

Economics Class Note

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Money

- refers to any commodity that can be used as a medium of exchange that is widely accepted for goods and services
- **Main forms of money today**
 - Cash
 - Bank deposits
 - Money reserves placed in commercial bank accounts in electronic form
 - Central bank reserves
 - Money held by the central bank
- **Money supply**
 - Notes and coins in circulation
 - Value of the bank deposits
- **Functions of money**
 - **Medium of exchange**
 - Widely recognized and accepted
 - **Unit of account**
 - Measures the market value
 - **Store of value**
 - Could be stored and used at some time in the future
 - **Standard for deferred payments**
 - Used as the standard for future payments of debt
 - A function of money that enable people to borrow and pay back later
 - Encourage the use of a credit
 - Could be paid back through multiple payments over a period of time
- **Characteristics of money**

Money could lose its value thanks to inflation !

 - **Acceptability**
 - Widely recognized and accepted as a medium of payment
 - **Portability**
 - Conveniently portable, could be carried easily

- **Scarcity**
 - Must be limited in supply in order to keep its value
- **Stability of value**
- **Recognizability**
 - could be easily recognized
- **Divisibility**
 - A 100 note could be divided into 50 or 20 or 10 notes
 - Cattle and livestock are not "useful" forms of money as they are not divisible
- **Durability**
 - Fairly long lasting yet easily replaced if it becomes worn
- **Uniformity**
 - All 50 notes should look the same in order to become recognizable
- **Barter system**
 - refers to the direct exchange of products
 - **Problems with bartering**
 - double coincidence of wants -> highly inefficient
 - divisibility
 - half a sheep or two-thirds of a chicken is not very useful for traders
 - portability
 - a sheep or a fish is not that portable compared to paper money

Banking

- **Central Bank**
 - the monetary authority that oversees and manages the nation's money supply and banking system
 - **Key functions of a central bank**
 - Establishment of financial rules and regulations
 - **Issues notes and coins**
 - only authority that can print money
 - helps to bring uniformity
 - Sets interest rates
 - **Lender of last resort**
 - lending money during financial emergencies
 - helps to build public confidence in the country's banking system
 - Supervises monetary policy
 - **Banker for the government**

- receiving deposits from government
- making short-term to the government
- making payments for items of government expenditure
- manages public sector debt
- represents the government in international financial markets (foreign exchange)
- **Banker for the commercial banks**
 - overseeing the cash reserves of commercial banks
- Participation in international financial meetings
- Control of lending
- Management of the national debt

- **Commercial Bank**

- refers to a retail bank that provides financial services to its customers, such as accepting savings, deposits and approving bank loans or mortgages
- responsible for maintaining the deposits of their account holders
- are governed by the central bank
- **Functions of commercial banks**
 - **Making advances (loans)**
 - provide advances to their customers (overdrafts and mortgages)
 - **Accepting deposits**
 - accepts deposits from customers, including private individuals, businesses and governments
 - **Credit creation**
 - increase the money supply in an economy by making money available to borrowers
 - Collecting and clearing cheques
 - Offering additional financial services
 - Providing safety deposit boxes
 - Providing money transfer facilities
 - Offering credit card facilities
 - Offering internet banking facilities

Income & Households

- **Income Resources**

- **Interest on savings**
 - return on capital

- **Rent**

- earned from leasing property
- return on land

- **Dividends**

- a share of a company's profits
- return on enterprise

- **Profit**

- earned from running a business
- return on enterprise

- **Disposable Income**

- refers to the income earned by an individual after income tax and other charges such as pension contributions have been deducted.
- amount of income a person has is available to spend on goods and services

- **Current Expenditure**

- money spent on goods and services consumed within the current year
- spending on food, clothing, entertainment and haircuts

- **Capital Expenditure**

- money spent on fixed items owned by an individual or firm which lasts more than 12 months
- computers, cars, furniture, buildings and equipment

- **Spending pattern of low income group**

- Spending
 - spend most of their income on necessities, e.g. food, clothing and housing
- Saving
 - tends to be low as there is not much income left over after spending on necessities
- Borrowing
 - borrow to fund their expenditure on capital items
 - in extreme conditions, people may borrow to fund current expenditure of necessities
 - banks less likely to lend money to low income learners as they represent higher risk

- **Spending pattern of high income group**

- Spending
 - spend the smallest proportion of income on necessities
 - purchase luxury goods and services
- Saving
 - high level of savings possible
 - save a greater proportion of their income
- Borrowing
 - occurs but there is only a small risk of not being able to repay loans for capital expenditure and mortgages
 - generally a smaller need to borrow money

- **Conspicuous income**

- the purchase of goods or services for the specific purpose of displaying one's wealth

- **Factors of spending, saving and borrowing**

- **Interest rates**

- cost of borrowing but reward for saving
 - saving - interest rate to be high
 - borrowing - interest rate to be low

- **Confidence levels**

- The level of spending in an economy is heavily influenced by the level of consumer and business confidence in an economy
 - During a recession or a period of low economic growth people may prefer to save rather than spend as they lack confidence about the future, which contrasts in a economic boom

- **Inflation**

- Price level increase, purchasing power reduces
 - Spending & Saving decrease, Borrowing increases

- **Age**

- A young single person may earn a relatively low income and may spend most of it on goods and services to support their lifestyle
 - As a person gets older their earnings would typically rise and saving might increase to buy a property or in anticipation of marriage and children

- **Size of household**

- The bigger your household, the greater you are going to spend

- **Attitude to saving**

- As every person is different, they each have a different attitude to saving

- **Income levels**

- The more money one earns, the more he is likely to spend.

- **Credit cards**

- Allows individuals and firms to purchase goods and services with deferred payment

- **Store cards**

- To encourage spending, as a credit card that can be used only in the individual retail outlet

Workers

- **Wage factors**

- the financial rewards that workers

- **Types of payment**

- **Wages**

- time-based, paid hourly, daily or weekly, so are a variable cos to firms

- **Salary**

- paid monthly a fixed rate irrespective of amount of work done

- **Piece Rate**

- gets a pay rate for the amount picked, packed, pruned or made

- **Commission**

- A percentage of the value of products sold

- **Bonus**

- An additional lump sum of money paid during the year, dependent on performance

- **Profit-related pay**

- Additionally payment of workers, based on the amount of profits made by a firm

- **Share issue**

- Workers receive shares in the firm to give them an incentive to work hard

- **Fringe benefits**

- Additional benefits, which have a monetary value

- **Non-wage factors**

- Length of training required
 - Length of education required
 - Recognition in the job
 - Personal satisfaction gained from the job
 - Level of experience required

- **Wage determination**

- determined by the interaction of the demand for labor and the supply of labor
 -

- **Demand for labor**

- refers to the number of workers that firms are willing and able to employ at a given wage rate
 - is a **Derived Demand**
 - labor is demanded for the G & S it produces, and not for itself

- downward-sloping demand for labor curve

- because firms are able to **hire more workers** when the **wage is lower**

- **Factors influence**

- **The level of total demand in the economy**

- demand for G&S increases in economic growth, and therefore the demand for labor would be higher to produce the G&S

- **The Productivity of labor**

- the demand for workers increases as their productivity increases

- **The cost of labor**

- as compared with the cost of machinery and technology that could replace the labor
- technology and machinery are expensive to purchase in the **short run**, but benefits in the **long run**

- **Supply of labor**

- people who are of working age and who are both willing and able to work at different wage rates
 - does not include people in full-time education
- **upward-sloping** supply of labor curve
 - more people are likely to work when the wages increase
- **Labor force participation rate**
 - the percentage of the working population that is working rather than unemployed
 - Influenced by
 - the official retirement age of the country
 - the age distribution of the workforce
 - the number of women in the workforce
 - the number of full-time and part-time workers in the labor force

- **Wage determination**

- **Changing social attitudes**
 - more women are entering the workforce and delaying having families
 - a falling birth rates and aging populations as a result
 - **Geographical mobility**
 - Family ties
 - Costs of living
 - **Occupational mobility**
 - some countries around the world have shortages in certain occupations
- **Relative bargaining power**
 - **Age and experience**
 - workers can negotiate higher salaries and wages if they have a greater degree of experience
 - in general a person's earnings potential declines after the age of 60
 - **Trade union**
- **Government policies**
 - minimum wage
 - **Disadvantage**
 - unemployment
 - workers earn more than min wage may request more to maintain wage differential
 - **Advantage**
 - workers are not exploited and receive a "liveable" wage
 - unemployed may have an incentive to work

- low income has more to spend -> increase consumption
 - easing the fear that higher wage would lead to unemployment
- **Between skilled and unskilled workers**
 - skilled worker -> relatively high demand and low supply
 - unskilled are elastic in supply, while skilled are inelastic
 - because unskilled are easy to increase the supply
 - skilled are difficult due to the level of qualifications and length of training
- **Primary, secondary and tertiary**
 - tertiary has high earnings
 - because it requires postgraduate-level study, professional examinations and year of experience
 - the reward for their time and effort is high wages
 - in some cases, students have to take out loans for university and postgraduate training, and they would only be prepared to do this because of the potential reward of high future earnings
- **Male and female**
 - more women in part-time work than men, lower earnings on average
 - women take career breaks to have children and therefore miss out on promotional opportunities
 - women may accept low-paid and part-time jobs as hours are flexible
 - women may face discrimination at work
- **Private and public**
 - private has higher earning potential due to profit maximization (more bonuses)
 - so they have more risk and jobs are less secure
- **Division of labour / specialisation**
 - **Specialization of labour**
 - occurs when a worker become an expert in a particular profession
 - **Division of labour**
 - occurs when a production process or task is split between different workers, who become experts in a part of the process
 - **Advantages**
 - workers become expert -> their productivity and efficiency increase
 - quality of the product or service increases
 - workers become skillful, so their earning potential may increase
 - culminate in higher motivation, productivity, output and competitiveness for firms

- **Disadvantages**

- work may become repetitive and boring
- workers may become alienated
- the production process may become overspecialized -> too dependent on an individual
- workers may become deskilled in other fields -> lack of flexibility
- culminate in lower motivation, productivity and output for firms

Trade Union

- an organization which exists to protect the rights of workers
- aim to bargain for better terms and working environment for their members
 - conflict between the aims of employees and employers
- paying a membership fee (yearly basis) to join
 - pay for the administrative and legal expenses of operating the trade union
- **Types of trade unions**
 - Craft unions
 - organize workers according to their particular skill
 - Industrial unions
 - represent all workers in their industry
 - are irrespective to skills
 - White-collar unions
 - recruit professional, administrative and clerical staff and other non-manual workers
 - such as teaching and banking
 - General unions
 - prepared to accept anyone
 - Professional body
 - some occupations don't have trade unions
 - sets entry requirements in terms of examinations, training and level of experience
 - such as law
 - Close shop
 - all workers must be in the trade union
- **Roles of trade unions**
 - **bargaining** for pay rises and better terms and conditions
 - ensuring equipment is **safe** to use
 - ensuring members are given **legal advice** when necessary
 - **giving support** to members when they are made redundant
 - providing **financial and legal** support to workers who may have been unfairly dismissed or disciplined
 - persuading the government to **pass legislation** in favor of workers
 - discuss the imposition of a national minimum wage

- **Collective Bargaining**

- a trade union representative voted by union members negotiates on behalf of the workers
- more powerful than each worker negotiates individually

- **Reasons for bargaining**

- a rise in cost of living due to inflation
- workers in comparable occupations who have received a wage increase
- increased profits of the firm and industry as a whole
- an increase in the productivity of labor

- **Industrial actions**

- **Strike**

- members refuse to work
- output of G & S ceases

- **Work to rule**

- members work to fulfill the minimum requirements of their job
- efficiency decreases

- **Go Slow**

- members complete their work very slowly
- productivity and efficiency fall

- **Sit in**

- members turn up to work and occupy the premises but do not undertake their normal work
- production ceases

- **Factors influencing the strength**

- number of members

- **reasons for high level membership**

- growth in manufacturing
 - often unionized as workers typically receive low pay and poor conditions
- a widening wealth gap

- **reasons for low level membership**

- government legislations
- decline in manufacturing jobs
- growth in part-time employment
- **increase in unemployment**
- **increase in employment in small firms**
- **increase in the number of self-employed people**

- degree of their unity

- **Ad & Disad of trade union membership**

- **Advantages**

- channel of communication
- negotiate with employers
- negotiate with the government
- can help reduce conflicts
- offer legal support

- **Disadvantages**

- trade unions are often portrayed to be negative due to industrial actions
- increase the firm's production costs

Firms

- **Different economics sectors**

- **The primary, secondary and tertiary sectors of an economy are interdependent**

- linked through the chain of production

- **Primary Sector**

- firms that extract **raw** materials from the earth
- e.g. fishing, mining and agricultural farming

- **Secondary Sector**

- firms that produce **manufacture goods**
 - changing raw materials into finished products
- firms that **construct buildings**
 - roads and bridges building

- **Tertiary Sector**

- firms that provide **services** to the general public and other firms
- e.g. retail shops and doctors

- **Private and Public sectors**

- **Private sector**

- gets money through demand and supply
- types of private sector firms
 - sole trader
 - a business owned and controlled by a single person
 - partnership
 - owned by between two and twenty people, with share ownership and risk-taking
 - private limited company
 - owned by shareholders, who cannot openly and freely share their holds
 - public limited company

- owned by shareholders, who can openly and freely share their holds
- **Public sector**
 - owned by the government
 - gets money through tax revenues
- **Size of firms**
 - **Number of employees**
 - < 50 people are considered small
 - some are high capital-intensive
 - **Market share**
 - firm's sales revenues as a proportion of the industry's sales revenue
 - 5% is considered to be a small firm
 - **Market capitalization of a firm**
 - stock market value of a company
 - calculated by *total number of shares * current share price*
 - **Sales revenue of a firm**
 - unit price times quantity sold
 - \$ 9.5 million is considered to be a small firm
 - **influence on the size**
 - size of market
 - higher the demand, larger the sale, larger the firm
 - availability of finance
 - can borrow to expand
 - age of firms
 - larger tends to be bigger
- **Small firms**
 - a **sole trader** is an individual who owns his or her personal business
 - **Why have small firms**
 - personal shopping experience
 - located in remote are
 - provide a range of goods which cannot be bought in a supermarket
 - can adapt quickly to changing consumer tastes
 - **benefits of small firms**
 - few legal formalities exist
 - the sole trader is the only owner of the firm
 - not having to take orders from others
 - know their customers on a personal level
 - easier to manage and control

- **disadvantages**

- limited start-up capital
- largest risk of business failure
- higher unit costs of production

- **Internal growth of firms**

- occurs when firms expand using their own resources
 - increasing the number of branches (stores)
 - selling their products in a greater number of countries
 - finance this expansion using profits earned within the business
 - help firms to increase its market share

- **External growth of firms**

- expansion involves another organization
 - such as mergers, takeovers and franchises
- **Merger**
 - two firms agree to form one new company
 - **benefits**
 - higher market share
 - skilled employees from each other
 - operating with fewer employees -> reduce costs
 - advantage of economies of scale
 - **drawbacks**
 - duplication of resources
 - job losses
 - diseconomies of scale
 - culture clashes

- **Take over**

- buying a majority stake in another business
- can be **hostile**
 - the firm being taken over might not agree

- **Franchise**

- an individual or a firm purchases a license from another firm to trade using the name of the parent company

- **Types of mergers**

- **Horizontal merger**

- when two or more firms in the same industry integrate

- **Backward vertical merger**

- when a firm from a higher sector merges with a firm from a lower sector

- **benefits**

- have control over quality of raw materials with which it is supplied
- the price of raw materials fall

- **drawbacks**

- total cost is increased
 - cost of running the farm in primary sector is added
- transport costs increase
 - raw materials were previously delivered by external suppliers

- **Forward vertical merger**

- when a firm from a lower sector merges with a firm from a higher sector

- **Conglomerate merger**

- when two or more firms from unrelated areas of business integrate to create a new firm

- **Economies of scale**

- the average costs of production fall as a firm grows or increases its output

- **Internal economies of scale**

- cost savings that arise from within the business as it grows

- **Purchasing economies of scale**

- decrease in the cost of raw materials, components to finished goods when bought in large quantities

- **Technical economies of scale**

- when large firms purchase expensive pieces of machinery and automated equipment
- large firms produce a large quantity of goods, thus
 - the high initial cost can be spread across the high quantity of output

- **Financial economies of scale**

- large firms are more likely to borrow money from banks

- **Risk-bearing economies of scale**

- when large firms produce a range of products in a variety of countries
 - therefore the risk is dispersed

- **Research and development economies of scale**

- large firms are able to fund research and development to be innovative and leaders

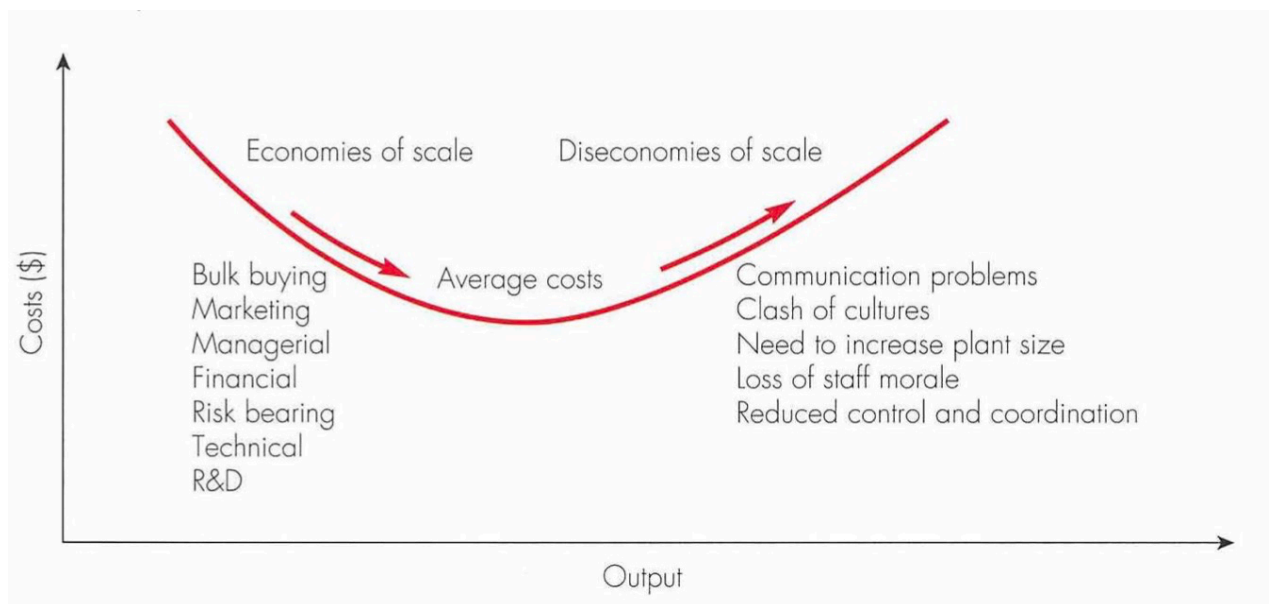
- **Marketing economies of scale**

- large firms have more advertising budgets on promoting products

- **Managerial economies of scale**

- large firms have the resources to employ specialist managers

- **External economies of scale**
 - arise due to the location of the firm, irrespective to the business
- **Availability of skilled labor**
 - high supply of skilled labour lowering the cost
- **Proximity of related firms**
 - other firms from the same production chain are near to the firm
- **Reputation of geographical area**
 - this provides all firms in the industry with publicity and exposure
- **Access to transportation networks**
 - beneficial if located near to major road networks
- **Diseconomies of scale**
 - the business may become too **too diverse** and start to operate in areas which it has less expertise, which cause costs to increase
 - **Managerial diseconomies of scale**
 - difficulties of managing large workforce
 - **External diseconomies of scale**
 -
 - **Technical diseconomies of scale**
 - physical limits on handling and combining inputs and goods in process
 - include overcrowding and mismatches between the feasible scale or speed of different inputs and processes
 - also occurs when a company's plant cannot produce the same quantity of output as another related plant



- **Average total cost**

- $ATC = AFC + AVC$
- **Average fixed cost**
- buying machines
 - expensive short run
 - cost saving long run
- marketing
- managerial-skilled-sabries
- research and development

Firms and Production

- **Factors of production**

- **land**
 - natural resources
- **labour**
 - workers
- **capital**
 - human capital (skills)
 - machines
- **enterprise**
 - willingness to start a business and take risk

- **Derived demand**

- the demand for factors of production rely on the demand for the product

- **Cost, availability and quality**

- **The quantity of FoPs**
 - the greater the availability, the lower their cost tend to be
 - demand and supply
- **The cost of FoPs**
 - the higher the cost, the lower their demands tend to be
 - labour replaced by machines when their costs are high
 - the demand for capital depends on the **cost of borrowing money**
- **The productivity of FoPs**
 - better quality resources tend to demand a higher price
 - the higher the productivity, the higher the demand for labour

- **Labour-intensive production**

- ratio of labour to machines is high
- can be very costly
- **Benefits**
 - suitable for producing customized goods
 - provided personalized service

- **Capital-intensive production**

- high costs initially
 - potentially cost saving
 - technological economies of scale in the long run
- to increase their output and productivity

- **Firm's decision**

- **profit maximizers**
 - choose capital-intensive method to minimize their unit costs of production
- **smaller scale**
 - choose labour-intensive to operate on a smaller scale or to safeguard jobs
- **cost of the resources**
 - firms tend to choose the lower costly resources
- **size of the market**
 - capital-intensive for markets

- **Production and productivity**

- **Production**
 - **total output** of goods and services in the production process
- **Productivity**
 - a measure of how well resources are used in the production process

- **Influence on productivity**

- **Investment**
 - expenditure on physical capital
 - depends on interest rate (high initial cost)
- **Skills and experience**
 - productivity is determined by the quantity and quality of labour

Firms' costs, revenue and objectives

- **Costs of production**

- the payments made by the firms in the production process
 - wages and salaries
 - wages are variable, salaries are fixed
 - rent
 - advertising expenditure
 - raw materials costs
 - utility bills
 - dividend
 - taxes

- **Types of costs**

- **Fixed costs**
 - costs that do not vary with output
- **Variable costs**
 - the costs of production that change when the level of output changes
- **Total costs**
 - the sum of all fixed and variable costs of production
 - $total\ costs = fixed\ costs + variable\ costs$
- **Average fixed costs**
 - fixed costs per unit
 - $AFC = \frac{FC}{Q}$
- **Average variable costs**
 - variable costs per unit
 - $AVC = \frac{VC}{Q}$
- **Average total costs**
 - aka cost per unit
 - the total cost of making one product
 - $ATC = \frac{TC}{Q}$

- **Revenues**

- **Total revenues**
 - the money payable to a business from the sale of its product

