

# Economics Class note G2

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### Unit 24 The Role of Government

- The roles

### Unit 25 The Macroeconomic Aims of Government

- The aims

- Conflicts

### Unit 26 Fiscal Policy

- Budget

- Taxation

- Government spending

- Limitations of fiscal policy

### Unit 27 Monetary Policy

- Money supply

- Exchange rate

- Monetary policy measures

- Monetary policy & Gov aims

- Limitations of Monetary policy

### Unit 28 Supply-side Policy

- Supply-side policy measures

- Supply-side policy and Gov aims

### Unit 29 Economic Growth

- Measurement of economic growth

- Nominal gross domestic product (nominal GDP)

- Judgements of GDP

- Growth & Recession

- The business cycle / The trade cycle

- Reasons for economic growth

- Reasons for recessions

- Consequences of economic growth

- Positive consequences

- Negative consequences

- Policies to promote economic growth

### Unit 30 Employment and Unemployment

- Changing employment patterns

- Measuring unemployment

- Types of unemployment

- Consequences of unemployment

- Policies dealing with unemployment

### Unit 31 Inflation and Deflation

- Degrees of inflation

- Values of money

- Measuring inflation

- Causes of inflation

- Consequences of inflation

- Potential costs

- Potential benefits

- Overall

- Deflation and disinflation

- Types of deflation

- Policies with inflation

### Unit 32 Living Standards

- Indicators of living standards

- 1. Real GDP Per Capita
- 2. Human Development Index (HDI)
- Factors affecting the living standards
- Unit 33 Poverty
  - Types of poverty
  - Causes and consequences of poverty
    - Vicious Cycle of Poverty
  - Measuring poverty
  - Policies with poverty
- Unit 34 Population
  - Factors of population growth
    - Birth Rate
      - Fertility Rate
    - Death Rate
      - Infant Mortality Rate
    - Net Migration Rate
  - Reasons for differences in the factors
  - Situations of population
    - The optimum population
    - Underpopulated
    - Overpopulated
  - Population distribution
    - Demographics
    - Gender distribution
    - Age distribution
      - Population pyramids
    - Dependency ratio
  - Effects of population changes
    - Population growth
    - Population distribution
- Unit 35 Differences in Economic Development Between Countries
  - Factors accounting for the differences
- Unit 36 International Specialization
  - Specialization at a country level
  - Advantages of international specialization
  - Disadvantages of international specialization
- Unit 37 Globalisation, Free Trade and Protection
  - Globalization
    - Role of MNCs
  - Free trade
    - Benefits of free trade
  - Protection
    - Methods of protection
    - Reasons for protection
    - Consequences of protection
- Unit 38 Foreign Exchange Rates
  - Determination of Foreign Exchange Rates
  - Floating exchange rate systems
    - Advantages
    - Disadvantages
  - Fixed Foreign Exchange Rate
    - Advantages
    - Disadvantages
  - Causes of foreign exchange rates fluctuations
  - Consequences of foreign exchange rate fluctuations
- Unit 39 Current Account of Balance of Payments
  - Structure of the Current Account
  - Current account deficit
    - Causes

- Consequences
- Solution -> using **conservative** methods
- Current account surplus
- Causes
- Consequences
- Solution -> using **progressive** methods

## Unit 24 The Role of Government

- the government needs to **collect tax revenue** from its citizens in order to operate effectively
  - from
    1. income tax
      - people employed legally
    2. import tax (tariff)
    3. firms

### The roles

#### 1. The local role

- *the local government*
  - a government or an organization with the authority to administer a range of policies within an area of the country
- the local government funds as a supplier
  1. **essential** goods and services
  2. **merit** goods
    - with positive externalities that improve social welfare
  3. **public** goods
    - non-excludable & non-rivalrous
  4. controls **natural monopolies**
- the local government acts as an employer
  1. hires workers to support the state enterprises -> reduces unemployment
  2. provides its workers with good quality training, prevents discrimination & ensures good pensions
  3. provides more secure employment

#### 2. The national role

- the central government makes decisions about how to achieve its macroeconomics aims
  - such as economic growth, stable price levels, low unemployment, a healthy balance of payment & redistribution of income
- **the policy areas include**
  1. **fiscal** policy 财政政策
    - how to raise money through taxation & other resources
    - decide its annual budget
  2. **monetary** policy 货币政策
    - decides interest rates/money supply to influence economic activities
    - through the central bank or other monetary authorities
  3. **supply-side** policy
    - minimum wage

- Competition Committee to regulate the action of firms
  - to promote economic growth through increasing the productive capacity of the economy
4. policies to protect the environment

### 3. International role

1. decides policies on **international trades**
  - restricts import & export
  - free international trades
2. attract or restrict the **MNCs** (multinational companies)
  - generates jobs and increases outputs
  - drives domestic firms out of business
3. be a member of the **trade bloc**
  - e.g. EU, WTO

## Unit 25 The Macroeconomic Aims of Government

- aims on a national level
- should focus on the *benefits, indicators & disadvantages* of the aims
- **conflicts**: doing one of the aims might result in the loss of the others
- every country can have these aims, but the extent is different based on the situation

### The aims

#### 1. economic growth

- increase the output of the economy
  - *Economic growth is an increase in the number of goods and services produced per head of the population over a period of time.*
- sustained economic growth is **important**
  - the most practical measure of **standard of living**
- can be shown by an outward shift of a PPC
- some countries that are having higher inflation, would aim for lower growth, while countries in a recession may aim for higher growth
- **Gross Domestic Product (GDP)**
  - the total market value of all final goods and services provided within an economy by its factor of production over a period of time
  - 1. *Nominal GDP*:
    - measured the current market value or prices
  - 2. *Real GDP*
    - measured assuming the price of goods are unchanged in a period of time
    - in constant prices, this GDP provides a measure of the real output of an economy
  - A **higher** GDP accounts for economic growth
    - indicates that the economy is utilizing its resources better or its productive capacity has increased

#### 2. stable price

- **inflation**

- the sustained rise in the general price level of an economy
- measured by (some)
  1. Consumer Price Index (CPI), mostly in the UK
  2. Retail Price Index (RPI), mostly in the UK
  3. GDP deflator

- if the price is not stable, high inflation,

- decrease in the living standards, quality of life decreases, purchasing power decreases, and the functions of money start to deteriorate (loses its potency)

### 3. **low unemployment**

- *a lowest possible level/rate of unemployment*

- full employment **doesn't** mean everyone in the labor force has the job because there is always some looking & switching between jobs

- **unemployment**

- people are **willing and able** to work, and are **actively seeking employment**, but are **unable** to find a job

$$\text{population} \begin{cases} \text{working population (age 18 - 65)} \\ \text{non - working population (children, full - time students, retired)} \end{cases} \begin{cases} \text{labour force (willing and able)} \\ \text{non - labour force} \end{cases} \begin{cases} \text{employ} \\ \text{non} \end{cases}$$

- it is calculated as

$$\text{unemployment rate} = \frac{\# \text{unemployed}}{\# \text{labour force}} \times 100$$

- **benefits**

1. complements economic growth
  - higher employment counts for higher GDP
  - hence tends to increase the standards of living
2. greater efficiency in the use of the economy's resources
3. a source of tax revenue to the government (income tax)
4. reduces social disruption from protests
5. reduces income and wealth inequalities

### 4. **BOP equilibrium**

- **balance of payment**

- a financial record of a country's transactions with the rest of the world for a given time period, usually one year
  - includes the country's trade in goods and services
  - **debit items**
    - all payments made to the other countries
  - **credit items**
    - all payments received from other countries

- **situations**

1. **surplus**  $+ > -$  (export > import)
2. **deficit**  $- > +$  (import > export)
3. **equilibrium**  $+ = -$  (import = export)

- BOP equilibrium is preferred
  - A small BOP surplus is acceptable
  - high surplus/deficit may bring negative consequences
- developing countries might want more export, as they need revenues

## 5. Redistribution of income

- aims to achieve greater equality in the distribution of income
- *The problem of the income distribution,*
  - arises because of natural unequal ownership of factors of production
- **progressive taxation**
  - charges a higher percentage tax as an individual's income rises
- **advantage of even income**
  1. trusts between economic agents
  2. decreases the number of the very poor - have access to education and be productive
  3. higher stability
  4. accelerates savings and results in more investment and greater demand for locally produced goods and services -> may further increase income

## Conflicts

- if the government chooses one objective to accomplish, another cannot be chosen
  - if you attempt one objective, the other objects will be affected

### 1. Full Employment v.s. Stable price

- once everyone has a job ->
  - they would have income ->
    - start to spend ->
      - INFLATION
- the firms may face shortages of workers ->
  - increase in the price of labor ->
    - the wage increase can translate to an increase in the price of other goods

### 2. Economic growth v.s. BOP stability

- growth can increase GDP and bring benefits, but it may cause disequilibrium in the BOP
- growth means higher GDP and higher income ->
  - higher income means more imported goods consumed ->
    - BOP will face a deficit

### 3. Economic growth v.s. Stable price

- increase in income ->
  - spend more ->
    - inflation

#### 4. Economic growth v.s. Redistribution of income

- in economic growth, richer get richer faster and easier ->
  - widen the income gap
    - make the redistribution of income a challenging task

### Unit 26 Fiscal Policy

- the use of **taxation** and **government spending**
  - to influence the **level of economic activity/total demand**
  - to achieve **macroeconomic aims**
- can be **expansionary fiscal policy**
  - stimulate the economic activity
  - through **increasing** government expenditure and **decreasing** taxes
  - used in **recessions**
- or **contradictionary**
  - reduce the level of economic activity
  - through **decreasing** government spending and **increasing** taxes
  - used when **high inflationary pressure**

### Budget

- Fiscal policy -> budget balance
- an annual statement in which the government sets out its plan for the amount to spend and raise in revenue
  - **Budget deficit**
    - government spending > tax revenue
    - hence, the gov has to borrow
  - **Budget surplus**
    - government spending < tax revenue
  - **Balanced budget**
    - government spending = tax revenue
- the balance of **government spending** and **government revenue**

### Taxation

- a government levy on income or expenditure
- **aims of taxation**
  1. **to raise revenue**
    - tax is the main source of government expenditure
  2. **to redistribute income from the rich to poor**
    - higher income pays more tax which is used to pay benefits to the poor
    - macroeconomic aim -> redistribution of income
  3. **to discourage the consumption of demerit goods**
  4. **to raise the costs of firms that impose costs on the others**
    - externalities in the production of firms
  5. **to discourage the consumption of imported goods and thus protect domestic products**
    - import **tariff**
  6. **to influence economic productivity**

- a reduction in tax can stimulate consumption
- **types of taxation**
  1. **direct taxes**
    - are taken directly from individuals or firms and their **incomes or wealth**
    - the **burden** falls directly on the firms or individuals responsible for paying for it
    - divided into
      1. personal income tax
      2. corporation (profits) tax
      3. capital gains tax
      4. wealth tax
    - normally **progressive** in nature
  2. **indirect taxes**
    - are taken indirectly from incomes when they are spent on goods and services
    - production tax is one of it
    - examples include
      1. excise tax
      2. value added tax
      3. sales tax
      4. custom duties
    - normally **regressive** in nature
  3. **progressive taxes**
    - the **tax rate** is **higher** for people with more income and wealth
    - e.g., income tax
  4. **regressive taxes**
    - the **tax rate** is lower for people with more income and wealth
    - e.g., VAT(Value-added Tax)
  5. **proportional taxes**
    - the **tax rate** stays **the same**
- **impact of taxation**
  1. *price and quantity*
    - shift the supply curve
  2. *saving*
    - high tax may discourage saving
  3. *economic growth*
    - reduces the incentive to work
    - reduction in taxation can lead to (1) economic growth and (2) a lower unemployment rate
  4. *distribution of health*
- **Tax evasion**
  - 逃税
  - an illegal attempt to defeat the imposition of taxes by individuals, corporations, trusts and others
  - cutting the rate of the tax **decreases** tax evasion

## Government spending

- **Reasons for government spending**

1. to influence **economic activity**
  - increasing spending -> increasing aggregate demand
2. to reduce **market failure**
  - spending on producing public goods and merit goods
3. to promote **equality**
  - redistribution of income
4. to pay interest on the national debt

## Limitations of fiscal policy

1. *recognition lags*
  - time lag in recognizing that something has to be done
2. *administrative lags*
  - the time delay between recognizing the need and implementing appropriate reactions
3. *impact lags*
  - the time delay between implementing the policy and seeing the results

## Unit 27 Monetary Policy

- **Monetary policy** is the manipulation of **interest rates**, **exchange rates**, and the **money supply** to control the amount of **spending** and **investment** in an economy
  - to influence *aggregate demand*
- the **aim** of monetary policy is to **control macroeconomic objectives** and to **affect the level of economic activity**
  - they can be used to either **contract** or **expand** the **economic activity** which can often be used to control changes in the **price level** in the economy
- In most countries, monetary policy measures are carried out by **central banks** on behalf of the government

### Money supply

to recap, money is any commodity that can be used as a medium of exchange for the purchase of goods and services

- **Money supply** refers to the **amount of money** in the circulation of an economy at a particular point in time
  - consists of **coins**, **banknotes**, **bank deposits** and **central bank reserves**
    - that meet money's functions including **medium of exchange** and **store of value**

### Exchange rate

- the **price of the currency in terms of another currency or currencies**

## Monetary policy measures

1. **Control of money supply**

- controlling money supply is rather **difficult**
  - as the definition of money is quite loose and banks can create credit fairly easily
- An **increase** in money supply

- encourages consumption -> encourages investment -> increases aggregate demand
- The **central bank** can **print more money**, **buying back government bonds** or **encourage commercial bank to lend more**
- A **decrease** in money supply
  - discourages consumption -> discourages investment -> decreases aggregate demand
  - The central bank can **sell government bonds in the open market** or **discourage commercial bank to lend**

## 2. Control of interest rates

- act as the **main** monetary policy measure to influence aggregate demand in terms of *consumer expenditure* and *investment*
- An **increase** in interest rate
  - people need to pay **more interest rates** on their loans -> **decreasing consumption**
  - **more expensive** to get a **new loan** to finance any spending or investments -> **decreasing investment**
  - **more incentive** to **save** as households earn more from saving -> **decreasing consumption**
- An **decrease** in interest rate
  - An **increase** in both spending and investment
- there may be times when a central bank decides to keep the **rate of interest** unchanged for a relatively *long period of time* in order to promote **certainty** for estimating loss and gain so **investment may be encouraged**

## 3. Control of foreign exchange rates

- controlling exchange rates is also rather difficult for many countries due to the **reliance on international trade** and **compliance with the regulations of the WTO**
- Exchange rate is determined by the **supply** and **demand** of the **currency** in the **foreign exchange market**
- An **increase** in exchange rates
  - **increasing price of exports** & **decreasing price of imports** -> decreasing net export -> decreasing AD
- An **decrease** in exchange rates
  - **decreasing price of exports** & **increasing price of imports** -> increasing net export -> increasing AD

### • Expansionary monetary policy

- aka. **loose monetary policy**
- can be used during **deflation** or **recession**
- aims to **boost** economic activity by expanding the money supply
  - done by **lowering interest rates**
    - makes borrowing more attractive to households and firms
    - people with loans would have more disposable income

### • Contractionary monetary policy

- aka. **tight monetary policy**
- used to reduce the threat of **inflation**, although in the long run can **harm economic growth** and **create unemployments**
  - done by **increasing interest rates**
    - reduce overspending and limit investment in the economy

## Monetary policy & Gov aims

### 1. Economic growth

- affecting the **interest rate** would affect the **aggregate demand**, and thus influences economic growth

### 2. Low unemployment

- as **aggregate demand** increases and **economic growth** occurs, low unemployment also achieves

### 3. Stable price

- **consumption** and **investment** influenced by monetary policies would affect inflation rates

### 4. BOP stability

- **exchange rates** would affect **BOP stability**

## Limitations of Monetary policy

### 1. Time lags

- it takes time for production and consumption to **adjust** according to interest rate changes
- including **Recognition lags**, **Administrative lags**, and **impact lags**

### 2. Uncertain outcome

- economic activity is **not totally** and **only dependent** on the interest rate
- **confidence level** also has an impact on GDP

## Unit 28 Supply-side Policy

- **Supply-side policies** are **long term** strategies aimed to **increase aggregate supply** and hence increase the **productive capacity** of the economy by using policies to improve the **quantity** and **quality** of the **factors of production**, meaning *the economy can produce more goods and services at all price level*
  - a general idea is the SSP tend to **increase the productivity of the FoPs & increase the productive capacity of the economy**
  - **Any policy measures that are designed to increase AS** -> **supply-side policies**
- the increased productive capacity can be shown as an **outward shift** of the country's PPC
- Supply-side policies **never** try to **reduce** aggregate supply

## Supply-side policy measures

### 1. Human Capital Investment

- **Human Capital**
  - the collective knowledge, skills and experiences of a country's workforce
- means Increasing government spending on (improving) education and training
  - increase **skills** of workers in order to **enhance productivity**
- **Government provisions** are needed in education industries in market economy
  - Government can directly fund the educational resources
  - or subsidize the private firms
  - both of these are costly to the government, so they may need to increase taxes

### 2. Deregulation

- refers to the removal or elimination of the barriers to entry (rules and regulations that have been enforced by law), thereby making markets more competitive and reducing government expenditure on regulating the industries and occupations

- with **more competition** in the market, **efficiency** may increase while the **costs of production** would be **lower**
  - however, deregulation might lead to **monopolies** as monopoly power can be abused to disrupt the market
3. **Privatisation**
- refers to the policy of selling of **state-owned assets** (property or public-sector businesses) to the **private sectors**
  - similar to deregulation, privatisation seeks to **increase competition** and **efficiency** by increasing the role of market forces
  - privatisation introduces the **profit incentives**, adds pressure to respond to the changes in **consumer demand** and makes them compete for the market share with high quality products at low prices
  - As with deregulation, there is **no guarantee** for more competition and **monopoly** may occur
4. **Tax Reforms**
- **lowering direct taxes and increasing incentives to work and invest**
    - **income tax cut -> increasing incentives & increasing disposable income**
      - may increase productivity and is good for low-income people
    - **reduce unemployment benefits -> increasing incentives to seek jobs & work**
      - may increase productivity (if they are fired, they would be benefited less)
    - **corporation tax -> increasing incentive to invest**
      - not be effective if the business **lack confidence** in the future
      - SSPs focus on the investments in research and development -> this would contribute to the economy
5. **Labour Market Reforms**
- designed to **make labour market more efficiently**
    - making it **easier** for employers to hire and fire workers and also provide more information of hiring
    - through providing more information of hiring
      - or removing the rigidities in labour markets, including excessive and complex employment legislation and the threat of strike action from trade unions
  - Overlap with **improving education and training** as well as **deregulation**
  - the **reforms of trade unions**
    - restricts the bargaining power of trade unions, which make workers more productive or reduce workers' benefits
6. **Subsidies**
- a government may provide subsidies to firms in particular industries for a number of reasons connected to **increasing the performance of the market**
  - subsidy is widely used and help reduce the cost of production

## Supply-side policy and Gov aims

- in the long run, **all** the government's macroeconomic aims have the potential to benefit from supply-side policy
    - as SSP directly affects the AS, improvement in which enables an economy continues to grow in a non-inflationary way.
1. **Economic growth**
- sustainable economic growth can be achieved by SSP as the **productive capacity** of the economy is increased

## 2. Low inflation

- prevent the general price level from rising beyond control
- as the productive capacity has increased
  - the production can better meet the surging demand, preventing a skyrocketed price

## 3. Low unemployment

- increase in the productive capacity will tend to increase **national output**, thereby creating jobs in the economy in the **long run**
- also, **training and education** provides would also lower the unemployment rate

## 4. BOP Stability

- improve international competitiveness and helps to boost export earnings
- The main criticism of SSPs is the **time** that it takes to reap the benefits
  - e.g., it might take decades for nations to enjoy the benefits of improved education system or better infrastructure

# Unit 29 Economic Growth

- **economic growth** is the annual increase in the level of national output
  - the annual **percentage** change in the country's **GDP**
- it can be shown diagrammatically by an outward shift of the **PPC**

## Measurement of economic growth

### Nominal gross domestic product (nominal GDP)

- measures the **monetary value** of goods and services produced within a country **during a given period of time**, usually one year
- its components include
  1. **Consumption Expenditure (C)**
    - the **total spending** on goods and services by **individuals and households** in an economy
    - such as spending on *housing and food*
  2. **Investment Expenditure (I)**
    - the **capital spending** of **firms** used to **increase production and to expand the economy's productive capacity**
      - the sum of capital spending by all businesses within the economy
      - such as spending on *machinery, technologies, and the construction of new factories*
  3. **Government Spending (G)**
    - the **total consumption and investment expenditure** of the **government**
      - such as spending on *infrastructure*
      - ignores payments made to others **without any corresponding output**
        - such as *unemployment benefits*
  4. **Export Earnings (X)**
    - the **monetary value** of all **exports** sold to foreign buyers
      - such as earning from *Apple phones that sold in China*
      - can be calculated in GDP as domestic businesses earn from these exports
  5. **Import expenditure (M)**
    - the **monetary value** of all payments for imports
      - such as *Chinese buy Apple phones*

- can be calculated in GDP as the spending on these items means that money leaves the domestic economy
  - so  $M$  should be **deduced**
- **Net Export**
  - the difference between the values of a country's exports and imports
  - $X_{net} = X - M$
- therefore, the GDP can be calculated as,

$$GDP = C + I + G + (X - M)$$

## Judgements of GDP

### 1. Real GDP

- the value of national income that is adjusted for **inflation**
  - reflects the true value of goods and services produced in a given year
  - inflation artificially raises the value of a country's output

### 2. GDP per head / GDP per capita

- the GDP divided by its **population size**
- a key measurement for **standard of living**
  - as it indicates the mean average national income per person
- *ceteris paribus*, the **larger** the population size, the **lower** the GDP per head for a certain level of GDP

## Growth & Recession

- economic growth occurs when there is an **increase** in the level of **economic activity** in a country over time
- technically, an economic growth/recession occurs when GDP increases/decreases for **2** consecutive years

## The business cycle / The trade cycle

- describes the fluctuations in economic activity in a country over time

## Reasons for economic growth

### 1. factor endowments

- the **quantity** and **quality** of a country's factors of production
- For example, Saudi Arabia is well endowed in the supply of oil
  - so it could therefore **specialise** production on a large scale and benefit from **economies of scale** and **export** their low-price products in overseas markets

### 2. the labour force

- the **size**, **skills** and **mobility** of the economy's workforce has an impact on the country's economic growth
- For example, Germany has high skilled labours and India has a large labour force

### 3. labour productivity

- the **amount** of goods and services that workers produce in a **given time period**
- it is a **key determinant** in economic growth
  - determines the competitiveness of the economics' products compared to the others
- depends on several interrelated factors
  - such as *technology, motivation and training*

### 4. investment expenditure

- increase in investment -> boosts AD
- helps to boost a country's **productive capacity in the long run**
- in order to remain competitiveness in the long run, countries must invest in capital resources

### Reasons for recessions

- mainly effects on AD and AS
1. a higher level of unemployment
  2. higher interest rates
    - discourages investment but raises demand for savings
  3. greater uncertainty in the economy
  4. lower rates of disposable income
    - causing a fall in consumer spending
  5. lower level of government expenditure
  6. a decline in the demand for exports
  7. lower levels of consumer and business confidence

### Consequences of economic growth

- remember that **individuals do not benefit equally from economic growth**

#### Positive consequences

1. **improved standard of living**
  - higher income levels -> higher disposable income
  - eliminate absolute poverty
2. **employment**
  - higher AD & AS -> higher employment
  - helps to raise consumption and encourages further investment in capital, helping to sustain economic growth
3. **tax revenues**
  - higher disposable income -> higher level of spending -> more sales tax
  - the government can also collect more corporate tax (higher AD leads to higher revenue)
  - tax can be used to further sustain the economic growth

#### Negative consequences

1. **environmental consequences**
  - externalities such as pollution and congestion
  - can damage people's wellbeing and quality of life in the long run
2. **rise of inflation**
  - excessive demand -> demand-pull inflation -> rising price of goods
  - lower international competitiveness, lower standard of living
3. **inequalities in income and wealth**
  - people who get resources earn more
  - poor people suffer from rising prices
4. **resource depletion**
  - using up the scarce resources

## Policies to promote economic growth

### 1. Fiscal policy

- control **demand**
- **expansionary** fiscal policies

### 2. Monetary policy

- control **demand**
- **expansionary** monetary policies

### 3. Supply-side policy

- control **productive capacity**
- seek increase **competition, productivity, and innovation**

## Unit 30 Employment and Unemployment

- **employment** refers to the **economic** use of labor as a **factor of production**
  - also includes those who are **self-employed**
  - the benefits of employment are discussed here
- **unemployment** occurs when people of working age are both **willing and able** to work but **cannot find employment**
  - the legal working age is 15 according to ILO
- **full employment** refers to the **ideal** situation **when everyone in a country is willing and able to work has a job**
  - however, low unemployment  $\neq$  full employment

## Changing employment patterns

### 1. Employment sector

- as country develops, the number of people employed in the **primary sector** tends to **fall**, with the majority of workers being employed in the **tertiary sector** (see how USA works)
- **economy develops -> primary shifts to tertiary**

### 2. Delayed entry to the workforce

- as more people study to tertiary education level, the **average age** of employees entering the workforce **rises**
- more **female** and **mature** students have also entered tertiary education, limiting the potential size of the economy's workforce
- more people study -> less workforce
- **more female and mature go into education -> less workforce**

### 3. Aging population

- as the average age rises, partly due to **lower birth rates** and **longer life spans** in developed countries, the labour supply would be **lower**, and hence firms would have to employ older employees and hire people beyond their retirement age
- **average wage rises -> less workforce -> older workforce employed**

### 4. Formal sector employment

- refers to officially recorded employment, where workers pay income taxes and contribute to the country's official GDP
- as the economy develops, there is an **increase** in the proportion of workers employed in the **formal economy** and a decline in the proportion who work in the informal sector
- **economy develops -> more in formal sector -> more income tax & GDP**

## 5. Female participation rates

- measures the proportion of women who are **active** in the labour force
- as the economy develops, there tends to be a greater proportion of women active in the labour force, due to changes in social attitudes towards women in the economy
- **economy develops -> higher female participation rates**

## 6. Public sector employment

- as more countries around the world move towards market economy, there is a decline in the proportion of people employed in the public sector
- **more market economy -> more people employed in the private sector**

## 7. Flexible working patterns

- changes in the world economy have meant that firms need to be far more **flexible** in order to **compete internationally**
- such as *hiring more part-time staff, allowing employees to work from home and introducing flexible working hours*
- **changes in the world economy -> more flexible in employment (e.g., working at home / working hours)**

## Measuring unemployment

### 1. **the claimant count**

- measures the number of people who are out of work and **claiming unemployment benefits**
  - to qualify for benefits, they must prove they are **actively seeking employment**
- critics argue that it underestimated the true level of unemployment as those who are only seeking part-time work or people on job retraining schemes can not eligible for the benefits

### 2. **the labour force survey**

- uses the ILO's standardized **household-based** survey to collect work-related statistics

### • **unemployment rate**

- a measure of the percentage of a country's workforce that is out of employment

$$\frac{\text{Number of unemployed}}{\text{Number of unemployed} + \text{employed} + \text{self employed}} \times 100$$

## Types of unemployment

### 1. **Frictional unemployment**

- **transitional** unemployment
- occurs when people change jobs due to the **time delay** between leaving a job and finding or starting a new one
- **always exists** in the economy
  - it takes time for the labour market to match available jobs with the people looking for jobs

### 2. **Structural unemployment**

- **structural** and **long-term**
- when demand for products produced in a particular industry continually falls, often due to *foreign competition*
  - therefore **derived demand** falls
- it would be hard for the unemployees to find a new job, so **retraining** is needed
- caused by **mismatch** between the jobs that are available and the people looking for work

### 3. Seasonal unemployment

- when people who work in **seasonal** jobs become unemployed when demand for labor decreases

### 4. Voluntary unemployment

- situation in which someone **chooses** to not work
  - either because they will not take a job with low pay, or they are satisfied with the amount they receive from the government in benefits while not working

### 5. Technological unemployment

- An example of **structural unemployment** due to the advance in technology brings in **labour-saving** machines so that workers are gotten rid of

### 6. Cyclical unemployment

- **demand-deficient unemployment**
  - the most severe type
  - affects every industry
- caused by **lack of demand** which leads to a **fall in the national income**
- experienced during **recessions** and **slumps**

## Consequences of unemployment

- **individuals**
  - may suffer from stress, a lack of dignity and homelessness
  - even suicide
- **family and friends**
  - low incomes -> arguments & divorce
- **local community**
  - falling house prices (and hence asset values) and crime rates
- **firms**
  - lose out -> bankruptcy
    - due to low consumer spending, subsidize
- **government**
  - needs high expenditure on welfare benefits and healthcare for the unemployed
    - can lead to government debts in the long run
- **taxpayers**
  - stand to lose due to opportunity cost of unemployment
    - such as increased reliance on taxpayer's money to finance unemployment benefits
- **economy as a whole**
  - suffers from being less internationally competitive due to falling levels of spending and national output

## Policies dealing with unemployment

### 1. Fiscal policy

- tackles unemployment caused by **demand-side** issues through expansionary policies

### 2. Monetary policy

- tackles **demand-side** unemployment through the manipulation of interest rate

- lower interest rate -> more investment and borrowing -> more demand -> more derived demand -> more wage -> more labour
- 3. **Protectionist measures**
  - such as **tariffs and quota** to save domestic jobs from international competition
  - protect **demand** as well
- 4. **Supply-side policies**
  - **permanent** impacts but takes **longer**
  - **investment in education and training**
    - training -> new skills -> employment
  - **a reduction in trade union powers**
    - trade unions be at a lower bargaining position
    - so that wage rises wouldn't be demanded and firms wouldn't have to cut employment to cut the cost of production
  - **incentives**
    - government can offer tax allowances and/ or subsidies to reduce the costs of training and hiring workers
    - special economic zones could be set up in areas of high unemployment to create jobs
    - firms may be unwilling as the unemployed's productivity might be low and risky
  - **reducing welfare benefits**
    - give unemployed incentive to work

## Unit 31 Inflation and Deflation

- **inflation**: a **sustained increase** in an economy's price level
  - **does not mean** that **every price is rising** or that they are **rising at the same rate**
  - it means that, **on average, prices are rising at a particular rate**
    - For instance, an inflation rate of 6% would mean that, on average, prices are 6% higher than in the previous period
- when the **price level increases**, the **value of money falls** and its **purchasing power declines**

### Degrees of inflation

- **Creeping inflation**
  - low and stable rate (such as 2%, which is generally not a problem)
  - seeing a low and steady rise in prices may **encourage firms to produce more**
- **Hyperinflation**
  - inflation with a rate exceeding **50%** or even higher
  - occurs when inflation gets **out of control** and **sometimes results in people restoring to barter**
  - in such cases the currency usually has to be replaced by a new currency unit
    - it has lost its function as a *medium of exchange*

### Values of money

- **nominal values**
  - the values at the prices operating at the time
  - the **actual price** of an item in sale

- **real values**
  - values **adjusted for inflation**
- transformation

$$\frac{\text{Nominal values}}{\text{Real values}} = \frac{CPI_{\text{current year}}}{CPI_{\text{base year}}}$$

## Measuring inflation

- **rate of interest** is measured by the percentage increase in the price level relative to the previous year/month
- the **consumer price index** is a weighted index of consumer prices in the economy over time. It measures the **cost of living** for an average household

### 1. Selecting a **base year**

- this is usually a relatively **standard year** in which nothing unusual has occurred
- it is given a value of 100

### 2. Carrying out a survey to find people's spending patterns

- A sample of the population's households are asked to keep a record what they buy. The products purchased are **placed into categories** such as food and clothing and footwear

### 3. Attaching weights to the different categories

- Weights are based on the proportion of total expenditure spent on the different categories

### 4. Finding out price changes

- Prices in a range of retail outlets and from a number of other sources such as gas companies and train companies are **recorded**

### 5. Multiplying weights by prices changes

- The total will give the change in the **consumer price index**, an index that shows the **average change** in the prices of a representative basket of products purchased by households

## Causes of inflation

### 1. Demand-pull inflation

- occurs if prices are pulled up by an **increase in aggregate demand** that **are not matched by equivalent increases in aggregate supply**
- caused by **excessive demand**
- **major sources of increased demand**
  - low-interest rates & taxes -> **consumer spending**
  - **Firms** may substantially **increase their spending by responding to large increases in demand from consumers** and need **extra capacity** to satisfy that demand
  - government spending
  - **world demand** for the economy's **exports**
    - due to a boom in the world economy

### 2. Cost-push inflation

- occurs if prices are **pushed up** by **increases in the cost of production**
  - associated with changes in the supply side of the economy

- **major sources of increased costs**
  - **wages and salaries**
    - increase in wages is the **most important** cause of increases in costs of production
  - **increasing indirect taxes & reducing subsidies**
    - caused by the government
  - **imports**
    - increase directly in the price of the products
    - increase in the price of semi-manufactured goods and raw materials

## Consequences of inflation

### Potential costs

- think about rising price levels and confidence and opportunity costs
1. **A reduction in net exports**
    - increasing price of exported goods -> reduction in international competitiveness -> lower export revenue
    - increasing price of domestic goods -> increase import expenditure
    - BOP Problem
  2. **An unplanned redistribution of income**
    - some people gain and some people lose as a result of inflation
    - if rate of interest does not rise in line with inflation -> borrowers will gain and lender will lose
  3. **Menu costs**
    - costs involving in **changing prices**
    - e.g., time cost in changing the price in ads
  4. **Shoe leather costs**
    - **opportunity cost** in finding the cheapest product/highest rate of interests
  5. **Fiscal drag**
    - when the income levels corresponding to different tax rates **are not adjusted in line with inflation**
    - increase in inflation -> lower real money of income
  6. **Discouragement of investment**
    - decreasing **confidence** in the economy
      - **uncertainty** so firms might not invest
    - **real return** of investment would be **lower**
      - so firms would not invest

### Potential benefits

- just consider about the money value v.s. the real value
1. **Stimulating output**
    - a **low and stable inflation rate** caused by **increasing demand** may give firms **confidence**
    - if prices > costs -> profit increase -> provides fund for investment
  2. **Reducing the burden of debt**
    - Real interest rate may fall due to inflation or may even become negative
      - cuz nominal interest rates do not tend to rise in line with inflation
    - **A reduction in the debt burden** may **stimulate consumer expenditure** that, in turn, could **lead to higher output and employment**
  3. **Preventing some unemployment**

- **inflation** enables firms to **reduce the real costs of labour** by keeping nominal wages constant or by not raising them in line with inflation

## Overall

- **inflation is all about confidence and price levels!**
- demand-pull inflation is **less harmful** than cost-push inflation
  - demand-pull -> rising output
  - cost-push -> falling output
- high rate of inflation is **more harmful** than a low rate
  - losing faith in the currency
- An accelerating inflation rate, or an fluctuating inflation rate, will cause **uncertainty** and may discourage firms from investment
  - the need to devote more time and effort to establishing future inflation will increase costs
- unanticipated inflation also creates **uncertainty**

## Deflation and disinflation

- **deflation** is sometimes taken to mean a **low level of economic activity**, which might be the result of government policy
  - it involves a **negative inflation rate**
  - results in a **rise in the value of money**, with **higher purchasing power**
- **Disinflation** occurs when the **inflation rate falls** but is **still positive**
  - such as an inflation rate falling from 8% to 3%

## Types of deflation

### 1. Benign deflation

- occurs as a result of an **increase in AS**
  - a fall in the price level but rise in real GDP
  - maybe created by **advances in tech**
    - new methods of production -> lower costs of production -> output increases -> unemployment decreases -> international competitiveness increases

### 2. Malign deflation

- when the price level is driven down by a **decrease in AD**
  - results in lower output, lower employment and lower GDP
  - may cause **deflationary spiral**
    - consumers delay their purchases, expecting prices to fall further
    - firms, seeing low demand, may cut employment and not invest
    - which results in a further reduction in demand and economic activities

## Policies with inflation

### 1. **Fiscal policy**

- expansionary -> +AD -> inflation
  - especially useful in deflation to avoid **deflationary spiral**
- contractionary -> deflation

## 2. Monetary policy

- expansionary -> +AD -> inflation
- contractionary -> -AD -> deflation

## 3. Supply-side policy

- increasing productivity and productive capacity -> lower demand-pull inflation
- lower cost of production -> lower cost-push inflation

# Unit 32 Living Standards

- **Standard of living** refers to the **social** and **economic wellbeing** of individuals in a country at a **particular point in time**

## Indicators of living standards

- **sustained economic growth** is the most practical measure of the standard of living in a country

### 1. Real GDP Per Capita

- $Real\ GDP\ Per\ Capita = \frac{GDP\ adjusted\ after\ inflation}{Population}$
- higher GDP per capita -> higher standard of living
  - not necessarily the biggest economy (highest GDP) when taking into account the population size
- it is poor as it omits **environmental changes**

### 2. Human Development Index (HDI)

- the United Nation's composite indicator of **living standards** in a country, comprising **three dimensions of human development**: **education**, **healthcare** and **income**
  - **Education**
    - measures **years of schooling** and the **expected years of schooling**
    - in general, the **higher** the average years of schooling, the **greater** the degree of human development
  - **Healthcare**
    - measure **life expectancy at birth**
    - the **better** the healthcare in a country, the **greater** its social and economic wellbeing tends to be
  - **Income levels**
    - the higher the **national income / GDP**, the greater human development tends to be
    - poor countries have a low HDI, wealth countries have a high HDI
  - in general, three indices are **life expectancy**, **income per head** and **expected years of education**
    - sometimes expected years of education can be replaced by **literacy rate** for older papers...
      - it is in the education aspect as well
- **Benefits of HDI**
  - it is a **composite** index - considers several key indicators of standards of living rather than a single one
  - education and healthcare are more likely than real GDP to indicate a country's level of social wellbeing, as **uneven distribution of income** occurs

- **Limitations of HDI**

- just consider anything beyond Education, Income and Healthcare that has an impact on your economic and social wellbeing

1. **Qualitative factors**

- the HDI ignores qualitative factors affecting living standards
- such as gender inequalities and human rights

2. **Income distribution**

- the HDI does not take account of the inequitable distribution of income in the economy, and hence lacks accuracy as an indicator of living standards for the "**average**" people

3. **Environmental issues**

- the HDI ignores environmental and resource depletion resulting from economic growth

4. **Cultural differences**

- the HDI ignores cultural variations and different interpretations of the meaning of standards of living

## Factors affecting the living standards

--- Country-wise ---

- **Role of governments**

- government can use **direct taxes** to redistribute income
  - mix economy is more able to do that
- a fairer distribution can help raise living standards for the majority of a population

- **Composition of the economic growth**

- if GDP increases due to higher government spending on the military, this does not translate to better living standards for the majority of the population

- **General price level**

- **inflation** increases the cost of living, having a negative impact on standards of living

- **Level of freedom**

- freedom can be considered as impacting the living standards....
- civil liberties, political rights, religious freedom and economic rights
- **Human Freedom Index** measures the level of freedom

--- Region-wise ---

- **Regional differences**

- there are regional income and wealth disparities within countries

- **Size of population**

- the **size** and **demographics** of a population have a direct impact on living standards. **Densely** populated cities tend to have higher rents due to limited space and high demand, as well as congestion, pollution and higher cost of living
  - just consider Hong King...

--- Person-wise ---

- **Productivity levels**

- differences in productivity levels cause differences in **wages** and **earnings**
- high skilled workers generally have a higher living standard

- **Level of education**

- there is a **positive correlation** between educational attainment and earnings

- the more educated, the higher their earning potentials, the higher their potential living standards

## Unit 33 Poverty

- the conditions that exist when people **lack adequate income and wealth** to **sustain a basic standard of living**
  - can cause poor health, deaths, crime, low national output, and etc

### Types of poverty

#### 1. Absolute poverty

- exists when there is **extreme outright poverty**
- income spent entirely on **minimal amounts** of **food, clothing and shelter**
  - the basic human essential for survival
- these people face **financial difficulties** to meet their **basic human needs**
- **income threshold / Poverty Line**
  - people under this certain level of income are considered to be absolutely poor
    - the most common threshold is under \$1.25 per day

#### 2. Relative Poverty

- a **comparative** measure of poverty, referring to those who have a **lower standard of living** in **comparison** to the **average member of society**
- measures the extent to which a person's financial resources fall below the average income for the **country's** population
  - although real GDP and HDI have grown over time, these gains are not evenly distributed across the population
  - so increase in the living standard/GDP measures might be inaccurate considering the in distribution of income and etc
- there can still be people who are relatively well off but still to live in absolute poverty
  - as although they earn more than the average, they still face financial difficulties in meeting their basic human needs

### Causes and consequences of poverty

- **Overall**, poverty can be regarded as **having low incomes**
  - and poverty is a **cycle...**

--- Money ---

- **Unemployment**

- people in poverty are likely to be unemployed
  - perhaps due to the combination of low literacy, lack of skills and poor health
- hence, **labour productivity** in less economically developed countries (LEDCs) tends to be **low**
  - which again makes it difficult for people to break out of poverty
  - much like a poverty spiral...
    - poverty -> low skills -> low productivity -> hard to break out from poverty

- **Low wages**

- the lower the GDP per capita, the poorer the country tends to be due to the low wages in the economy

- low wages make it hard for people to sustain their basic needs, also would cause people to be under the average wealth level of the country

--- Personal Health ---

- **Illness**
  - illnesses caused by malnutrition and a lack of healthcare reduce **life expectancy**
    - the lower the life expectancy, the poorer the country tends to be and so the greater the degree of poverty in the country
    - they can make less money with a lower expectancy...
- **Age**
  - elderly people don't have an income to sustain their basic needs
  - poverty causes **child labours**
- **Low literacy rates**
  - literacy rates measure the proportion of the population aged 15 or above who can read and write
  - poverty -> insufficient investment in education and training -> low literacy rate -> lower productivity and production -> poverty
- **Poor healthcare**
  - poverty -> insufficient investment in health services -> poor healthcare -> lower life expectancy & lower productivity & weaker population -> poverty

--- Country Wise ---

- **High population growth**
  - population growth measures the annual percentage change in the population of a country
  - poverty -> high population growth rates (lack of family planning and sex education) -> cause the sharing of resources become even crowded -> poverty
- **Poor infrastructure**
  - infrastructure refers to the transportation and communications networks necessary for the efficient functioning of an economy
  - poverty -> poor infrastructure -> poorer living standard & productivity... -> poverty
- **Low foreign direct investment (FDI)**
  - the lack of capital resources also limits the ability of a country to create income and wealth
  - FDI refers to cross- border investment made by multinational companies and other investors
    - Poor countries, with their lack of economic growth and poor infrastructure, do not tend to attract FDI due to the **expected high risks** and **low financial returns**. This keeps these countries stuck in poverty
  - The witte system...
- **High public debt**
  - public debt refers to the money owed by the government
  - poverty -> more likely to borrow -> high debt -> low living standard (as the government needs to repay the loans with interest)
- **Reliance on primary sector output**
  - poverty -> over-rely on primary sector -> this sector has low prices and profit margins
- **Corruption and instability**
  - there are high **opportunity costs** of civil war and corruption
  - hinder economic development, result in greater inequalities in income distribution, and create poverty

## Vicious Cycle of Poverty

- the situation where people become **trapped** by poverty
- those who are poor are likely to have worse than average education and healthcare
  - this will reduce their productivity, employment opportunities and income, and will also affect the prospects of their children
    - which leads to further poverty
- once stepped into poverty, people are **trapped**

## Measuring poverty

- the **Multidimensional Poverty Index (MDI)**
  - a measure of poverty based on deprivation in **education, health and living standards**
- **Household surveys** are undertaken
  - e.g. asking how many households have no member who has completed five years of schooling, someone who is malnourished, and who has no access to clean water and no electricity
- each dimension counts for **1/3** of the total weighting
  - each subcategories evenly divided these one-thirds
- a household is regarded to be poor if they suffer deprivations on a third or more of the ten indicators

## Policies with poverty

- **overall**, there are two main ways: **redistribution of income** (relative poverty), **create more income/jobs** (absolute poverty)
- **promoting economic growth**
  - use the expansionary policies (monetary and fiscal)
  - help to create jobs
  - sustained economic growth create more income and wealth, which can be redistributed to the deprived and underprivileged members of society
- **improving the quantity and quality of education**
  - supply-side policies
  - improving access to education -> narrows the wealth gap
    - Chinese Gaokao...
  - education -> productivity -> economic growth -> less poverty
  - education -> more job opportunities -> less poverty
  - same approaches for healthcare as well
- **redistribution of income**
  - through progressive tax systems
    - richer pays more
  - so income can be transferred
    - transfer payment
- **introducing or increasing a national minimum wage**
  - improve the standard of living for low-income households
    - they have more income to meet their needs
- **encouraging MNCs**
  - the opening up of more firms creates job opportunities
    - just like how China did before...

- **providing more generous state benefits**
  - government provision of welfare benefits gives financial assistance to enable the unemployed and disadvantaged to meet their basic needs
  - but raising the benefits will influence the incentive to work...
- **land reform**
  - many countries (like Imperial Russia), workers work for landowners and so they don't want to increase the fertility of the lands as they are not theirs
    - a more equal distribution of land would increase incentive to produce and also living standards
      - as peasants can sustain their own life through the land not earning just little from the landowners or pay high rents to the owners
    - this is also a similar approach to redistribution of income

## Unit 34 Population

- **Population** refers to **the total number of inhabitants** of a particular country.
  - it is important as people are essential for the economic prosperity and also responsible for scarcity
- **Population Growth** refers to **the rate of change in the size** of a country's population

### Factors of population growth

#### Birth Rate

- measures **the number of live births** per **thousand of the population in a year**
- measured by

$$\text{birth rate} = \frac{\text{total \# of births}}{\text{population size}} \text{ (expressed per thousand of the population)}$$

#### Fertility Rate

- measures **the average number of births** per woman
- indicates **the potential for population change** in a country
- a fertility rate of **2** is considered to be the minimum **replacement fertility rate** of a stable population
  - the number of children that the average women must have to maintain a stable population size

#### Death Rate

- measures **the number of deaths** per **thousand of the population in a year**
- measured by

$$\text{death rate} = \frac{\text{total \# of deaths}}{\text{population size}} \text{ (expressed per thousand of the population)}$$

- the lower the death rate, the greater a country's population growth will tend to be
- the death rate is dependent on factors that **affect the quality of life**
  - such as income levels, health technologies, nutrition and housing

## Infant Mortality Rate

- measures **the number of infant deaths** for **every 1000 live births**
- indicates the overall health of a society

## Net Migration Rate

- measures **the difference** between **immigration** and **emigration** rates for a country

$$\text{Net immigration rate} = \text{immigration} - \text{emigration}$$

- indicates the **physical movement** of people into and out of a country
- it **does not** distinguish between workers migrants refugees and unlawful migrants
  - a **downside** of net migration rate
- **Immigration**
  - when people **enter** a country to live and work
- **Emigration**
  - when people **leave** a country to live and work abroad
- **Net immigration**
  - when immigration > emigration
- **Net emigration**
  - when emigration > immigration

## Reasons for differences in the factors

- **Birth rate**
  - More economically developed countries (MEDCs) tend to have a **lower** birth rate than less economically developed countries (LEDCs)
    - due to education, access to contraception, high costs of raising children, and women pursuing careers
- **Death rate**
  - MEDCs have a **lower** death rate
    - due to better education, healthcare, nutrition and sanitation
  - LEDCs have a **higher** death rate
    - due to famine, poverty, poor housing, high infant mortality rates and diseases
- **Net migration rate**
  - MEDCs **tend** to have a **higher** net migration rate
    - as people migrate for reasons such as better job opportunities and so on and there might be civil unrests in LEDCs
  - LEDCs is also **attractive**
    - as LEDCs might contain more undiscovered opportunities

MEDCs	LEDCs
Lower Birth Rate	Higher Birth Rate
Lower Death Rate & Infant Mortality Rate	Higher Death Rate & Infant Mortality Rate

## Situations of population

### The optimum population

- exists when the output of goods and services per head of the population is **maximized**
  - meaning that **GDP per capita** is maximized
  - intuitively, every resource is used efficiently by people using their full potential

### Underpopulated

- when there are not **sufficient labors** to make the best of use its resource
- in this case, GDP per head of the population could be **increased** if there were more human resources
- Fertility rate **below** the replacement level can lead to **under-population** -> causing potential economic decline
- to avoid, government can introduce measures to increase the population size
  - such as encouraging immigration

### Overpopulated

- where the population is **too large**, given the available resources of the country
- Fertility rate **above** the replacement level can lead to **over-population** -> causing potential negative consequence
  - such as famine, housing shortages, energy shortages, and diseases
- this causes a **fall** in GDP per capita as there are **insufficient resources** to sustain the population
- to avoid, government can introduce measures to reduce population size or to boost investment and productivity

## Population distribution

- refers to the **composition and structure** of a country's population

### Demographics

- the study of **population distribution and trends**

### Gender distribution

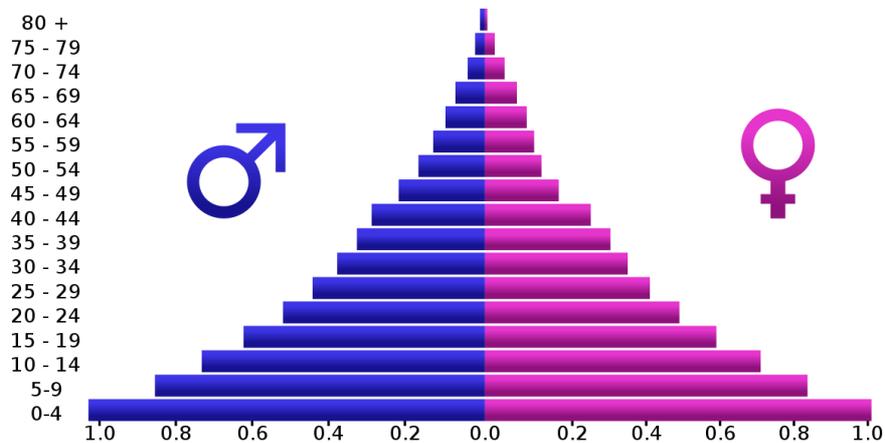
- the number of males compared to the number of females in the population
- the gender split is **quite even**

### Age distribution

- the number of people in different age groups in the population
- **LEDCs**
  - relatively **larger** proportion of their population in the younger age groups
- **MEDCs**
  - relatively **smaller** proportion of their population in the younger age groups
  - older societies

### Population pyramids

- a graphical representation of the age and gender distribution of a country's population



## Dependency ratio

- a comparison of the number of people who **are not in the labour force** with the **number of people in active paid employment**
  - **dependent population:** those aged between 0 and 14, and those aged 65 and above
    - including the unemployed and full-time students
  - **working population:** the active labour force aged 15-65
    - those in paid employment, the self-employed and the unemployed
- measured as

$$\text{dependency ratio} = \text{dependent population} \div \text{working population}$$

- the higher the dependency ratio, the **greater** the **tax burden** on the working population
  - to support those who are not economically active
- the dependency ratio can raise because
  - higher birth rates
    - mainly in LEDCs
  - higher compulsory school leaving age
  - social changes
    - such as workers entering the labour force at a later stage due to greater demand for higher education

## Effects of population changes

### Population growth

- put pressure on the resources of the country -> negatively impacting living standards
- but also give more labour force later on

### Population distribution

#### 1. Demands

- customers have different demands based on their age and gender
  - elderlies -> more healthcare and related products
  - young children -> education and clothing

## 2. Supply of labour

- rapid population growth (high birth rate and low infant mortality rate) -> increase the future supply of labour
- ageing population -> profound impacts on the future supply of labour

## 3. Tax revenue

- continual population growth
  - government is able to collect more tax revenues from a larger workforce
  - but also add pressure to the gov as it needs to offer more public services, welfare benefits and state pensions

## 4. Economy's resource

- continual population growth
  - put more pressure on an economy's scarce resource
    - inflationary pressures
    - increase in the demand for imports

## 5. Natural environment

- continual population growth
  - non-renewable resources are depleted in the production process
  - increased level of production also increased externalities
    - such as congestions

# Unit 35 Differences in Economic Development Between Countries

- **Economic development** is an intangible concept that considers both **quantitative** and **qualitative** variables in **raising the standard of living within a country**.
  - generally, refers to **an increase in the standard of living within a country**
  - factors include a reduction in poverty and income inequalities, and an increase in self-esteem, gender equality, and political freedom (both physical and mental)

## Factors accounting for the differences

### 1. Differences in income

- the **higher** the national income (real GDP per capita) of a country, the **greater** economic development tends to be
  - a **positive** relationship
    - because they have more money to fulfill their needs and wants
- LEDCs -> low national income per head
  - due to low nominal GDP and high birth rates
- High GDP -> **not necessarily** mean a higher standard of living
  - due to income inequalities
  - due to the composition of GDP
    - if spent more on national defense, living standards don't improve
  - due to externalities of economic growth
    - pollution, climate change, and environmental damage

## 2. Differences in population growth

- high population growth would lead to
  1. **low GDP per head**
  2. **competing pressure on scarce resources**
- But it also leads to more labour force and a relatively younger population
- Overall, rapid population growth can **harm** economic development

## 3. Differences in productivity

- the **higher** the productivity, the **greater** the economic development
  - a **positive** relationship
  - because an increase in productivity means more can be produced -> higher GDP
- LEDCs -> no access to the latest technologies and automated production systems

## 4. Differences in the size of economic sectors

- **Primary sector**
  - primary sector activity tends to dominate in LEDCs
- **Secondary sector**
  - predominant sector in most industrializing and developing countries
- **Tertiary sector**
  - the most important sector in high-incoming economies
- the **more** people working in the tertiary sector, the **greater** the economic development
  - primary and secondary sectors are more physically demanding, yet low rewarding
    - meaning lower living standards

## 5. Difference in saving and investment

- the **higher** the savings and investment, the **greater** the economic development
  - a **positive** relationship
  - because people in the LEDCs barely have enough money to meet their basic needs, let alone saving or investing
    - back to the topic of income again...
  - the more investment -> more funds for the firms to produce and expand -> more GDP -> more development

## 6. Difference in education

- the **better** the education, the **higher** the economic development
- because education is an indicator of HDI...
- Education can refer to
  - school leaving age
  - literacy rate

## 7. Difference in healthcare

- the **better** the healthcare, the **higher** the economic development
- because healthcare is an indicator of HDI as well
- Healthcare can refer to
  - life expectancy at birth
  - children mortality rates
  - country's expenditure on healthcare as a percentage of its GDP

## 8. Difference in geographical distribution of people

- the **higher** the rural to urban migration, the **higher** the economic development
- because people depend less on subsistence farming and agriculture
  - and the advancement in technology makes the demand for physical labours low
    - so they have to find a job in urban areas
    - and there are more opportunities in urban areas as well

## Unit 36 International Specialization

- **Specialization** occurs when **individuals, firms, regions, or countries** concentrate on the production of a particular good or service
  - **Individuals**
    - people might specialize in computer science or psychology
    - specialization allows people to become **more skilled and efficient**
      - increasing the quantity and quality of the goods and services being provided
  - **Firms**
    - KFC and MacDonald's specialize in fast food and etc.
  - **Regions**
    - Silicon Valley specializes in high-techs and etc.

### Specialization at a country level

- **International specialization** occurs when countries concentrate on the production of certain goods and services
- They concentrate on the product that they are **best at making** and are **in high global demand**
  - what countries are best at producing is influenced by **the quantity and quality** of their resources
- For example, Thailand and Vietnam specialize in the production of rice

### Advantages of international specialization

- International specialization can benefit both consumers, firms, regions and the country as a whole
- International specialization boosts an economy's productivity, so
  - **product quality** increases (as workers specialize)
  - **product quantity** increases
    - economies of scale
      - lower price
        - international competitiveness
  - **productive capacity** increases

#### 1. Efficiency gains

- specialization makes better use of scarce resources
  - as the scarce resources are manipulated by the one who knows many about it
- therefore, productivity increases -> GDP increases

## 2. Labour productivity

- workers become more skilled in the jobs they do
  - because they repeat and concentrate on a single task
- therefore, better-quality products can be produced

## 3. Increased productive capacity

- specialization shifts a country's PPC outwards
  - as it better uses the scarce resource, so more could be produced with the same amount of input
- therefore, more can be produced (with a higher productive capacity) -> GDP increases

## 4. Economies of scale

- specialization increases GDP and global trade
- therefore, firms are able to enjoy benefits from large-scale operations (economies of scale)
  - can avoid cost-push inflation

## 5. Improved international competitiveness

- specialization helps to enhance international trade and exchange
- competitive prices -> improve the international competitiveness -> economic growth
  - competitive prices come from economies of scale and better productivity

# Disadvantages of international specialization

## 1. Overspecialization

- occurs when an individual, firm, region, or country concentrates **too much** on producing very limited number of goods and services
- can cause **regional** and **structural unemployment**
  - due to the decreasing demand for the goods and services, or the unavailability of resources
- overspecialization countries suffer most during **recessions**
  - if the product that the country focuses fail due to production conditions (i.e., bad weather conditions)
    - the country would be badly harmed
  - same thing wouldn't happen for a diverse country as it has many products that it can rely on

## 2. Greater Interdependence

- specialization may cause a country to be **overly dependent** on the other's products
  - probably because they are the raw materials or tools
- therefore, the country would be adversely affected by the events happening in the other countries

## 3. High labour turnover

- specialization works are **boring**
  - so workers would choose to leave their jobs in search of more challenging and less boring ones

- **labour turnover**

- the movement of persons into and out of employment

$$\text{labour turnover rate} = \frac{\text{number of employees leaving in a period}}{\text{average number employed during the period}}$$

- so a rate of 12.5% means that every 1 out of 8 worker changes his/her job in each time period (a year)
- High labour turnover would be **expensive** for the economy
  - as firms have to continually hire and train workers

#### 4. **Low labour mobility**

- low-skilled
  - low training, and so cannot develop the necessary skills to find alternative jobs
- high-skilled
  - so professional that it would also difficult for them to change to alternative professions and jobs
    - as they need to learn from scratch
    - such as pilots
- low labour mobility can reduce an economy's overall efficiency and decrease its competitiveness

#### 5. **High labour costs**

- firms that hire workers with highly specialized skills tend to face very **high salary demands**
- high labour costs can have negative effects on **profits** and reduce **competitiveness** (due to rising price)

#### 6. **Lack of variety for consumers**

- specialization often leads to **standardized, mass produced products**
- domestic customers might look at the alternative products from foreign suppliers
  - reducing the competitiveness of domestic firms that overspecialize

## Unit 37 Globalisation, Free Trade and Protection

### Globalization

- **globalization** is the process by which the world's economy become increasingly **interdependent** and **interconnected**
  - due to **greater international trade and cultural exchanges**

### Role of MNCs

- a **multinational company** is an organization that **has its headquarter in a country** but **produces** in a number of countries
  - such as Apple and Coca-Cola
- **Host country**: the country where a MNC operates and produces
- **Home country**: the country where its headquarter locates

- **Advantages of operating as an MNC**

--- for the economy ---

- Job creation
  - MNCs are able to help improve standards of living in the countries in which they operate
- More choices offered
  - MNCs can offer more choices for consumers in an indigenous market

--- for the MNC itself ---

- Economies of scale
  - MNCs operate on a very large scale
  - they can pass on cost savings to their customer in the form of lower prices
    - so they have high competitiveness
- Larger customer base
  - MNCs also have a larger customer base -> more profits
    - benefits the home country too as profits are repatriated
- Spreading risks
  - MNCs are able to spread risks by operating in overseas markets
    - so adverse trading conditions in one country wouldn't hurt that much
- Avoiding taxes
  - MNCs can avoid any trade restrictions (e.g., import taxes) through producing in the country
  - MNCs can also set its headquarter in a country that charges the lowest amount of corporation tax
    - just like how Alibaba and Tencent set their headquarters in Cayman Islands
- Reducing transportation cost
  - MNCs don't have to export products to overseas (cuz they produce overseas)

- **Disadvantages brought by MNCs**

--- for the economy ---

- Unethical and cost-cutting practices
  - poor working conditions and low wages for workers in low-income countries
    - see Nike's previous factories in Taiwan and Vietnam, people worked there are low-paid and suffering from poor working conditions and exposure to toxic materials
- Harming the local firms
  - MNCs huge market power and ability to exploit EOS mean that local firms might struggle to compete
    - so protectionism is needed
  - moving and expanding overseas can also have a detrimental impact on domestic employment
- Exploiting governments
  - MNCs are often in a powerful position to exploit foreign government over decisions such as location of the business
    - because they can bring benefits to the government...
- Overreliance on MNCs
  - some low-income countries are too dependent on MNCs

- and hence if they would suffer intensively once MNCs move away

--- for the MNC itself ---

- Adaptation costs
  - different countries have different legal systems, tax regulations, and etc
  - the lack of local knowledge can cause problems for the MNCs
- Communication costs
  - different countries have different spoken languages, time zones, and etc

## Free trade

- **international trade** refers to the exchange of goods and services **beyond national borders**
  - entails the sale of **exports** and **imports**
- **free trade** means that international trade takes place **without protectionist measures**
  - such as quantitative limits or tariffs

## Benefits of free trade

--- for customers and producers---

- **Greater choice**
  - free trade enables consumers and firms to freely access a large variety of goods and services around the world
    - the goods and services wouldn't be banned from being imported
- **Lower prices**
  - free trade reduces **cost of trading**
    - firms become more competitive
    - consumers pay lower prices

--- for producers ---

- **Access to resources**
  - producers can gain free access to raw materials and resources from all around the world
- **Economies of scale**
  - as firms are operating on a larger scale in global markets, international trade enables them to benefit from economies of scale
- **Increased market size**
  - firms can reach more customers through free trade -> higher revenues and profits

--- for the economy ---

- **Efficiency gains**
  - free trade forces domestic producers to focus on improving the quality of their output due to **foreign competition**
    - free trade makes the market more competitive with more producers and better producers
- **Improved international relations**
  - free trade encourages international trade and cooperation between countries

## Protection

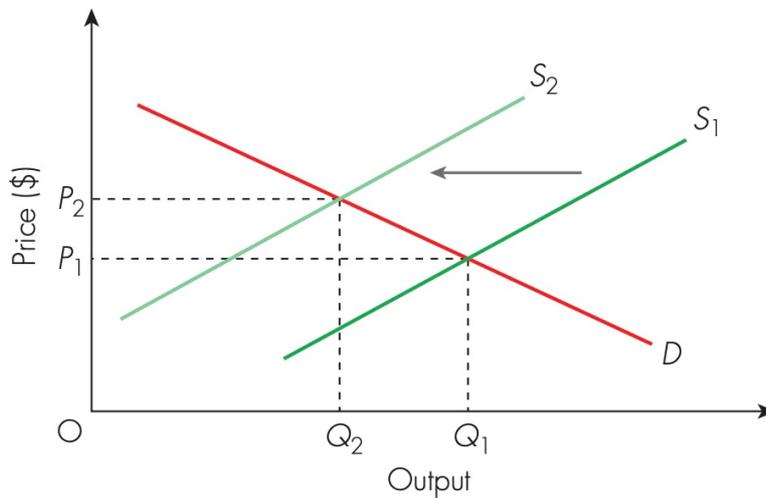
- **protection** refers to the use of **trade barriers** to restrain foreign trade, thereby **limiting overseas competition**

### Methods of protection

- **Tariffs**

- **a tax on imports**

- **raising the price** of foreign goods in the domestic market and **lowering the quantity** of products imported

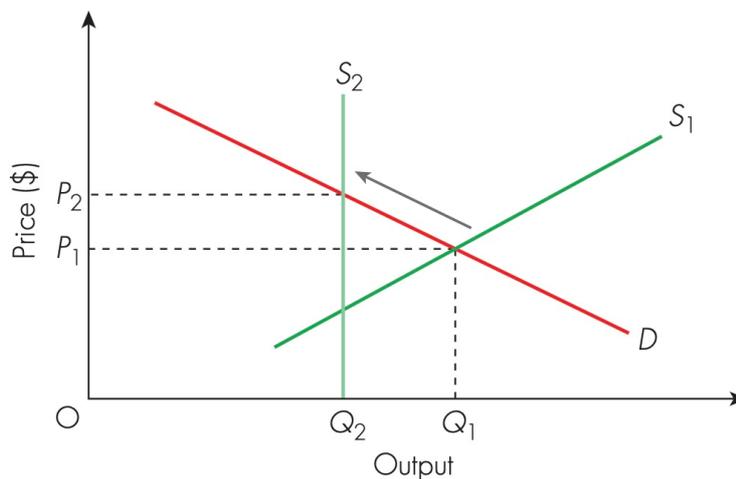


The tariff raises costs of production, so it shifts the supply curve from  $S_1$  to  $S_2$ . This leads to prices of the import rising from  $P_1$  to  $P_2$ , and output falling from  $Q_1$  to  $Q_2$ .

- **Import quotas**

- **a quantitative limit on the sale of a foreign good in a country.**

- **raising the price** of foreign goods in the domestic market and **lowering the quantity** of products imported



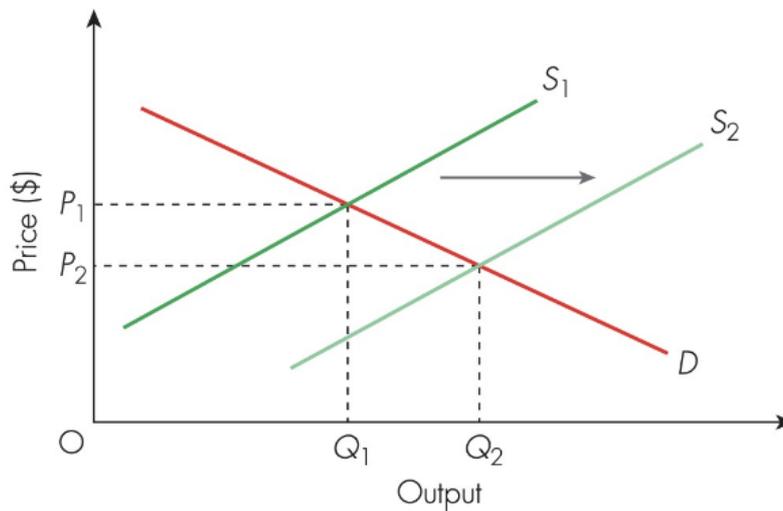
The imposition of a quota at  $Q_2$  reduces the supply of the import from  $S_1$  to  $S_2$  (where supply is perfectly price inelastic). This leads to the price of the import rising from  $P_1$  to  $P_2$ , and output falling from  $Q_1$  to  $Q_2$ .

- **reducing quota** means **more protection !!!**

- **Subsidies**

- **a form of government financial assistance to help cut production costs of domestic firms, enabling them to compete against foreign producers**

- **lowering the cost** of domestic firms



The subsidy reduces costs of production, so it shifts the supply curve from  $S_1$  to  $S_2$ . This leads to a fall in price of the export from  $P_1$  to  $P_2$ , and output increases from  $Q_1$  to  $Q_2$ .

- **Embargoes**

- a ban on trade with a certain country, often due to a trade dispute or political conflict
  - **rarely benefits local consumers** -> they suffer from less choices and higher prices

### Reasons for protection

- **Infant industry**

- new industries with relatively low output and high cost
- protectionist measures help safeguard infant industries (new, unestablished businesses) from foreign competitions
  - new industries, which have potential to grow, may be eliminated by foreign competition before they've really started
  - with the protection, these sunrise industries might finally grow and take the advantage of EOS and become internationally competitive

- **Declining industry**

- old industries which are going out of business
- protectionist measures help allow the declining industries to decline gradually at an acceptable pace
  - so that there won't be significant unemployment if the workers are immobile and there aren't job vacancies

- **Strategic industry**

- industries that are considered important for the survival or development of the country
- protectionist measures help safeguard strategic industry that are beneficial for the country's development
  - such as clean energy

- **Avoidance of dumping**

- dumping: selling products in a foreign market at a price below the cost of production
- protectionist measures help avoid these unfair competitions
  - foreign countries might use dumping to drive domestic firms out of business
    - although these may benefit the consumers in a short run, in the long run the foreign companies would gain more market power
- Avoidance of foreign subsidized firms

- foreign firms may be gaining an unfair competitive advantage by enjoying subsidies by their governments
- protectionist measures help avoid these unfair competitions through controlling the price and etc

### Consequences of protection

- **Lower choice, higher prices, less efficiency**
  - as the market is less competitive, and firms may be too reliant on the government
- **Higher cost of production**
  - protectionist measures might stop/raise the price of the cheap and productive raw materials overseas
    - so firms can only utilize the inferior domestic raw materials -> increase their cost of production
- **Retaliating**
  - other countries would react to protectionism by **imposing their own trade barriers**
    - the host country might also export less -> less GDP... less trading positions...S
    - hinder global economic growth and prosperity

## Unit 38 Foreign Exchange Rates

- refers to **the price of one currency measured in terms of other currencies.**

### Determination of Foreign Exchange Rates

- as the **value** of a country's currency **falls**, its demand for imports tends to **fall**
  - because e.g., a good that values 400USD (2400CNY) previously, might now cost 2800CNY. Increase in price would reduce the demand for the good.
- demand for some imports is **price inelastic** -> because they are **not readily available** in the domestic economy but **essential** for production
  - such as oil and other vital raw materials
  - therefore, domestic firms have to spend more if the exchange rate falls
- **High import price (low exchange rate)** can be **good** and **bad**
  - **good**: less demand for imports, higher competitiveness for exports
  - **bad**: the imports of essential goods are expensive

### Floating exchange rate systems

- the currency is allowed to fluctuate against other currencies according to **market forces, without any government intervention**
  - if the demand for a country's goods and services increases, the value of the country's currency would increase
- **appreciation** in the exchange rate if the exchange rate is rising against other currencies
  - **increase** in a currency's value relative to another currency operating in a floating exchange rate system
- **depreciation** of the exchange rate if its value falls against other currencies
  - **decrease** in a currency's value relative to another currency operating in a floating exchange rate system

## Advantages

- **Automatic Stabilization**
  - any **disequilibrium** in BOP would be automatically corrected by a change in the exchange rate
    - If there is an BOP deficit, the country currency's exchange rate would fall, contributing to the increasing import price -> less imports and hence less BOP deficit
- **Frees up internal policy**
  - free the government from caring about the exchange rate instead to pursue employment and growth
- **Insulated from external changes**
  - helps to insulate a country from **inflation** elsewhere
  - if there is an inflation in other countries, fixed exchange rate system would import inflation
    - as inflation -> demand for the goods decreases -> less price, but a fixed rate would still import goods at a high price
- **Don't need too much foreign reserves**
  - no need to maintain reserves to deliberately change the exchange rate
  - the reserves can be used to import capital goods to promote economic growth

## Disadvantages

- **Uncertainty**
  - confidence might be lost in the economy if the currency value fluctuates too rapidly
- **Lack of Investment**
  - uncertainty -> lack of investment
    - as they cannot predict the economic conditions that might happen in this country
- **Speculation**
  - day-to-day fluctuations might encourage **hot money** to be transferred within countries, thus further causes rate fluctuations
- **Lack of Discipline**
  - the need to maintain an exchange rate imposes a discipline upon the national economy

## Fixed Foreign Exchange Rate

- the government intervenes in **foreign exchange markets** to maintain its exchange rate at a predetermined level
  - when the **central bank** buys and sells foreign currencies to ensure the value of its currency stays at the **pegged value**
  - **foreign exchange rate market**: where different currencies can be bought and sold
- **Revaluation** is a deliberate rise in the value of a fixed exchange rate
- **Devaluation** is a deliberate fall in the value of a fixed exchange rate
- **Equilibrium market foreign exchange rate**: the price at which demand and supply of the currency equals

## Advantages

- **Certainty**
  - people don't need worry about the effects of automatic changes in exchange rate
- **Stability encourages investment**
  - greater certainty -> encourages investment
- **Keep inflation low**

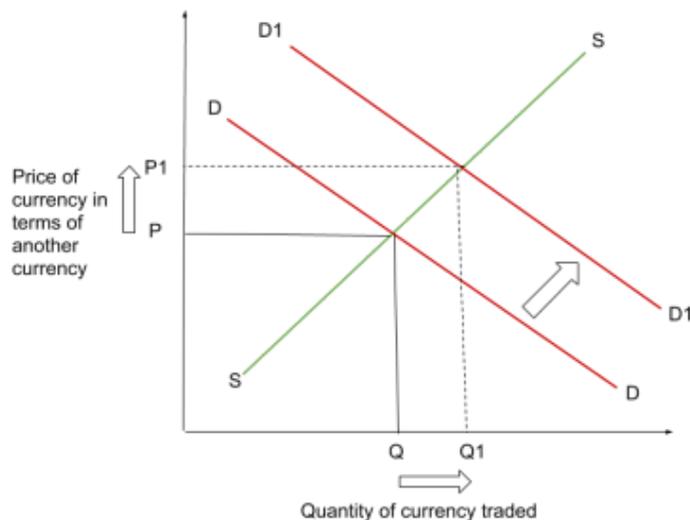
- depreciation of a currency can cause inflation as demand, prices and costs for firms rise
- fixed-rate: lower inflation
- **Stability**
  - sudden change in BOP would not affect the currency price, keeping it stable

### Disadvantages

- **Conflict with other macroeconomic objectives**
  - e.g., if the interest rate is raised to remove the pressure of the currency to fall, economic growth might be adversely affected
- **Less flexibility**
  - difficult to respond to temporary shocks
  - For example, if the price of oil increases, a country which is a net oil importer will see a deterioration in the current account balance of payments. But since the country operates a fixed exchange rate, it cannot devalue the currency too much and thus cannot make an effective intervention to improve the current account.
- **Risk of overvaluation or undervaluation**
  - its difficult to know the right rate to fix the exchange rate at
    - too high -> exports uncompetitive
    - too low -> inflation

### Causes of foreign exchange rates fluctuations

- **changes in the demand for exports and imports**
  - if import > export, the demand for the currency is less, causing the exchange rate to fall
  - if there is a BOP surplus, the exchange rate will rise



- **inflation**
  - inflation -> high price -> less exports -> less demand for the currency -> fall in exchange rate
- **changes in interest rate**
  - increase in interest rates -> higher investments -> more demand for the currency -> rise in exchange rate
- **MNCs**
  - MNCs need to operate using local currencies -> more demand for the currency -> rise in exchange rate
- **Speculations**

- foreign exchange traders and companies move money around the world to take advantage of higher interest rates and variations in exchange rates to earn a profit.
- "hot money" -> huge sum of money is involved in the transfer, causing exchange rate fluctuations, at least in a **short run**
- low confidence -> less investment -> less demand for the currency
- high confidence -> more investment -> more demand for the currency
- **Government intervention**
  - central bank can buy or sell their currencies to increase the currency's supply or demand

## Consequences of foreign exchange rate fluctuations

- **Fall in exchange rate** -> **import prices to rise and export prices to fall**
  - import spending++, export spending--
  - if PED > 1: reducing trade deficit
- **Rise in exchange rate** -> **import prices to fall and export prices to rise**
  - import spending--, export spending++
  - BOP--
- **Consumers** -> greater purchasing power when the rate increases
- **Employment** -> less exports means less derived demand for the workers
- **Inflation** -> more exports means demand increases -> high level of money
- **Economic Growth** -> more demand -> more growth

## Unit 39 Current Account of Balance of Payments

- **Balance of Payment: financial record** of a country's all monetary transactions with the rest of the world over a given time period, divided into
  1. the current account
  2. the capital account
  3. the financial account
- **Current Account:** the **largest** component of the BOP, recording all exports and imports of goods and services between a country and its trading partners, plus net income transfers from abroad.

### Structure of the Current Account

- **Trade in Goods**
  - a record of the exports and imports of **physical goods** -> **visible balance**
- **Trade in Services**
  - a record of the export and import of **services** (intangible produces) -> **invisible balance**
    - for example, tourism expenditure
- **Primary income**
  - a record of a country's **net income** earned from the investments abroad -> **investment income**
  - such as
    - profits earned by subsidiary companies
    - interest received from loans and deposits
    - dividends earned from financial investment
    - foreign direct investments
    - money send home by people working abroad
- **Secondary income**

- a record of the **income transfer** between residents and non-residents -> **net income transfers**
- such as
  - donations to charities abroad
  - foreign aid
  - payments of pensions to retired people now based in overseas countries
- Hence, the current account can be calculated as

$$\text{Current account} = \text{balance of trade} + \text{primary income} + \text{secondary income}$$

## Current account deficit

- When the financial outflows in the current account exceed the financial inflows

### Causes

- **Higher exchange rate:** export price too high, import price too low
- **Economic growth:** growth -> more disposable income -> more demand for the imports
- **Decline in competitiveness:** decline in competitiveness -> exports fall (the major reason)
- **Inflation:** inflation -> export price too high -> exports fall
- **Recession in other countries:** more trade restrictions and less money in other countries -> less exports
- **Borrowing money:** if countries are borrowing from other countries to finance their expenditure and growth, current account deficits will develop (negative net secondary income)

### Consequences

- **Low growth:** deficit -> less exports -> lower aggregate demand -> lower growth
- **Unemployment:** lower aggregate demand -> lower derived demand
- **Low standard of living:** lower demand and employment -> less income -> lower standard of living
- **Capital outflow:** investors losing confidence -> taking capital away
- **Loss of foreign currency reserves:** foreign currency revenue is falling (due to less exports); more foreign currency is spent on imports
- **Increased borrowing:** countries need to borrow in deficit to subsidize imports or service debts
- **Lower exchange rate:** fall in demand for exports, rise in demand for imports -> reduces the exchange rate -> essential imports become more expensive

### Solution -> using **conservative** methods

- **DO NOTHING** -> a floating exchange rate would correct it
  - in deficit, a floating exchange rate system would decrease the exchange rate (as the demand for the country's goods is lower than the supply) -> a **depreciation** would occur
  - as a result, import price++ and export price--
- **Contractionary fiscal policy** -> reduces AD and hence the demands on imports
  - but will have many side-effects on the economy such as unemployment
- **Contractionary monetary policy**
  - reducing interest rate -> less foreign investment
  - devalue exchange rates -> import price++ and export price--
- **Protectionist measures** -> reduces the competitiveness of imports, making the domestic consumption more attractive

## Current account surplus

- When the financial inflows in the current account exceed the financial outflows

### Causes

- **Improved competitiveness:** higher competitiveness (due to higher productivity or lower price) -> more demand on exports
- **Growth in foreign countries:** growth -> higher demand
- **High foreign direct investment:** high net secondary income
- **Depreciation:** depreciation -> trade surplus
- **High domestic savings rates:** low consumption -> less consumption of imported goods
- **Closed economy:** protectionism -> low imports

### Consequences

- **Economic growth:** net exports++ -> GDP++
- **Employment:** net exports++ -> derived demand++
- **Appreciation:** exports increase -> demand for the currency increases -> value of the currency increases -> exports price++, imports price--
- **Better standards of living:** employments++, demand++ -> income++ -> living standards++
- **Inflation:** net exports++ -> AD++ -> demand-pull inflation -> diminish international competitiveness

### Solution -> using **progressive** methods

- **DO NOTHING** -> a floating exchange rate would correct it
  - an **appreciation** would occur
- **Expansionary fiscal policy** -> increases AD and hence demand on imports
- **Expansionary monetary policy**
  - lower interest rates -> reduces investments from abroad
  - high exchange rates -> imports price--, exports price++
- **Remove protectionist measures** -> number of imports++