets** where no supplier has any "pricing power"

Elastic Supply

When the quantity supplied changes by a greater percentage than the change in price.

Price sensitive - a raise in P = a larger raise in S, and a drop in P makes a larger drop in S
Shallow supply curve, heading towards the horizontal
(PES is greater than 1 but less than infinity)

Perfectly Inelastic Demand

(https://www.tutor2u.net/economics/reference/price-elasticity-of-demand)

Perfectly Inelastic Demand (Ped = 0)

If the co-efficient of price elasticity of demand = zero, demand is perfectly inelastic i.e. demand does not vary with a change in price

- A perfectly inelastic demand curve is an extreme case for it implies that consumers are willing and able to pay any price for the product. If supply falls, equilibrium market price can rise without any contraction in the quantity demanded

Inelastic Supply

When the quantity supplied changes by a smaller percentage than the change in price.

Price insensitive - a raise in P = a smaller raise in S, and a drop in P makes a smaller drop in S
E.g. arable crops are inelastic, because no matter what the price, the quantity produced will take at least a year to change. (Some produce can be made more elastic moving produce to a different place or market)
Steep supply curve, heading towards the vertical
(PES is greater than 0 but less than 1)

Unit Elasticity of Demand

(https://www.tutor2u.net/economics/reference/price-elasticity-of-demand)

Unitary Elastic Demand (Ped = 1)

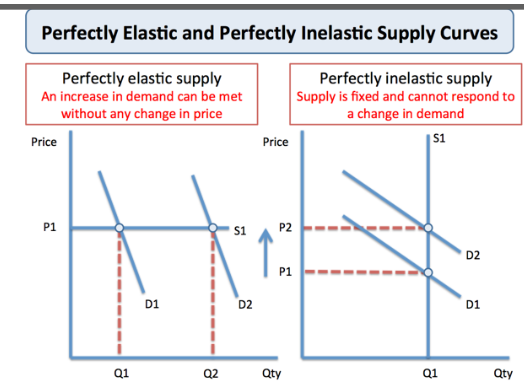
A demand curve with unitary price elasticity has a coefficient of PED equal to 1 (unity) throughout

- With a demand curve of **unitary price elasticity**, a change in price is met with a **proportionate change in demand**
- This means that **total spending** by consumers on the product **will remain the same** at each price level

Determinants of Price Elasticity of Supply

- time taken to produce it - A product made quickly has a low cost to altering supply, e.g. bread. A product made slowly has a large cost to altering supply, e.g.crops. The supply for most products become more elastic as the time period increases (selling/buying factories/offices etc., advances in tech, reducing production period).
- Cost of altering its supply - if producer has plenty of spare capacity, supply can be adjusted fairly quickly.
- Feasibility of storing it - if product can be stored it gives greater flexibility to quantity produced
- Ease with which to be able to shift markets, e.g. becoming a substitute for another unrelated product, so resources can be easily relocated

Perfectly Inelastic Supply
https://www.tutor2u.net/economics/reference/price-elasticity-of-supply



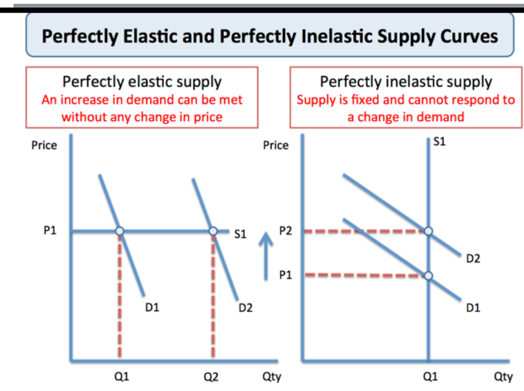
Public Sector

The part of the economy controlled by the government.

It covers gov't run services and **state-owned enterprises (SOEs)**, also called nationalised industries.

Aims: provide affordable services that the private sector don't or can't provide, utilise scarce resources to maximise a country's productivity, serve the community, create employment,

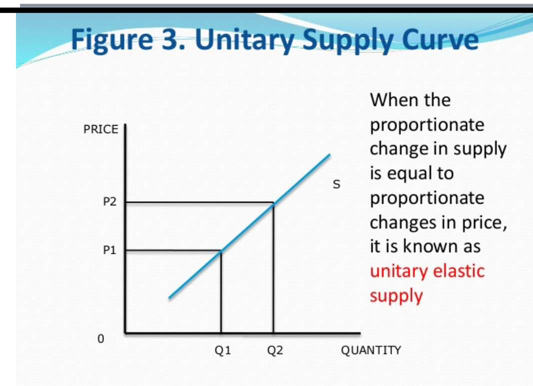
Perfectly Elastic Supply
https://www.tutor2u.net/economics/reference/price-elasticity-of-supply



State-owned Enterprises (SOEs)

Organisations owned by the government which sell products. Also known as nationalised industries.

Unit Elasticity of Supply (Unit PES)
https://www.slideshare.net/mahofuzmasum/micro-economics-unit-2



Price Mechanism

The system by which the market forces of demand and supply determine prices.

PES and Decision Making

Customers benefit from S being elastic, as it can be more responsive to consumer D, with P rising at a smaller % than the % change in D Sed
Producers also want elastic S as they can maximise profits in D booms and minimise loss in D dips.
Law can effect the ease with which firms take on and lose staff, strongly affecting elasticity of S.
Subsidies can significantly increase production when S is elastic, e.g. not charging tax on fuel for domestic flights. Subsidies on inelastic supply is generally for strategic reasons, e.g. maintaining food or oil production in your own country, keeping employment high or winning votes.

Market Failure

Market forces resulting in an inefficient allocation of resources.
When market forces fail to produce the products that consumers demand in the right quantities and at the lowest possible cost.
Indicators of market failure include: shortages, surpluses, high prices, poor quality, and lack of innovation.
Reasons for market failure: producers having more power than consumers, information failure, when external benefits and cost are not taken into account, immobility of resources, and short-termism.

Advantages of a Market Economic Systems

For the consumer:
- consumer is sovereign: has power over what's produced
- Consumer choice
- Lower costs and prices
- Higher quality of goods

For the company (some of the above also apply):
- Resources allocated in response to D: the **price mechanism** informs which products have ↑ing or ↓ing D; financial incentive for reallocating resources to high D goods; firms that don't adapt to D are punished.

For the country:
- desire for £ + high competition = firm/country efficiency
- Only products that are wanted are produced

Disadvantages of a Market Economic Systems

When **market** forces are not working well or **failing,** and not ensuring maximum benefit for society.
- Firms make decisions for themselves, not stakeholders.
- Competition not always there: natural monopolies or smaller competitors been pushed out of the market, = ↑P, ↓quality and little/no customer choice
- Ltd resources/workers may prevent responding to D
- Free riders prevent products being overly profitable, so producers don't want to produce
- Advertising distorts true D for a product, and with insufficient information, poor decisions are made.
- Can get inequality in Y = inequality in society. Without gov't intervention can become self-prepetuating.

Allocative Efficiency	When resources are allocated to produce the right products in the right quantities, thus improving consumer satisfaction. When a S&D curve is in equilibrium allocative efficiency has been achieved. When they are in disequilibrium there is allocative inefficiency - either resulting in a surplus or a shortage of the product produced. Market forces - changing price in response to S&D - move the market towards allocative efficiency. Firms that are allocative inefficient will be punished by competition and profit figures.	Free Rider	Someone who consumers a good or service without paying for it. E.g. one person in a sweet buys a high tech security system. Everyone in the street benefits, so no one else bothers buying it. As an economic issue, the problem occurs when everyone can consume a resource in unlimited amounts, no one can limit anyone else's consumption, but someone has to produce and maintain the resource. - Private companies generally refuse to provide them, so they become public services, e.g. armed forces, street lighting, etc.
Productively Efficient	When products are produced at the lowest possible cost and making full use of resources. When a firm or an economy is productively efficient, it will be operating right on its production possibility curve.	Third Parties	Those not directly involved in producing or consuming a product.
Dynamic Efficiency	Efficiency occurring over time as a result of investment and innovation.	Social Benefits	The total benefits to a society (i.e. private + social) of an economic activity.
Private Benefits	Benefits received by those directly consuming or producing a product.	Social Costs	The total costs to a society (i.e. private + social) of an economic activity.
Private Costs	Costs borne by those directly consuming or producing a product.	External Costs	**Costs imposed on those who are not involved in the consumption and production activities of others directly.** E.g. Those from living near a chemical factory, such as air, noise, water and visual pollution. Society needs less supply than individual demand (e.g. CO2 emissions), so the external costs on the s&d curve would be shown as a supply curve (titled Sx) to the left of S. When S&D and Sx&D are in equilibrium, Qx will be lower then Q. (p102) **Private costs** (of the individual consumer) **+ external costs** ((those to everyone else) **= Social costs**

External Benefit	**Benefits enjoyed by those who are not involved in the consumption and production activities of others directly.** Where the external benefits are greater to society than the benefits enjoyed by the consumer, it can be shown as a demand curve (titled Dx) drawn to the right of the D curve - society is demanding more of the product than any one individual, E.g. uni degrees - the more people have them the better for society, making Qx greater than Q, when S&D or S&Dx are in equilibrium. (p103) **Private costs** (of the individual consumer) **+ external costs (**(those to everyone else) **= Social costs**	Public Good	**A product which is non-rival (**one person using it doesn't prevent someone else using it), **non-excludable** (can't stop people who haven't paid for it from using it), **non-rejectable** (can't refuse the service), **and supplying to an extra person will make no difference to the costs, hence they need to be financed by taxation.** These are goods that wouldn't be made if the government didn't make them, such as, coastal defences, as private companies would not profit from it. The private sector may provide a service if the government is willing to pay.
Socially Optimum Output	**The level of output where social cost equals social benefit and society's welfare is maximised.** Any less than the optimum (where Dx does not equal D, and Sx does not equal S), by definition, means markets are failing to allocate their resources efficiently, for the benefit of society. Social cost > social benefit = road space by private cars. **Private costs** (of the individual consumer) **+ external costs (**(those to everyone else) **= Social costs**	Private Good	**A product which is both rival** (if one has it, another one can't) **and excludable** (if you don't pay for it, you can be prevented from using it). Most goods fit into this category, but it can also include such things as health care and education, as they can be charged on a case by case basis and if one person uses it, it prevents another from using it.
Merit Goods	**Products which the government considers consumers do not fully appreciate how beneficial they are and so which will be under-consumed (and therefore under-produced) if left to market forces. Such goods generate positive externalities.** E.g. health care - give info, and minimal cost/ subsidies/free so people know they should see a doctor if they get symptoms/need inoculating etc.. External benefit: less sick-leave, reduced spread of disease. Sometimes make it compulsory - e.g. seatbelts	Monopoly 1.	**A single seller, or multiple sellers acting as a single seller (cartels and price-fixing).** **Cons:** can lead to inefficiency, customer tastes ignored and new products not developed, price fixing, Governments may act against this by: removing restrictions that prevent new entrants entering the market, using Competition and Markets Authority (CMA) to prevent one company buying too much of the direct competition, making practices like price-fixing illegal.
Demerit Goods	**Products which the government considers consumers do not fully appreciate how harmful they are and so which will be over-consumed if left to market forces. Such goods generate negative externalities.** E.g. cigarettes, alcohol. Measures to curb demand include: banning, limiting use, tax, price rises, providing info on harmful effects.	Price fixing	When two or more firms agree to sell a product at the same price.
Immobility of Resources	When resources cannot be moved as needed to produce the products that are demanded. This may be for **geographical** or **occupational** reasons. Government can: improve education and provide new training for different sectors, investment grants for land and buildings to change uses, make houses cheaper for key workers in certain areas, financial help for moving workers to new locations.	Short-termism	When companies put short-term gains before long-term interests. E.g. making a profit today rather than investing the money for the future. Government can: simulate investment through tax cuts and subsidies, or do some investments itself.

Rationing

A limit on the amount that can be consumed.

Environmental Policies

Policies put in place to limit environmental damage done by businesses.
E.g. place restrictions on amount of pollutants emitted - Fines may be used to enforce policies, or permits, where any unused allowance can be sold to competitors.

Lottery

The drawing of tickets to decide who will get the products.

Regulation

Rules and laws which place restrictions on the activities of firms. E.g.
Regulating target audience
Quality of product
Methods of staff management.

Pro: They are backed by law and are easily understood.
Con: Often difficult and expensive to enforce, can create barriers to new entry, reduce market flexibility, doesn't directly compensate those who suffered due to market failure.

Maximum and MInimum Pricing

Can be set by the government.
Max: to limit price so that poor can afford it, e.g. gas. (needs to be below equilibrium price to have an impact) - to prevent over consumption at new lower price, rationing or lottery might be brought in.
Min: to encourage production of a product, e.g. labour minimum wage (needs to be above equilibrium price to have an impact) - to prevent over supply bringing down price, the gov't have to buy up surplus.

Nationalisation and Privatisation

State-owned enterprises
Pros: decisions made with full costs/benefits in mind; can influence economic activity; don't abuse power of natural monopolies; owning whole industry simplifies planning/coordination; ensures survival of basic industries for the benefit of all other industries, e.g. water. electricity
Cons:hard to manage/control; can be inefficient; subsidised if loss
Privatisation
Pros: more choice; less inefficiency; low prices; high quality; lower admin due to min gov't regs; faster response time to changing business environment; less risk of under-development
Cons:might not feel full pressure of market forces or competition (monopolies); may ignore externalities;; reduces gov't control of an economy.

Subsidies and Indirect Taxes

Indirect taxes: a tax levied on goods and services rather than profit or income, e.g. VAT, landfill tax, fuel, alcohol and tobacco duties.
Indirect taxes raise a firms' costs of production. Taxing inelastic goods raises gov't revenue. Taxing elastic products curbs consumption.
Subsidies: money given by the state to help an industry or business keep the price of a commodity or service low or to stimulate production.
If D is inelastic, it will have a big impact on the P. If D is elastic it will have a bigger impact on Q more than P.
Subs to suppliers shift the supply curve.
Subs to consumers shift the demand curve

Nationalisation

Moving the ownership and control of an industry from the private sector to the government.
Industries owned by the gov't are state-owned enterprises or public corporations. The chairman and board of directors are appointed by the gov't. There are no shareholders and the board is accountable to the gov't.
Funded: gov't, gov't approved loans or private sector.
Aim: to work in the public interest.

Competition Policy

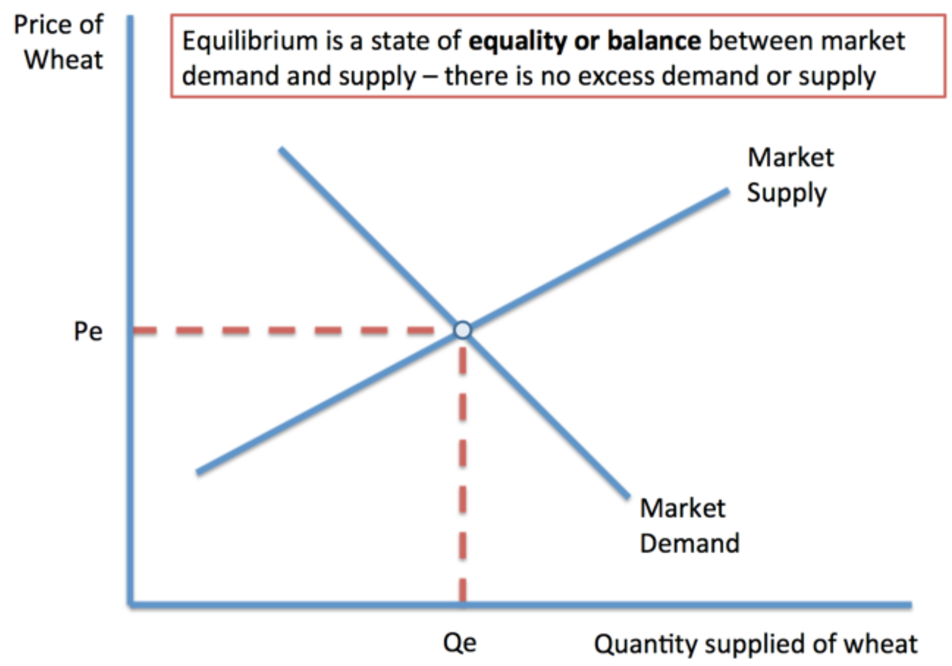
To prevent any one company having too much power.
How: prevention of mergers; removal of barriers to entry; regulation of monopolies; and prohibition of uncompetitive practices e.g. predatory pricing (low prices to push competition out of market), and limit pricing (setting price low to discourage new entrants).

Public Corporations

A business organisation owned by the government which is designed to act in the public interest.

		Direct Provision	Those goods and services a gov't produce that they think are essential, e.g. affordable housing to rent, education, healthcare.
		Government Intervention	**Reasons to intervene:** • Correct market failure • Equality/fairness/protect vulnerable groups **Possible issues:** • A gov't may fail • Over estimate benefits of merit goods • Difficult to calculate the most efficient quantity of Public goods to supply • Gov't corruption/political factors affecting decisions • Arguably high income tax and unemployment benefits offer disincentives to work, while high corporation tax percent entrepreneurs from starting businesses or investing.
		Cost Benefit Analysis (CBA)	A method of assessing assessment projects which takes into account, social costs and benefits.
		Multinational Companies (MNCs)	**Companies which produce in more than one country.** **For the firm** **Pros:** producing where selling cuts transport costs; close contact to market; local expertise+global mgmt skills; avoid import regs/tax; cheap labour/materials; gov't grants **Cons**: more competition, small firms struggle to compete **For host country** **Pros:** increase employment, output, & tax rev.; bring in new tech/mgmt techniques; develop new infrastructure **Cons:** may pollute in low regulation countries; can leave with no notice; can put pressure on gov'ts; may drive domestic firms out of business as employment shifts; profit goes to shareholders.

Equilibrium Prices in a Supply and Demand Diagram



Market Disequilibrium

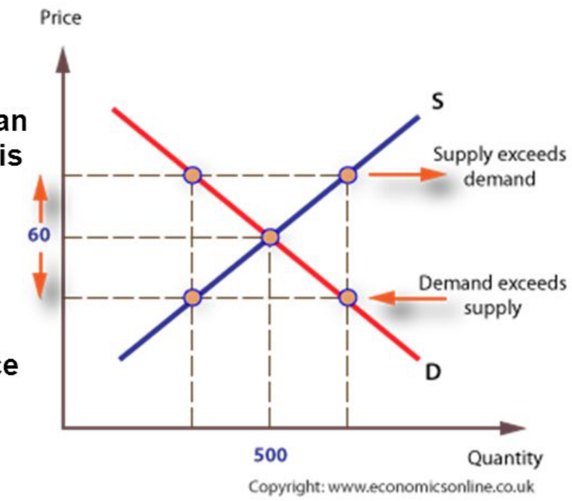
If the market price or quantity supplied is anywhere but at the equilibrium price, the market is in a state called disequilibrium. There are two causes for disequilibrium:

1.) Excess Demand

- **Excess demand occurs when quantity demanded is more than quantity supplied (when price is too low).**

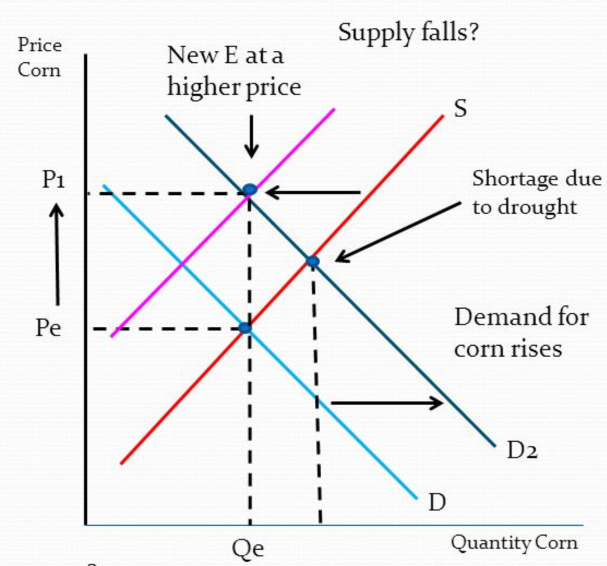
2.) Excess Supply

- **Excess supply occurs when quantity supplied exceeds quantity demanded (when price is too high).**



Simultaneous Shifts of Supply & Demand Curves

- The demand for corn has increased due to the new government regulation that gas must contain 10 % ethanol (ethanol is made from corn).
- The supply for corn has decreased due to a massive drought in the Midwestern US. How do these 2 events affect the market for corn?



Will supply decrease?

Perfectly Elastic Demand (Ped = infinity)

If the co-efficient of PED = infinity, then demand is perfectly elastic – there is one price at which consumers are prepared to pay

- If demand for a product is **perfectly elastic**, a change in market supply (shown on the right as an outward shift of supply) will not lead to any change in the equilibrium price. This demand curve applies to highly **competitive markets** where no supplier has any "pricing power"

Perfectly Inelastic Demand (Ped = 0)

If the co-efficient of price elasticity of demand = zero, demand is perfectly inelastic i.e. demand does not vary with a change in price

- A perfectly inelastic demand curve is an extreme case for it implies that consumers are willing and able to pay any price for the product. If supply falls, equilibrium market price can rise without any contraction in the quantity demanded

Unitary Elastic Demand (Ped = 1)

A demand curve with unitary price elasticity has a coefficient of PED equal to 1 (unity) throughout

- With a demand curve of **unitary price elasticity**, a change in price is met with a **proportionate change in demand**
- This means that **total spending** by consumers on the product **will remain the same** at each price level

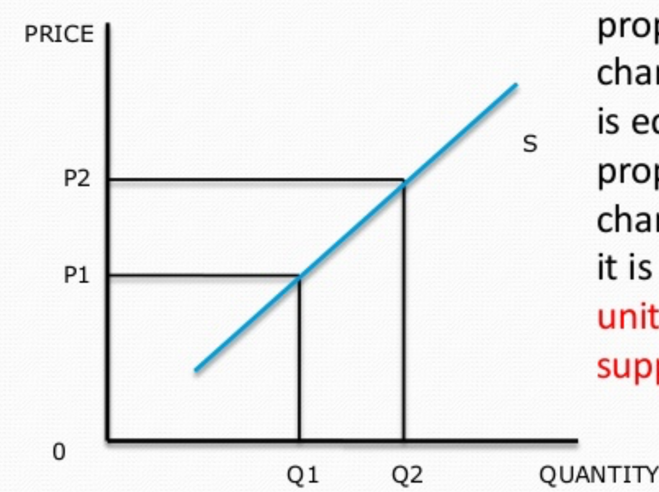
tutor2u

Perfectly Elastic and Perfectly Inelastic Supply Curves

Perfectly elastic supply
An increase in demand can be met without any change in price

Perfectly inelastic supply
Supply is fixed and cannot respond to a change in demand

Figure 3. Unitary Supply Curve



When the proportionate change in supply is equal to proportionate changes in price, it is known as unitary elastic supply

Economics Key Terms: Section 3

Microeconomic decision makers

Money

An item which is generally acceptable as a means of payment.

Legal tender is any form of payment which, by law, has to be accepted in settlement of a debt.

Function: medium of exchange. store of value, unit of account, standard of deferred payment.

Characteristics: durable, portable, divisible, homogeneous and recognisable.

Central Bank 2.

Role:

- Act as banker to the gov't and commercial banks
- Act as lender of last resort to banks with short-term cashflow problems
- Manage the national debt
- Holds the country's gold and foreign currency reserves
- Issues bank notes
- implements the gov't monetary policy (setting interest rates)
- represents the gov't at meetings with other central banks and international orgs, e.g. World Bank and International Monetary Fund

Commercial Banks 1.

Banks which aim to make a profit by providing a range of banking services to households & Cos.

Functions: take deposits, lend, enable payments by customers.

Accounts **Current a/c:** easy/mmediate access to £, minimal if any interest given to customer, generally for receiving/make payments.

Deposit a/c: notice has to be given to withdraw £, used for saving, interested paid to customer.

Borrowing **Overdraft:** agreed, can spend more have in the a/c, relatively expensive interest paid, short-term debt.

Loan: long-term debt, cheaper, for particular time and thing, collateral may be asked to secure the loan

Acting as agents for payments and transmission services: credit cards, standing orders, direct debits, debit/credit cards and online banking.

Disposable Income

Income after income tax has been deducted and state benefits received.

Factors that influence expenditure: wealth, confidence, interest rates, distribution of income, advances in technology.

If you have to been spending more than your disposable income, you are dissaving (from past savings or debt). If you do not spend all your disposable income, you are

Commercial Banks 2.

Extra functions: Provide and change foreign currency, secure deposits for important documents and small valuables, administration of customers' wills., provide financial advice including help with filling in tax forms, purchase and sale of shares and bonds, insurance, different types of savings a/cs, mortgage loans.

Aims: make profit for shareholders, liquidity (balancing loans (that bring in profit) with deposits),

Islamic finance: not allowed to charge an interest on loans, so may lean money with the condition of taking a share of the profit

Wealth

A stock of assets including money held in bank accounts, shares in companies, gov't bonds, cars and property.

How wealth is linked to expenditure:

- wealth generates income
- wealth can be cashed in
- wealth can be used as security for loans
- wealth can affect confidence

Liquidity

Being able to turn an asset into cash quickly without a loss.

Rate of Interest

A charge for borrowing money and a payment for lending money.

Central Bank 1.

A government-owned bank which provides banking services to the government and commercial banks and operates monetary policy.

- Federal Reserve Bank of the USA (the Fed)
- European Central Bank (ECB)
- Bank of England
- Reserve Bank of India
- People's Bank of China

Independence: Some can set own interest rate but Gov't set aims of banks and target for inflation (UK 2%). Independence of the central bank means trained economists set rates rather than politicians, and nothing is done to win voters approval.

Average propensity to consume (APC)

The proportion of household disposable income which is spent.

APC = consumption / disposable income

As income rises, expenditure rises, but the APC falls, as people do not need to spend so much of their income proportionally.

APS + APC = 1 (as disposable income is either spent or saved)

Consumption	Expenditure by households on consumer goods and income.	Mortgage	A loan to help buy a house
Savings	**What you have left over when the cost of consumer expenditure is subtracted from the amount of disposable income earned in a given period of time - income which is not spent.** **Contractual:** a contract has been signed agreeing to save a certain amount on a regular basis, e.g. insurance policies or pension schemes. **Non-contractual:** placing money in bank and building society accounts, buying gov't securities, shares and property. **Reasons to save:** target savers (for specific purpose), retirement, children's future, rainy day, to earn income from it.	Earnings	The total pay received by a worker. In addition to the **basic wage**, earrings may also include **overtime pay**, **bonuses** and **Commission.**
Savings Ratio	The proportion of household disposable income that is saved. Influences on saving: income, wealth, the rate of interest, tax treatment of savings, range and quality of financial institutions, age structure, social attitudes.	Wage Rate	A contracted payment for work made by an employer to a worker. It is the basic wage a worker receives per unit of time (a time rate system) or unit of output (a piece rate system). Time rate: can easily calculate cost of labour, workers can bargain collectively about the rate paid. Doesn't reward harder workers. Piece rate: can only be used if individual workers output is easily measured/product is standardsied. Quantity comes before quality. Less worker supervision needed. Pressure to perform may adversely affect workers.
Average Propensity to Save (APS)	**As savings ratio, it is the proportion of household disposable income that is saved.** APS = savings / disposible income APS is the same as the savings ratio or savings rate. As disposable income rises so do savings and, therefore, savings as a proportion of disposable income APS + APC = 1 (as disposable income is either spent or saved)	Overtime	**Pay workers receive for work done in excess of contracted hours.** **Pros:** pay is often higher for workers, employers can respond to higher demand without taking on new workers or reduce contract hours when there is a demand slump. **Cons:** workers can work themselves into the ground, tired workers are not productive, those working long hours hold back on effort to pace themselves for the whole shift.
Borrowing	Moves income from those who do not want to spend it now to those who need more money than they currently have. The cost of borrowing comes in the form of interest. Factors affecting ability to borrow: availability of loans and overdrafts, interest rates, confidence, social attitudes	Bonuses	**An extra payment over and above contracted wages/salary. Generally paid for working better/harder/more productively than expected.** **Pros:** may retain workers, workers may work harder, attracts self-confident workers **Cons:** may create resentment within a company, those that don't get one may become demotivated, employees start to see them as their basic pay.

Commission	Most often paid to sales people when a contract or deal has been completed. May supplement basic salary or be total of take home pay.	Wages and public opinion	Wages decided by how society values jobs and what a worker is paid: - education and skill required to do a job - one job compared to another (*comparability argument*) - public Vs private sector
Factors that motivate people to take a job	**Wage factors:** wages, overtime, bonuses, commission **Non-wage factors:** type of work, job satisfaction, career prospects, size of firm, location, flexible working hours, chance of promotion, option to work from home, holidays, work conditions, pensions, fringe benefits, job security **Limiting factors:** qualifications, skills, experience, location, opportunity cost. (In business, motivation within a job is divided into financial (wage, salary, piece-rate, commission, bonus schemes, fringe benefits, profit sharing, shares) and non-financial rewards (job rotation, enlargement, enrichment, quality circles, team working, delegation) - similar, but exam looking for different things.)	Wages and women	Discrimination affects chances of gaining employment. Low demands for certain groups mean they have to take lower wages. Women on the whole are paid less than men because: • often less well qualified (in some countries) • they are heavily concentrated in low-paid occupations • less likely to belong to trade unions and professional organisations • still suffer discrimination.
National Minimum Wage (NMW)	A minimum rate of wage for an hour's work, fixed by the government for the whole economy.	Wages and Changes Over Time	The main reason for rises and falls are changes in: • S - changes in size of labour force, qualifications/ training to do a job, non-wage benefits of a job, & wages • & D - changes in D for a product, labour productivity, and P of capital (cheaper to buy machines?)… But also • changes in the stages of production - primary sector generally less well paid. As country develops it outsources primary and increases tertiary employment.. • bargaining power, • changes in gov't policies - min wage, size of public sector, outsourcing to private sector, education levels, immigration, discrimination laws, advances in tech. • and public opinion.
Wages and Gov't Policies	Policies that promote economic growth: push up wages throughout the economy as increased demand for labour. Specific policies: have an impact on particular occupations Gov't labour market policies, e.g. min wage: some think it might cause unemployment, others think increases productivity.	Primary Sector	Firms whose business activity involves the extraction of natural resources, e.g. mining, farming, forestry etc.
Wage Differential	The difference in wages between individuals/jobs/industries etc.	Secondary Sector	Firms that process and manufacture goods from natural resources, e.g. construction, factory work, etc.

Tertiary Sector	Firms that supply a service to consumers and other businesses, e.g. banking, restaurants, cinemas, transport, hotels etc.	Trade Union	**A group of workers who join together forming an association, to protect their interests.** **Types of TUs:** Craft, General, Industrial & White Collar **Roles:** collective bargaining (employee negotiations; Industrial action (e.g. strikes) more effective; support for workers; social benefits; legal support/insurance **Determinants of strength:** health of economy; number of members; level of skill; consistent demand for the product; gov't's position on TUs and the corresponding legislation. **Pros:** Co. doesn't negotiate with individuals; can maintain stds of craftsmanship; helps stds for non-members too **Cons:** can limit labour supply; striking cost firms/country £ and flexibility.
Elasticity of Demand for Labour	**A measure of how demand for labour changes when the wage rate changes.** Main factors that determine EDofL: • Proportion of labour costs (in total cost) • How easy labour can be subbed by capital (buying machines etc.) • Elasticity of demand for the product produced • The time period (more elastic over time as can prepare subs etc.)	Collective Bargaining	Representatives of workers negotiating with employers' associations.
Elasticity of Supply of Labour	A measure of how the supply of labour changes when the wage rate changes. Main factors that determine ESofL • Qualifications and skills required • Length of training period • Level of employment • Mobility of labour • Degree of vocation • The time period (more elastic over time, as workers adapt to new situations)	Industrial Action	When workers disrupt production to put pressure on employers to agree to their demands.
Specialisation	**The concentration on particular products or tasks** **Individual specialisation** **Pros:** workers become particularly skilled in certain areas; skilled workers can command higher wages; workers can follow their personal specialist interests; **Cons:** bored workers; overly reliant on any one individual; some workers cost more to employ	Strike	**A group of workers stopping work to put pressure on an employer to agree to their demands.** **Official:** approved and organised by the union - voted on. **Unofficial:** has not been approved by the union - done before a vote, or after a vote that came on the side of no action. **Measure of strike action:** numbers involved, length of strike, number of strikes that take place. The gov't do not encourage strikes as they have a negative impact on the economy - loss in production.
Division of Labour	**Workers specialising in particular tasks. Can lower costs of production and produce higher quality goods, but it can also have the reverse effects. Good products made cheaply lead to a thriving economy and more exports.** **Pros:** specialising workers; money saved on a quicker and cleaner production process; can reduce work pressure; not making full use of a workers abilities **Cons:** not everyone can use all tools; harder to replace or cover highly skilled workers; work can become monotonous; costs aren't necessarily reduced; harder to move workers to new positions if D falls.	Industry	A group of firms producing the same product, e.g. the jeans industry or car industry.

Real Income	Income adjusted for inflation.	Rationalisation	Eliminating unnecessary equipment and plant to make a firm more efficient.
Quaternary Sector	Firms that supply a service to consumers and other businesses, that is knowledge based e.g. IT	Economies of Scale	**Cost reductions that occur when co.s up production, leading to lower long run average costs (LRAC).** **Internal** - economies made within the company, e.g. buying, selling, managerial, labour, financial (borrow more, cheaper), tech, R&D, risk bearing (more prods divide risk) **External** - from a growth in the industry as a whole, e.g. skilled labour force, good rep, suppliers to other industries (palm oil to replace sunflower), specialist services, specialist markets, improved infrastructure. **Diseconomies of scale:** When costs proportionally rise **Internal:** difficulties controlling firm, communication problems, poor industrial relations. **External:** traffic to an area, more comp raising costs etc
Classifications of Firms	**Stages of production:** primary, secondary, tertiary (sometimes include quaternary) **Ownership:** public, private **Size of Firms:** number of workers, value of output, value of financial capital it employs (**Size influenced by:** age of firm; availability of financial capital (to expand); type of business organisation (selling shares to expand); internal economies/diseconomies of scale; size of market)	Corporation Tax	A tax on profits of a company.
Reasons to be a Small Firm	• Size of market • preference of consumers • owner preference • flexibility in tough market conditions • starting out - generally in a low *barrier to entry* industry • lack of financial capital • location • working with other small companies to gain economies of scale without having to size up • specialisation • government support.	Total Cost (TC)	The total amount that has to be spent on the factors of production used to produce a product. Average cost (unit cost) = TC / output
Business Growth	**Internal/natural/organic growth:** an increase in the size of a firm due to increasing the market for a current product or diversifying into other products, as a result, enlarging existing plants or opening new ones. **External growth:** an increase in the size of a firm due to mergers or take overs. (Much faster than organic, and higher risk) **Mergers:** **Horizontal-** 2 firms, same product, same stage of prod. **Vertical-** 2 firms, same product, different stage of prod. Forward: with a co. higher up supply chain, e.g. outlet Backwards: lower in supply chain, e.g. raw materials **Conglomerate-** 2 firms, 2 products., any stage of prod.	Fixed Costs (FC)	Costs which do not change with output in the short run, e.g. rent. Average fixed cost = total FC / output As output increased, the FC per item goes down.

Variable Costs (VC)

AKA direct costs. Costs that change with output. As output increases, the variable costs go up, e.g. raw materials needed to make a product - the more you make, the more you need.

Average VC = VC / output
This often goes down as you make more, due to economies of scale.

Costs can be cut by reducing waste/inefficiency, raising productivity and increasing the scale of operation.

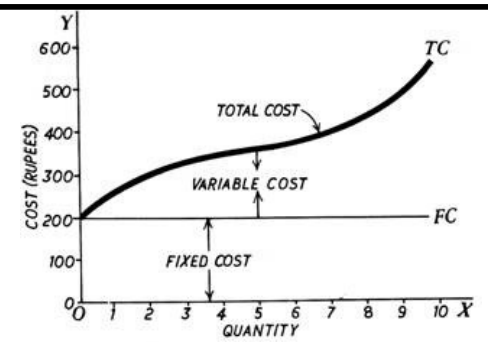
Profit Satisficing

Sacrificing some profit to achieve other goals due to a separation of ownership and control - owners (shareholders) wants to maximise profit, while managers (who control the company) and workers may be wanting a good place to work, that benefits the local community.

These goals may be improving working conditions, working towards more sustainable/environmentally friendly production,

Fixed and Variable Costs

(http://www.economicsdiscussion.net/articles/costs-in-the-production-of-a-commodity-variable-and-fixed-costs/1635)



Fixed Cost, Variable Cost, Total Cost
Fig. 23.1

Profit Maximisation

Making as much profit as possible.

This is the general objective of most organisations. This may be seen as a short-term or long-term objective.

Some companies are happy to make a loss on one product so as to make larger gains over all, e.g. supermarkets charging less for beans than production costs to get customers in the shop.

Long Run

The time period when all factors of production can be changed and all costs are variable.

Costs that can be changed in the short run are variable. Fixed costs will not change in the short run.

Firm Objectives

- Survival
- Growth
- Social Welfare
- Profit Satisficing
- Profit Maximisation

Price

The amount of money that has to be given to obtain a product.

Price (P) X Quantity sold (Q) = Total Revenue (TR)

Profit

Profit is made when the revenue from a good or service is greater than the costs of providing that good or service. To raise profit, reduce costs or increase revenue.

Profit = revenue — cost
Total Profit (TP) = Total revenue (TR) — total costs (TC)
Profit margin (profit per unit) = average R — average TC

Profit is maximised when the profit margin is at its highest. The higher the profit in a market is, the more competitive that market will be. high profits = more capital and loans easier to acquire, to invest and expand the business, Share value goes up & more employees want to work for the co.

Revenue

Income that a business has from its normal business activities, usually from the sale of goods and services to customers. AKA sales or turnover. It is NOT profit or cash flow.

Total Revenue (TR): The total amount of money received from selling a product.
Average revenue = TR / Quantity sold (Q)

Can be raised by altering price (D is elastic, lower P, D inelastic, raise P), improving product, adapting more quickly to changes in consumer demand and advertising.

Market Structure

The conditions which exist in a market including the number of firms.

Ranging from very competitive (a high number of sellers and buyers - the higher the number of sellers, the smaller the share of the total market each seller will have, so the change in output of one company will have little or no effect on the price) to monopoly.

Competitive Market	**A market with a number of firms that compete with each other.** Competition is needed to encourage efficiency - keeping costs low to maximise revenue. The faster a company responds to consumer demands, the greater its competitive advantage over the competition.	Sunk Costs	Costs that cannot be recovered if the firm leaves the industry. E.g. advertising spending, industry-specific equipment.
Normal Profit	**The minimum level of profit required to keep a firm in the industry in the long run.** Supernormal (abnormal) profit: profit above that needed to keep a firm in the market in the long run. When abnormal profit is being made, more companies will join the market. This will increase competition, lower prices, and so lower profit until they return to normal.	Natural Monopoly	**Where only one firm provides a good or service to the market as the start up costs make it inefficient and unprofitable for more than one to do so at the current price rate, or the product is unique (e.g. patent of product or manufacturing process) and cannot be made by anyone else.** It is a natural monopoly as it occurs naturally and without sneaky business practices.
Monopoly 2	**Market/industry that's dominated by 1 supplier/product** **Pure monopoly:** where 1 co. has 100% market share (e.g. Network Rail - owns all the UK rail tracks, public sector, natural monopoly,). **Monopoly power** is over 25% of market (in UK) (e.g. Tescos and The Sun, both approx. 27% of their market)s, and a **dominant monopoly** is over 40% (e.g. Google approx 87% of search engine market, Apple, approx 50% of smart phone market)) **Characteristics of a monopoly:** high barriers to entry/exit; single seller; price maker; economies of scale Reasons for: overtime, mergers/takeovers, natural, patents, laws		
Barrier to Entry/Exit	**Entry:** Anything that makes it difficult for a firm to start producing the product, e.g. scale of production, brand loyalty, access to outlets (e.g. waitrose/Duchy products), barriers to exit (e.g. long-term contract, can't get out of Ocado/M&S) Legal barriers: patents, government acts. **Exit:** Anything that makes it difficult for a firm to stop making the product. e.g. long-term contracts to provide a good, inability to recover sunken costs.		
Scale of Production	The size of production units and the methods of production used.	CHECk NATURAL MONOPOLIES DEFINITION	

Economics Key Terms: Section 4

Government and the macroeconomy

Local Government	A government organisation with the authority to administer a range of policies within an area of the country.	Economic Growth	**An increase in the output of an economy & in the long run, an increase in the economy's productive potential.** **Actual:** an increase in the output of an economy. **Potential:** an increase in an economy's productive capacity. Both can be shown on a production possibility curve. **Pros:** raise living standards, can help other economic aims, such as employment levels, export levels, generate extra tax, voting power at the International Monetary Fund increases etc. **Cons:** increased pollution, decrease of non-renewables **For long-term growth both D (**fiscal and monetary) **& S-side policy measures.**
Strategic Industries	Industries that are important for the economic development and safety of the country.	Aggregate Demand	**The total demand for a country's produce at a given price level.** It consists of consumer expenditure (C), investment (I), gov't spending (G) and net exports (exports (X)— imports (M)) **C + I + G + (X — M)** A shift to the right in the aggregate demand curve could be due to an increase in population, lower exchange rates and greater consumer confidence.
National Champions	Industries that are, or have the potential to be, world leaders.	Aggregate Supply	**The total amount of goods and services that domestic firms are willing to supply at a given price level - so supply in general, rather than of any specific product.** In a full employment country, supply becomes perfectly inelastic, as output cannot increase. In a significantly under employed country, supply becomes perfectly elastic as more can always be made. Usually, supply lies somewhere between these two poles. A shift to the right will occur if costs of production fall and if the quantity or quality of resources increase.
Trade Bloc	A regional group of countries that remove trade restrictions between themselves.	Employment	**Full employment:** The lowest level of unemployment possible. **Unemployment rate:** The percentage of the labour force who are willing and able to work but are without jobs. **Unemployment/labour force X 100** Those who are unable or choose not to work (e.g. children, retired, disabled, in full-time education, etc.) are defined as economically inactive and are not included in the employment rate. Those who are economically active (whether they are job seekers or in employment) make up the labour force.
Free International Trade	The exchange of goods and services between countries without any restrictions	Price Stability	The price level in the economy not changing significantly over time. Pros: it ensures greater economic certainty, keeps the county's products internationally competitive, households and firms can plan with greater confidence. Full employment may compete with stable prices.

Inflation Rate	**The percentage rise in the price level of goods and services over time.** **Raise in inflation** **Pros:** might not be a real raise (e.g. products evolving so not necessarily comparing same product year on year, more products sold in sales or second0hand than at full new value), encourages producer to produce more, cuts wage bills if they have not also raised in line with inflation	Multiplier Effect	The final impact on aggregate demand being greater than the initial change.
Balance of Payments	**The record of a country's economic transactions with other countries. A balance of payments is when a countries exports (X) 'balance' with its imports (M), so the country spends no more in imports than it receives through exports.** X > M = prevents a country getting into debt, but limits choice to the inhabitants of that country. Short-term deficits or surpluses are usually not of concern to a government.	Government Spending	• To influence economic activity • To reduce market failure • To promote equity • To pay interest on national debt
Current Macroeconomic Performance Indicators	UK / USA / Fr / D Unemployment rate (%): 3.8 / 3.6 / 8.1 / 3.2 Inflation rate (%): 1.8 / 2.5 / 1.4 / 1.7 Economic growth rate: 1.1 / 2.3 / 0.8 / 0.4 Current account position($bn) (M—X): -107 / -466 / -37 / +296	Government Revenue	Raised through taxes… • To redistribute income from rich to poor • To discourage the consumption of demerit goods (e.g. cigarettes) • To raise the costs of firms that impose costs on others (e.g. pollution causing firms) • To protect domestic companies by discouraging the consumption of imports • To influence economic activity
Budget	The relationship between government revenue and government spending. Budget **deficit** = spending > revenue Budget **surplus** = revenue > spending Both surplus and deficit can be expressed in absolute amounts or as a% of GDP	Taxes 1	**Direct:** on income and wealth, e.g. income tax **Pro:** can make some work harder (need £), can ↑spending, redistribute income(Y), act as automatic stabilisers, gov't Y. **Con:** can discourage effort, enterprise and saving. **Indirect:** on expenditure, e.g. VAT **Pro:** easy and cheap to collect, less of a disincentive to enterprise than direct taxes, can achieve specific aims e.g. alcohol consumption reduction, harder to evade, people don't have to pay them if they don't buy the product, can raise gov't Y in countries with big informal economies. **Con:** generally regressive - disproportionally hit poor, raises prices, can lead to inflation
National Debt	The total amount the government has borrowed over time.	Taxes 3	**Main types of tax:** Income, corporation, capital gains, inheritance, sales tax (e.g. VAT), excise duty, customs duty, licences (e.g. TV, car), local taxes (e.g. council tax) **Principles of taxation:** equity, certainty, convenience, economy, flexibility, efficiency **Tax base:** the amount of money that is taxed **Tax burden:** the % of tax paid. Sometimes expressed as % of GDP. Whether burden is paid by the consumer or the firm (indirect tax) depends on how elasticity of product. **Inelastic:** D = consumer pays, S = supplier pays more **Elastic:** D = firm pays, S = consumer pays.

Tax 2

Progressive: one which takes proportionally more from you the richer/wealthier you are, e.g. 10% tax in first £12k, 20% on the next £20k, etc. E.g. current UK income tax
Proportional: takes the same percentage of income from all tax payers regardless of their financial situation, e.g. flat rate income tax
Regressive: tax that goes down proportionally, the more you earn, e.g. VAT on food, the more you earn the smaller a % of your income you spend on it - can only eat so much.,
Flat taxes: taxes with a single rate. Simple to administer, less incentive to evade paying tax, regressive in nature.

Monetary Policy (D)

Decisions on the money supply, the rate of interest and the exchange rate taken to influence the supply and/or price of money and thereby aggregate demand.
Expansionary: Increases money supply/interest rate to up aggregate D = lower unemployment/ up economic growth
Contractionary: changes in money supply/interest rates to reduce aggregate D = lower inflation
How to increase supply of £: print more, buying back gov't bonds, encouraging commercial banks to lend more.
Interest rates: main tool used. Raising = costs of new debt up, disposable income for those with old debt down, savings up, and exchange rate up.
Exchange rate: sometimes directly changed (e.g. for M/X).

Automatic Stabilisers

Forms of government expenditure and taxation that reduce fluctuations in economic activity, without and change in government policy.

Foreign Exchange Rate

The price of one currency in terms of another currency or currencies.

Inflation

The rise in the price level of goods and services over time.
Cost-push: caused by higher costs of production
Demand-pull: caused by excess demand
- Monetary inflation (excessive growth in £ supply)

Hyper inflation: A very large and rapid rise in price level

Supply-side Policy (S)

Measures designed to increase aggregate supply (creating growth without inflation)**.**
Policy measures: education and training, cut direct tax and benefits, labour market and TU reforms, subsidies, deregulation, and privatisation.

Informal Economy

That part of the economy that is not regulated, protected or taxed by the government. AKA black, underground or shadow economy,
Reasons for black economy: Small scale business, costs of registering seem to high to the entrepreneur; illegal activity; work done by people who are not legally allowed to work, such as minors or immigrants; tax avoidance; avoiding gov't regulation.
Size influenced by: gov't regs; tax rates; number of activities declared illegal; penalties for tax evasion

Deregulation

The removal of rules and regulations.

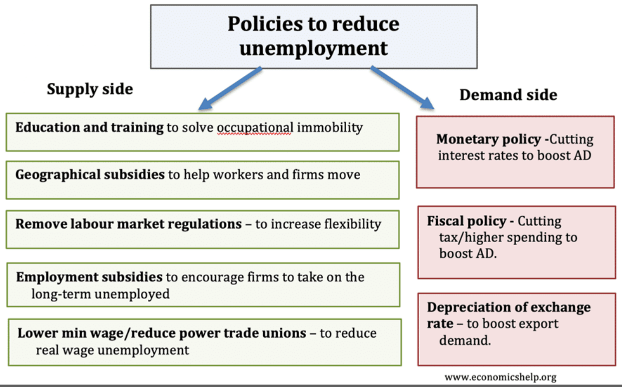
Fiscal Policy (D)

Decisions on government spending and taxation designed to influence aggregate demand.

Expansionary: rises in gov't expenditure and/or cuts in taxation designed to increase aggregate demand.
Contractionary: cuts in gov't expenditure and/or rises in taxation designed to reduce aggregate demand.

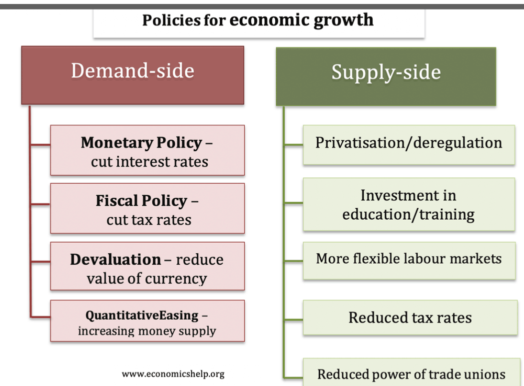
Policies to reduce Unemployment

(https://www.economicshelp.org/blog/3881/economics/policies-for-reducing-unemployment/)



Policies for economic growth

(https://www.economicshelp.org/blog/5272/economics/policies-for-economic-growth/)



Gross Domestic Product (GDP)

The total output of a country - but not black market or unpaid work/goods/services.

Measures: Output, Income, Expenditure

Where output = income = expenditure

Output- double counting is avoided by calculating *value added* at each stage of production.

Income: includes all earned incomes, but not *transfer payments*, as there's no corresponding output.

Expenditure: +exports - imports

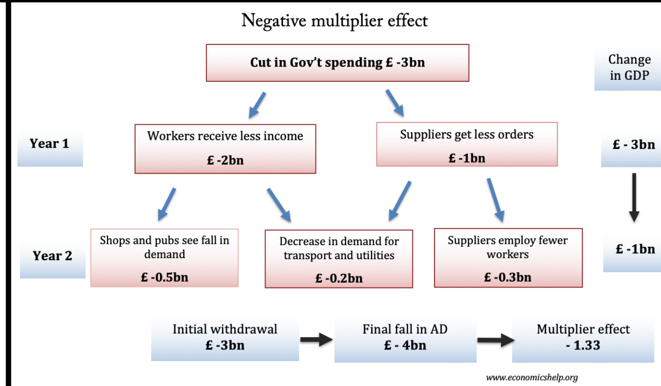
Nominal GDP: GDP at current market prices, so not adjusted for inflation.

Real GDP: GDP at constant prices so inflation adjusted.

Use real GDP **per head** to check standards of living

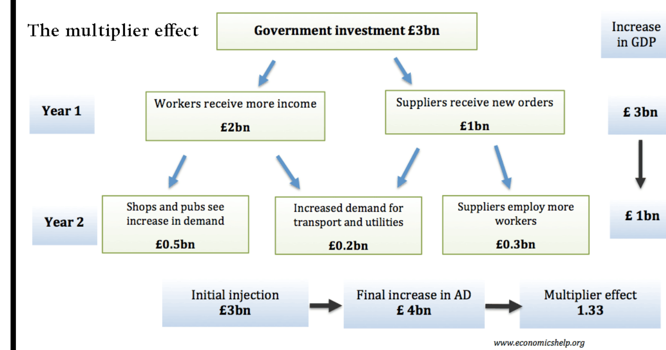
Negative Multiplier Effect

(https://www.economicshelp.org/blog/160827/economics/negative-multiplier-effect/)



Multiplier Effect

(https://www.economicshelp.org/blog/1948/economics/the-multiplier-effect/)



Fiscal Vs Monetary Policy

(https://www.economicshelp.org/blog/1850/economics/difference-between-monetary-and-fiscal-policy/)

Fiscal Policy	Monetary Policy
Change in government spending and tax rates	Change in interest rates / money supply.
Set by the Government	Set by a Central bank
No specific target	Target inflation
Side effect on government budget / borrowing	Side effect on exchange rate and housing market
Strong political dimension to changing tax rates	Mostly independent from the political process

www.economicshelp.org

Supply-side Policies

(https://www.economicshelp.org/macroeconomics/economic-growth/supply-side-policies/)

Supply-side Policies

Free market oriented	Interventionist
Privatisation – sell state owned assets to private sector - improve incentives.	**Public sector investment** in infrastructure - improve transport and reduce costs.
Deregulation – allow new firms to enter market - open monopolies to competition.	**Education** - increase funding to schools and universities - improve labour productivity.
Income tax cuts – greater incentive to work longer hours	**Vocational training**. Gov't schemes to provide new skills to those who lose jobs.
Remove regulations/red tape – make it easier to build new factories and housing.	**Housing supply**. Increase supply of council housing improves geographical mobility.
Flexible labour markets – reduce power of trade unions, min wages and regulations.	**Health spending**. Public spending on health can reduce hours lost to ill-health.
Free-trade agreements – reduce tariff barriers and other obstacles to trade.	
Reduce welfare benefits – increase incentive to get a job.	

Policies to avoid a recession

(https://www.economicshelp.org/blog/236/recession/how-to-avoid-a-recession/)

Policies to avoid a recession

1. Monetary Policy
   - Cut interest rates
   - Quantitative easing
   - Helicopter money
2. Fiscal Policy
   - Higher government spending
   - Tax cuts
3. Higher inflation target
4. Financial stability
   - Guarantee bank loans/mortgages

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Monetary and Fiscal Policies

(https://www.economicshelp.org/blog/113/uk-economy/monetary-and-fiscal-policy-in-the-uk/)

	Monetary Policy	Fiscal Policy
Tool	Interest rates	Tax and government spending
Effect	Cost of borrowing/mortgages	Budget deficit
Distribution	Higher interest rates hit homeowners but benefit savers	Depends which taxes you raise.
Exchange rate	Higher interest rates cause appreciation	No effect on exchange rate
Supply-side	Limited impact	Higher taxes may affect incentives to work
Politics	Monetary policy set by independent Central Bank	Changing tax and government spending highly political.
Liquidity trap	Cuts in interest rates may not work in liquidity trap	Fiscal policy advised in very deep recessions

Policies to Control Inflation

(https://www.slideshare.net/tutor2u/as-macro-revision-inflation-and-deflation-31476072)

Macroeconomic Policies to Control Inflation

Inflation can be reduced by policies that (i) slow down the growth of AD or (ii) boost the rate of growth of aggregate supply (AS)

- **Fiscal policy**: A tightening fiscal policy would include less spending on public and merit goods or welfare payments or raising direct taxes
- **Monetary policy:**
  - A 'tightening of monetary policy' via higher interest rates or a reversal of quantitative easing or tougher controls on bank lending
  - Higher interest rates may cause the exchange rate to appreciate bringing cheaper imported goods and services
- **Supply side policies** to increase productivity, competition and innovation
- **Direct controls**
  - Public sector pay controls e.g. Limiting pay rises for NHS workers
  - Capping or other regulation of prices of utilities such as water bills

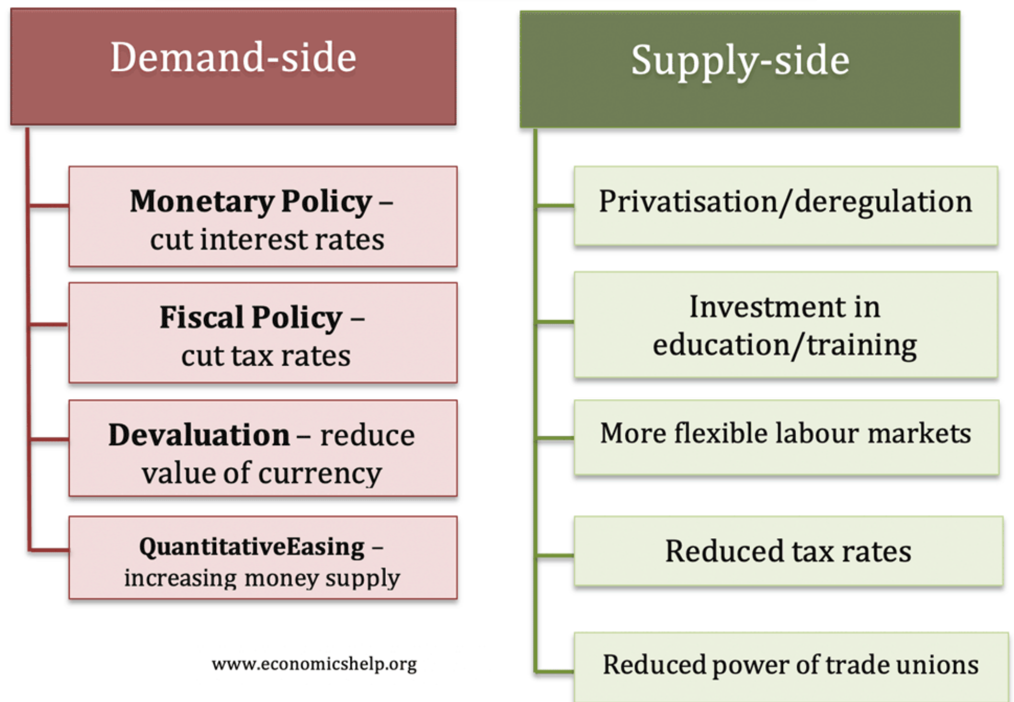
Policies to reduce trade deficit

(https://www.slideshare.net/tutor2u/as-macro-revision-the-balance-of-payments)

Economic Policies to Reduce a Trade Deficit

- Demand management: A tightening of fiscal and/or monetary policy reduces **real spending power** of consumers and leads to lower spending on imports (fall in M improves trade balance)
- **Lower exchange rate** reduces the overseas price of exports and makes imports more expensive – causes changes in demand
- Supply-side improvements:
  - Policies to raise **labour productivity** and encourage start-ups with export potential e.g. Life sciences, digital etc
  - Investment in **human capital** to boost productive **capacity** and **competitiveness** in high-value industries such as bio-technology, engineering, medicine, tourism
- Protectionist measures such as import quotas and tariffs *(NB: limited by global trade agreements e.g. EU and WTO rules)*

Policies for economic growth



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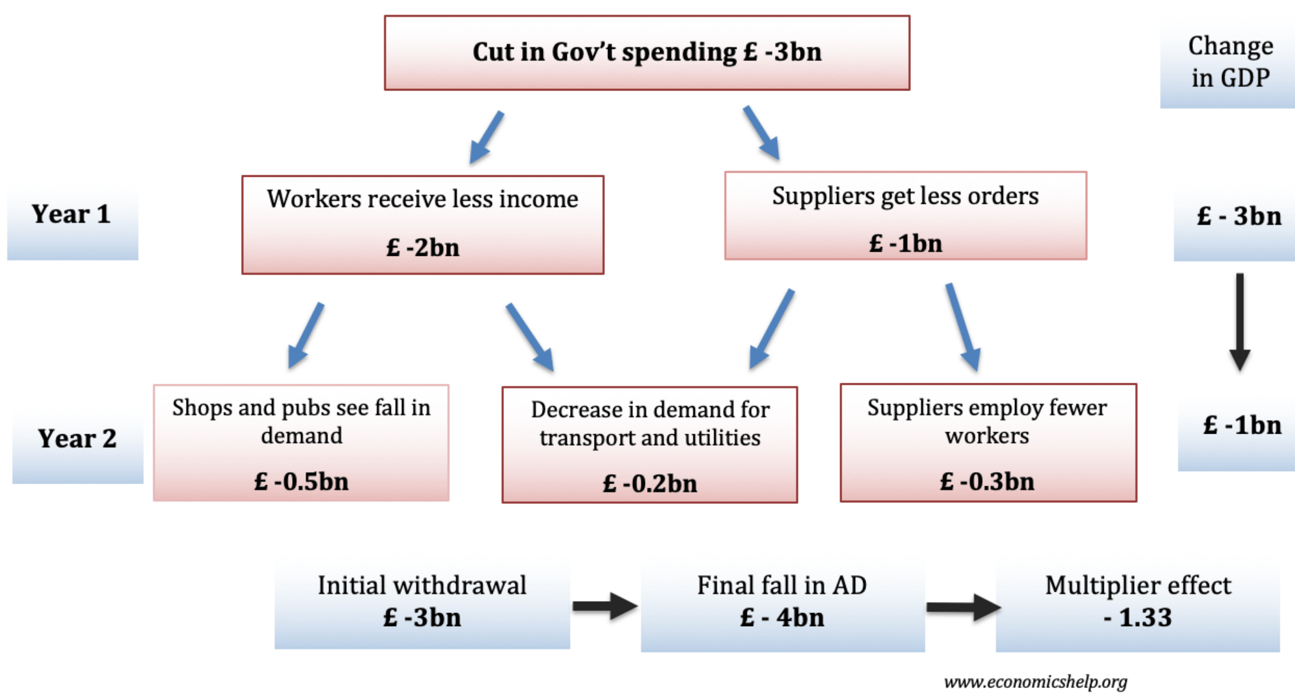
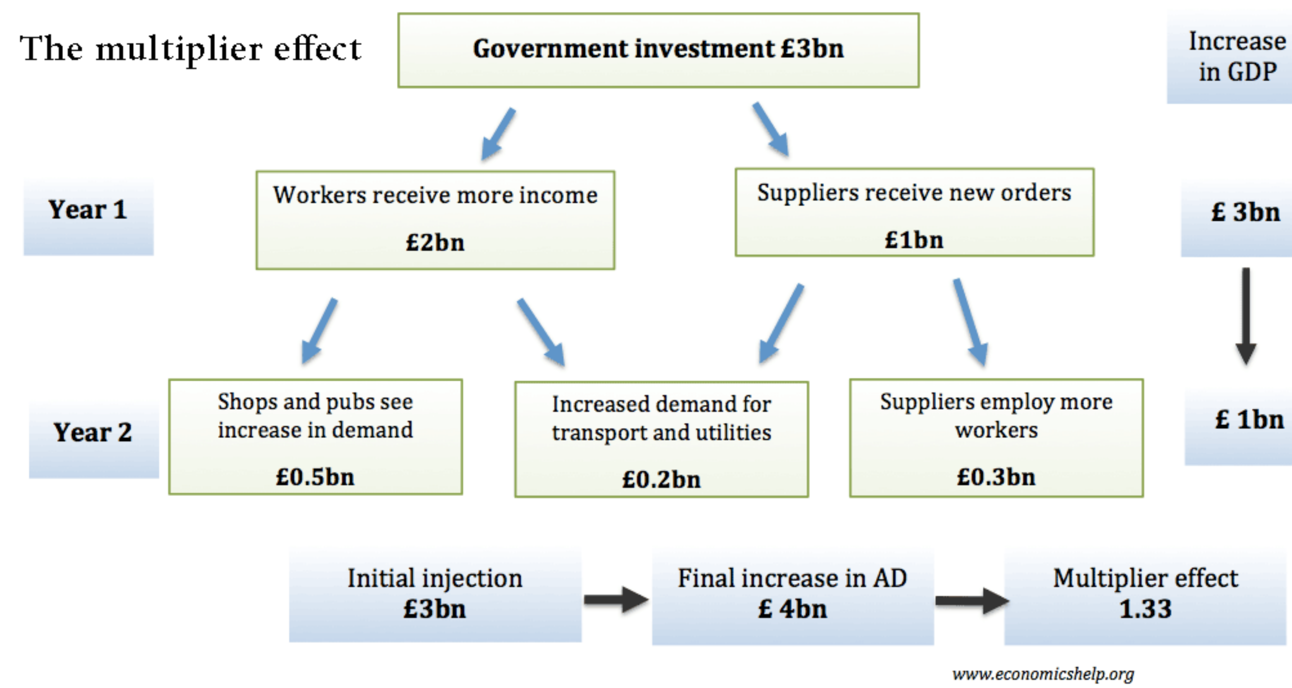
Negative multiplier effect





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- **Direct controls**
  - Public sector pay controls e.g. Limiting pay rises for NHS workers
  - Capping or other regulation of prices of utilities such as water bills

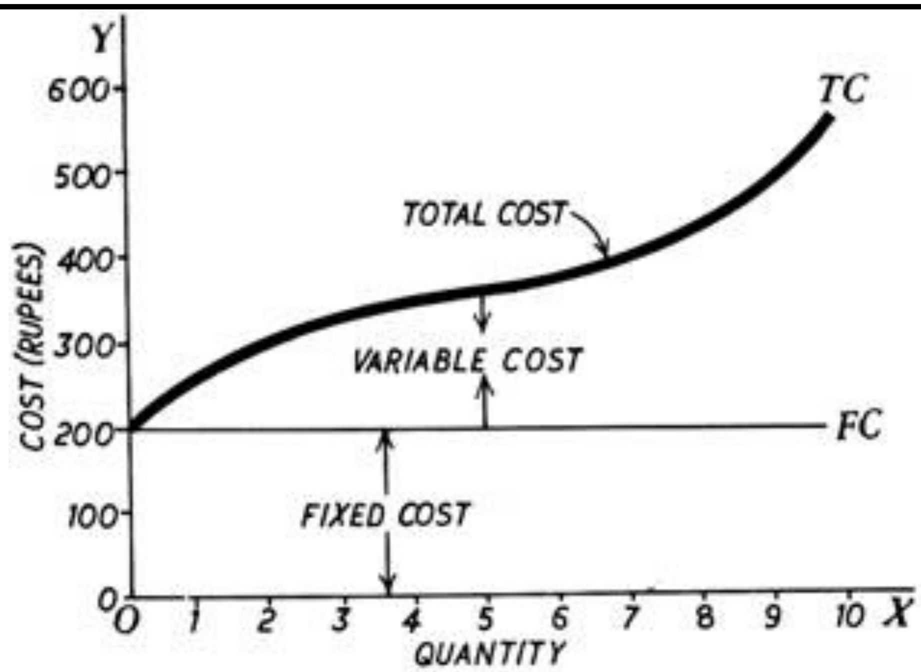
Policies to reduce unemployment

Supply side

- **Education and training** to solve occupational immobility
- **Geographical subsidies** to help workers and firms move
- **Remove labour market regulations** – to increase flexibility
- **Employment subsidies** to encourage firms to take on the long-term unemployed
- **Lower min wage/reduce power trade unions** – to reduce real wage unemployment

Demand side

- **Monetary policy** -Cutting interest rates to boost AD
- **Fiscal policy** - Cutting tax/higher spending to boost AD.
- **Depreciation of exchange rate** – to boost export demand.



Fixed Cost, Variable Cost, Total Cost
Fig. 23.1

Circular Flow of Income	The movement of expenditure, income and output around an economy.	International Monetary Fund (IMF)	An international organisation which promotes international cooperation and helps countries with balance of payments problems.
Value Added	The difference between the sales revenue received and the cost of raw materials used.	Sustainable Economic Growth	Economic growth that does not endanger the country's ability to grow in the future.
Transfer Payments	Transfer of income from one group to another not in return for providing a good or service. E.g. pensions, benefits etc.	Flexible Labour Force	**A labour force that adjusts quickly and smoothly to changes in market conditions.** **numerical flexibility:** how easy to hire and fire **temporal flexibility:** how easy to change no. of working hours **locational flexibility:** how easy to change the location **functional flexibility:** how easy to change tasks **wage flexibility:** how easy to change wages
Recession	**A reduction in real GDP over a six month or more period.** **Causes:** decrease in aggregate D &/or S **Negative Demand-side Shock:** fall in customer spending/ investment; fall in business confidence; financial crash; fall in house prices; gov't spending reduced; exports fall; rise in exchange rates etc. **Negative Supply-side Shock:** rise in raw materials; war; gov't regulation etc. **Consequences:** lower output; unemployment; lower living stds; investments drop; tax rev decline; gov't spending and possible debt increase; may or may not be accompanied with inflation depending if D or S side cause..	Economically Active	**Those in the labour force, both the employed and unemployed.** **Economically inactive:** those that are not in the labour force, e.g. retired/student/long-term sick.
Employment	**Being involved in a productive activity for which a payment is received.** **Patterns of employment:** industrial structure of country; working women; private V public sector; full/part-time; employed/self-employed; formal/informal economies; high/ low quality employment; flexible employment. **Geographical and occupational mobility** play a key role in employment. **Incentives t**o work may also help employment, e.g. cutting income tax/benefits, as are gov't incentives for co.s to move to areas of high unemployment. The labour *stock* (no. of unemployed at any one time) is determined by rate of flow of people into unemployment and the time period of unemployment.	Labour Market Participation Rate	**The proportion of the working-age population who are in the labour force.** **Factors that influence:** wages on offer; social attitudes to working women; provision for childcare and elderly; social attitudes and provisions for disabled to work; proportion of school leaves who go into higher education.

Claimant Count	A measure of unemployment which counts as unemployed those in receipt of unemployment benefits,	Disinflation	A fall in the rate of inflation (but inflation is still occurring, e.g. at 3% instead of 8%).
Labour Force Survey (ILO) Measure	**A measure of unemployment which counts as unemployed people who identify as such in a survey.** **Pro:** more accurate, can make international comparisons **Cons:** less accurate depending on how questions asked, answers interpreted and the representativeness of the sample selected; takes time to collect; doesn't measure underemployment. (ILO - International Labour Organisation, as it uses their definition of unemployment)	Consumer Prices Index (CPI)	A measure of the weighted average of the prices of a representative basket of goods and services. Need: • Selected base year • Know how households spend their money • Know price changes • Assign weights to price index
Unemployment	**Being without a paid job while willing and able to work.** **Types:** frictional; structural; cyclical; search; casual; seasonal; regional; technological **Frictional:** between jobs - temporary unemployment. Types of frictional include, search, casual and seasonal **Structural:** changes in patterns of D/methods of prod long-term. Types of include, regional and technological. **Cyclical:** lack of aggregate D. Most serious type **Search:** lost job & looking for adequate replacement job **Casual:** regularly being between periods of employment. **Seasonal:** fall in D at particular times of year. **Regional:** decline in jobs in a particular area **Technological:** workers replaced by capital equipment.	Wage-price Spiral	Wage rises leading to higher prices which, in turn, lead to further wage claims and price rises.
Consequences of Unemployment	**For the individual** - drop in stds of living; lower physical and mental health; higher chance of family break up; can't afford to improve life chances for off-spring; reduces chances of getting a new job; in periods of high unemployment prices remain low. **For the firm** - keeps wages low, available labour if expanding, workers become more flexible, in periods of high unemployment low demand for products, prices low **For the economy** - in periods of high unemployment the economy is not at peak production, direct/indirect tax rev from co.s & individuals reduces, gov't spending increases. frictional;&structural;=S-side cyclical=D-side Gov't policy	Monetarists	A group of economists who think that inflation is caused by the money supply growing more rapidly than output.
Deflation	**A sustained fall in the price of goods and services.** **Causes:** S or D-side, e.g. P down due to new tech or up in labour productivity OR people put off buying now as they think it will be cheaper in the future. **Consequences:** good deflation (S-side) = more internationally competitive, bad deflation (D-side) = lower employment = downward spiral in D. All deflation pushes up repayment cost of debt. Gov't (central bank) action: nothing for good deflation; expansionary monetary and fiscal policy for bad deflation	Index Linking	Changing payments in line with changes in the inflation rate.

Menu Costs	Costs involved in having to change prices as a result of inflation.		
Shoe-leather Costs	Costs involved in moving money around to gain high interest rates.		
Consequences of Inflation	**Pros:** may encourage firms to borrow and expand; debt is worth less; can reduce the cost of workers (all these are more likely to happen in demand-pull inflation) **Cons:** fall in value of money; redistributes income in an unplanned way; makes extra costs for firms (menu, shoe-leather, raw materials); economic uncertainty; increase costs of imports, decrease export revenue; fiscal drag		
Fiscal Drag	Inflation and corresponding earnings growth pushes taxpayer into higher tax bracket, and thereby reducing their 'real' income. Consequences: raises gov't revenue without putting up tax rates; reduces aggregate demand; helps lower inflation		

Economics Key Terms: Section 5

Economic development

Measures of Living Standards	**GDP (per head):** a measure of size/health of an economy over a period of time (usually a 1/4 or yr). Gives an average. May not reflect actual increase in stds, Not include black market. **Real GDP per head** also adjusts for inflation. **International comparison**: need to allow for value of £$€. **Human Development Index (HDI):** takes into account education, life expectancy & GDP per head (income). Doesn't measure political freedom/environment/gender etc. **Genuine Progress Indicator (GPI):** includes income (Y), leisure time, crime, distribution of Y and environment. **Gender Inequality Index (GII):** inc. health/work/ed **HappyLifeExpectancyIndex(HLEI):** life exp.X happy index **Gross National Happiness (GNH):** inc Y, wellbeing, eco…	Poverty	**Types:** absolute, relative **Causes:** unemployment, low paid work, illness, old age, lack of education etc. **Possible Gov't action to raise living stds.:** education, economic growth, national minimum wage, encourage more multinationals to set up in your country, state benefits, land reform. **Possible Gov't action to redistribute wealth:** (progressive) taxation, benefits, free state education and healthcare, labour and macroeconomic policies e.g. min wage, etc.
Purchasing Power Parity (PPP)	An exchange rate based on the ratio of the price of a basket of products in different countries.	Multidimensional Poverty Index (MPI)	A measure of poverty based on deprivations in education, health and standards of living.
Absolute Poverty	A condition where people's income is too low to enable them to meet their basic needs.	Net Emigration	**More people leaving a country to live in another country (emigrants) than people coming to a country from elsewhere (emigrants).** **Effects:** size of working population likely to be reduced; greater burden of dependency; average age of labour force will increase; gender distribution may be affected; may be a shortage of skilled workers; (brain drain); under-utilisation of resources; money may be sent home.
Relative Poverty	A condition where people are poor in comparison to others in the country. Their income is too low to enable them to enjoy the average standard of living in their country.	Birth Rate	**The number of births in a year per 1000 population in a year.** **Influenced by:** average age of pop, no. women in pop., women's fertility rate **Reasons for growth:** young mean age of pop. where girls marry young; high infant mortality; girls not highly ed.ed; attitudes to female employment; cost of bringing up kids; min. available contraception; gov't incentives to have children; lack of gov't care for sick or elderly. **Reducing:** education/employment opp.s for women; contraception ed; better healthcare/nutrition to reduce infant mortality; state pensions/care for elderly; raise costs of bring up kids; no financial support; laws limiting no.s
Poverty Trap/Vicious circle of poverty	A situation where people become trapped in poverty.	Death Rate	**The number of deaths in a year per 1000 population in a year.** **Influenced by:** nutrition housing conditions medical care lifestyes working conditions war **Reasons for decrease:** healthy diets; good housing; high quality medical care; no smoking & minimal alcohol consumption; exercise; good working conditions; no war

Net Immigration

More people coming to live in the country (immigrants) than people leaving the country to live elsewhere (emigrants).

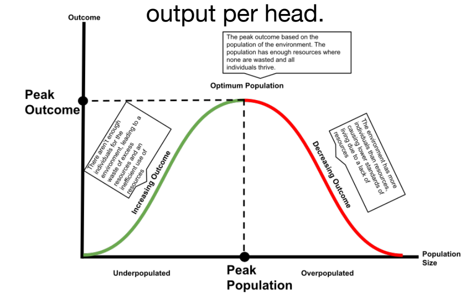
Influenced by: living standards; persecution; control on movement of people

Most emigrants are single people of working age.

Optimum Population

(https://en.wikipedia.org/wiki/Optimum_population)

The size of population which maximises the country's output per head.



It is a balance between population and resources.

Infant Mortality Rate

The number of deaths per 1000 live births in a year.

Population

All the inhabitants of a particular place.

Effects of increasing population if…
Under-populated: can make better use of resources; size of markets will increase; reduced training costs if using skilled migrants; extra demand generated; rise in labour force
Over-populated: concerns about famine; demand-pull inflation; living standards reduce; overcrowding; environmental pressures; pressure on employment opportunities; balance of payment pressure.

Net Migration

The difference between immigration and emigration.

Ageing Population

Increase in the average age of population due to lower birth rate, net migration and/or lower death rate, e.g. Japan, Italy, Germany, USA
Consequences: rise in dependency ratio; change in the labour force; higher demand for healthcare; greater need for welfare services; rise in the costs of state and private pensions; changes in the patterns of demand.
Possible counteractions: raise retirement age; compulsory saving for retirement; make workers more productive through education and training; encourage young, skilled migrants through issuing more work visas.

Population Pyramids

A diagram showing the age and gender structure of a country's population.

Reasons for more females: higher life expectancy and infant mortality rate.
Reasons for more males: cultural preference/abortion (India/China), migration of workers (UAE).
Categories: under 16; 16-64; over 65

Internal Migration

Migration within a single country, often rural to urban migration, but can also be urban to rural.

Generally powered by the need for employment, but can leave services and industries under employed, such as teachers, farmer labourers, carers etc.

Rapid expansion can lead to : slum areas, over-crowding; rent rises; congestions; inadequate infrastructure; social pressures; rises in crime etc.

Dependency Ratio

The proportion of the population that has to be supported by the labour force (those below school leaving age and above retirement age).

$$\frac{\text{No. in dependent age groups}}{\text{No. in the labour force}} \times 100$$

Economic Development

An improvement in economic welfare.
Improves living standards, reduces poverty, expands the range of economic/social choices, increases freedoms and self-esteem. Starts with meeting basic needs, then spreads to choice and consumerism. It tend to mirror GDP, & an increase in one country often benefit other countries.
Measures: real GDP (usually in US$ per head, for comparison); Human Development Index (HDI) (scale of 0-1, 0.55 very low, 0.8 very high development))
Causes of differences: incomes per head and resulting savings; investment; population growth; education and healthcare; size of primary, secondary and tertiary sectors; range of exported products; productivity.

Low Economically Developed Countries	**E.g. Chad, Gambia, Liberia** **Problems:** high population growth; high levels of international debt; reliance on the export of primary products; lack of investment in human capital and capital goods; emigration of key workers; trade restrictions on their products; unbalanced sectors within their economy. **Possible measures to promote economic development:** - Import substitution - promote export - Improve infrastructure - attract MNCs or borrow		
The World Bank	An international organisation which provides long term loans on favourable terms, to promote development.		
The International Monetary Fund (IMF)	An international organisation that promotes international trade and global financial stability.		
Foreign Aid	Food, money or other goods given or lent by one country to another. **Pro:** increase development **Cons:** can create dependency; postpone necessary reforms; bring in inappropriate technology; possible corruption; used for non-profitable ventures. **Tied aid:** foreign aid with strings, e.g. all products must be purchased from donor country. **Bilateral aid:** from one country to another **Multilateral aid:** aid channelled through international organisations, e.g. UN, IMF, EU, Oxfam etc.		

Economics Key Terms: Section 6

International trade and globalisation

Specialisation	**The concentration on particular products or tasks** **Firm specialisation** **Pros:** ec.s of scale (buying materials/using machinery; ups international trade (new mgmt ideas, products, tech.) **Cons:** over dependance on other countries (raw materials, markets etc.); import tax/restrict on exports of materials **Economy specialisation** **Pros:** higher national output/real GDP; can consume more than country's production possibility curve as trading possibility curve can raise overall output; up lining stds. **Cons:** hard to know what best at producing; S&D affect whole nation; transportation costs may reduce natural competitive advantage.	Free Trade	Where no restrictions are placed on import and export or goods, products and services. Pros: allows countries to produce what they are best at; greater economies of scale; makes for more efficient production and economies; lower prices, better quality and more choice for consumers.
Absolute Advantage	Ability of a country/region/firm to produce a greater quantity of a good, product, or service than competitors, using the same amount of resources.	Trade Protection (protectionism)	**The shielding of a country's industries from foreign competition by restricting trade.** **Types** Tariff, Quota, Embargo, Exchange control, Quality standards, Expensive paperwork, Voluntary export restraints (VERs), Subsidies **Reasons** Protect infant, declining or strategic industries, raising employment & protecting trade position, protection from low wage competition, protecting industries from dumping, protection from other unfair competition (e.g. foreign gov't subs). Cons: less choice, higher prices, inefficiency, retaliation
Comparative Advantage	Ability of a country/region/firm to produce a greater quantity of a good, product, or service than competitors at a lower opportunity cost. Comparative advantage changes as relative costs change - as a country gains new skills, tech, natural resources, the opportunity cost of producing one thing over another changes.	Quota	A limit placed on imports or exports
Tariff	A tax on imports, aka, import duty, customs duty. Can be used to raise revenue, but generally to discourage the purchase of imports.	Embargo	A ban on imports or exports
Globalisation	**The process by which the world is becoming increasingly interconnected through trade and other links. Through…** • Reduced transport costs • Advances in communications • Removal of some trade restrictions **Consequences** **Pros:** increase comp.; greater choice; production moved to most efficient places **Cons:** economies more susceptible to external shocks; wider implications have to be considered in national policy; MNC have power over a country & its employment rates; occupational mobility is increasingly necessary.	Exchange Control	A limit on the amount of foreign currency that can be obtained

Voluntary Export Restraints (VERs)	Agreements with other governments to restrict their exports to the country.	Foreign Exchange Rate	**The price or value of one currency in terms of another currency or currencies.** **Foreign exchange rate index** is the price of one currency in terms of a basket of currencies, weighted according to their importance in the country's international transactions. **Reasons for exchange rate fluctuations:** Speculation, D of M/X, purchase and sale of financial assets, foreign direct investment and central bank action. **Gov't/central bank action:** buy and sell the currency; raise interest rates; raise X, reduce M to raise value of currency. **Effects:** Ex rate up = higher X P, cheaper M P, Ex rate down = higher D for domestic products = output/employment up/ P of raw mats up = inflation up.
Infant Industries	New industries with relatively low output and high cost, aka sunrise industries.	Fixed Exchange Rate	**An exchange rate whose value is set at a particular level in terms of another currency or currencies.** A fall in the value of a fixed exchange rate is called a **devaluation** and a rise is called a **revaluation**. **Pros:** Creates certainty; easy to plan **Cons:** central bank may have to use up large amount of foreign currency to maintain value; may have to use policy measures (e.g. raise interest rates) that go against other gov't objectives; if a gov't can't maintain an exchange rate at a given value, it may have to change its price, causing a loss in confidence int he economy.
Declining Industries	Old industries which are going out of business, aka sunset industries.	Floating Exchange Rate	**An exchange rate which can change frequently as it is determined by market forces.** A fall in the value of a floating exchange rate is called a **depreciation** and a rise is called an **appreciation**. **Pros:** can help eliminate gap between X rev & M expenditure, don't need reserves of foreign currency to use to influence price of own currency. **Cons:** can fluctuate making it difficult to plan, speculation can cause significant swings in value, large depreciation can cause inflation - in practice, a central bank may still intervene when needed & not leave it all to market forces. (As a S&D curve, it is the P of one currency in terms of another, usually US$.)
Strategic Industries	Industries that are considered important for the survival or development of the country.	Foreign Direct Investment (FDI)	Setting up production units or buying existing production units in another country
Dumping	Selling products in a foreign market at a price below the cost of production. This may be to maintain high prices in the domestic market, or kill off foreign competition (predatory dumping)	Hot Money Flows	The movement of money around the world to take advantage of differences in interest rates and exchange rates.

International Competitiveness	**Indicators of how competitive a country is internationally:** – economic growth rate (stable) – share of world trade (reasonable) – level of expenditure on investment and R&D (high) – quantity/quality of education/training (good) – state of a country's infrastructure (developed) **In short-term:** changes in the exchange rate and inflation rate can influence a country's international competitiveness - a fall in both would make a country's products more attractive to buyers both domestically and abroad. **In long-term:** changes in productivity have lasting effects.	Balance of Payments: Current Account	Shows the income received by a country and the expenditure made by that country through dealings with other countries. It is usually divided into: • trade in goods • trade in services • Primary income • Secondary income. Added together these give the current account balance, or current balance. **Surplus:** when credit exceeds debit **Deficit:** when debit exceeds credit. Over time, you want balance of payments stability.
Trade in Goods	**The value of exported goods and the value of imported goods.** **Deficit:** expenditure on M goods exceeding revenue from X goods. **Surplus:** revenue from X goods exceeding expenditure on M.	Exports & Imports X & M	Factors that affect value: – a country's inflation rate – a country's exchange rate – productivity – quality – marketing – domestic GDP – Foreign GDP – Trade restrictions
Trade in Services	**The value of exported services and the value of imported services.** **Deficit:** expenditure on M services exceeding revenue from X goods. **Surplus:** revenue from X services exceeding expenditure on M.	Current Account Surplus	**Causes:** low exchange rate; high quality of domestically produced products; high incomes abroad; low costs of production; high investment income earned abroad; the receipt of high workers' remittances. **Consequences:** country not consuming as much as it can afford; increase in surplus = increase in aggregate D = rise in real GDP & higher employment; more money entering than leaving an economy can = demand-pull inflation; can lead to raise in exchange rate as higher D for currency. **Corrective action:** revalue fixed exchange rate/encourage raise in floating Ex.rate; raise M with expansionary fiscal policy & monetary policy (e.g. drop income tax to up sales).
Primary Income	**Income earned by people working in different countries and investment income which comes into and goes out of the country.** Compensation of employees (inc. wages, salaries etc.) + investment income (inc. profit, dividends etc.) from abroad — compensation of employees/investment income to foreigns	Current Account Deficit	**Causes:** incomes at home/abroad (cyclical deficit: low incomes abroad &/or high incomes at home); high exchange rate (=high XP, low MP); structural problems (e.g. manufacturing, costs of production, marketing issues etc.); deficit on primary income &/or secondary income. **Consequences:** country consuming more than it is producing; fall in D = reduction in inflation; output and employment lower than possible; Corrective action: reduce M, increase X- restrictions, subsidies, reduce exchange rate; fiscal policies to lower domestic demand (raise income tax, interest rates, VAT etc.); supply-side policies to improve trade performance (education/training) - generally best in the long-term.
Secondary Income	**Transfers between residence and non-residence of money, goods or services, not in return for anything else.** E.g. gifts, charity donations, workers income sent back to family, gov't aid		