

Topic 3 – Microeconomic decision makers

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3.1 Money and banking

Money: any commodity used as medium of exchange when purchasing goods/services

Forms - cash, bank deposits & central bank reserves

Functions

1. **Medium of exchange** - widely accepted as a means of payment for most goods/services
2. **Measure of value** - more efficient to express price of goods/services
3. **Store of value** - ppl can save money coz it keeps its value, so it can be used in the future
4. **Standard of deferred payment** - enable ppl buy goods on credit

Characteristics DAD SUP

Durability, Acceptability, Divisibility, Scarcity, Uniformity, Portability

Long time ago...

Bartering: act of swapping items in exchange for other items through a process of bargaining & negotiation

Problems

1. **Need double coincidence of wants** - inefficient
2. **Low divisibility & portability**

Types of banks

Banks	Functions
Commercial banks	<p>(Primary)</p> <ol style="list-style-type: none"> 1. Accept deposits eg sight & time deposits 2. Provide advances eg overdrafts & mortgages 3. Credit creation - make money to ↑ money supply - ↑ purchasing power, ↑ consumption & investment for firms <p>(Secondary)</p> <ol style="list-style-type: none"> 4. Collect & clear cheques on behalf of client 5. Offer additional financial service eg foreign exchange dealings 6. Online banking eg Amazon <p>But</p> <ul style="list-style-type: none"> • Banks may charge in high interest rates to ↑ its profit - makes borrower more difficult to repay & might have debt
Central banks	<ol style="list-style-type: none"> 1. Sole of issuer of banknotes & coins - print banknotes & coins 2. Gov's bank eg accept deposits, provide advances, manage gov debt → stabilise external value of nation's currency 3. Banker's bank - oversee cash reserves of commercial banks → manage claim made by banks against each other → enable commercial bank ↑ efficiency 4. Lender of last resort - require commercial banks to keep certain % of their cash balance as deposits with central banks

- build public confidence in country's banking system
- protect jobs
- ensure commercial banks X collapse

3.2 Households

Influence on spending

1. **Disposable income** (income after compulsory deduction eg tax) & **wealth**
 - ↑ income/wealth ↑ purchasing power ↑ spending
2. **Interest rates** - ↑ interest rate, ↓ borrowing, ↑ saving, ↓ spending
3. **Inflation & Confidence**
 - inflation → ppl expect high employment / feel confident about future, ↑ spending
4. **Needs/wants for products** - to satisfy needs eg food or wants eg luxury goods
5. **Factors affecting pattern of spending** eg time of year - Christmas

Influence on saving

1. **Save to purchase goods/services later** eg children's education / retirement
2. **Provide income** from interest paid on savings
3. **Precautionary reason** eg accident

Influence on borrowing

1. **Purchase expensive goods/services** eg property, land
2. **Fund education, large projects** eg firm expansion
3. **Start up new business**

Firms adv

- Improve products by spending on R&D
- Spend on advertising to increase demand
- Invest capital to improve efficiency to increase profit

3.3 Workers

Wages factors: financial rewards that workers receive in return for their labour services

Wages	Time-based payment
Salary	Based on fixed annual amount
Overtime	Payment for work in excess of standard, contracted hrs
Commission	Payment based on % of sales worker makes
Bonus	Extra payment for exceptional performance
Piece rate	Fixed amount paid per item produced/sold
Profit-related pay	Additional payment to workers, based on amount of profits made by firm
Share options	Workers receive shares in firm ↑ motivation ↑ profit
Fringe benefits	Additional benefits eg pensions

Non-wages factor

1. **Job satisfaction** eg ppl enjoy challenging occupation
2. **Type of work** - safe or dangerous environment
3. **Working hours**
4. **Size of firm**
5. **Career prospects** - clear career progression eg teacher
6. **Fringe benefits** eg pension, health insurance
7. **No. / length of holidays**
8. **Location of job**

Wage determination - determined by market force eg doctors → high demand, low supply → high pay

Demand of labour: no. of workers that firms are willing & able to hire at given wage rate

Factors affecting demand of labour

1. **Level of total demand** - boom → ↑ production ↑ labour
2. **Productivity of labour**
3. **Cost of labour**

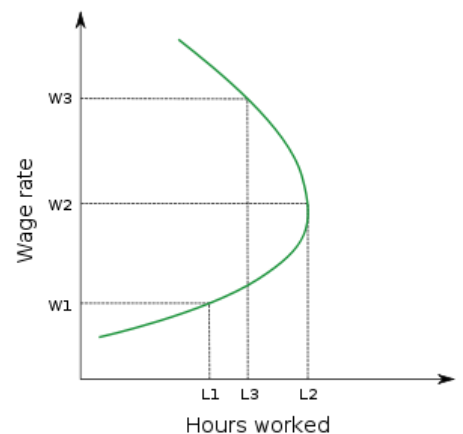
Supply for labour: ppl willing & able to work at different wage rates

Factors affecting supply of labour

1. **Availability & level of welfare benefits**
2. **Changing social attitudes**
3. **Geographical mobility**
4. **Occupational mobility**

Backward-bending supply of labour curve

- ↑ no of hours worked, ↑ wage rate
- But, when a person get to a very high position and his salary ↑ highly, the no of hours he works may ↓
- CEOs and executive managers at the top of the management tend to have backward-bending labour supply curves



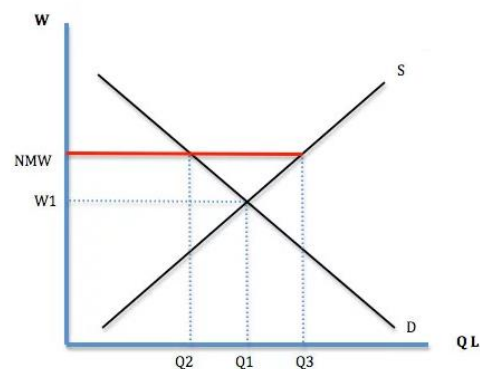
Relative bargaining power - ↑ bargaining power ↑ wages

Factors affecting bargaining power

1. **Trade unions**

2. Age & experience
3. Level of education

Gov policy - Nation minimum wages (NMW): lowest amount a firm can pay its workers set by gov



Reasons of differences in earnings

1. **Skilled vs unskilled**
- (skilled) high level of education, ↑ productivity, low supply compared to unskilled ppl → harder to employ
2. **Primary vs secondary vs tertiary sector**
3. **Male vs female** - (female) part-time coz take care of family, discrimination
4. **Private vs public sector** (public) less wages, more secure, have pension

Specialisation of labour: workers being expert in a particular process / profession

Adv	Dis
1. ↑ productivity 2. ↑ quality 3. Workers more skillful, ↑ earning potential	1. Repetitive, boring 2. Deskilled in other areas → less flexible 3. Overspecialisation

3.4 Trade unions

Types

1. **General unions** - skilled & unskilled workers with different jobs in different industries
2. **Industrial unions** - ppl from same industry
3. **'White collar unions'** - ppl with different professional occupation
4. **Craft unions** - skilled workers perform similar tasks in different industries

Roles

1. Negotiating improvements in non-wages benefits of workers eg pension
2. Improving working conditions eg better safety measures
3. Developing skills of workers → provide training
4. Provide financial & legal support to workers who's made redundant / unfairly disciplined
5. Bargaining with employers for ↑ wages & conditions

Adv	Dis
<ul style="list-style-type: none"> Achieve higher wages, workers afford eg better healthcare, motivate workers, improve skills of workers Improve working conditions increase labour productivity increase competitiveness, increase econ growth 	<ul style="list-style-type: none"> Increase firms' cop, reduce profits, reduce wages, reduce output Increase industrial action, reduce productivity, disrupt economy, reduce investor confidence Restrict ability of firms to change output, reduce responsiveness Workers pay fee to be a member - reduce spending power

<ul style="list-style-type: none"> • Increase communication between workers & employers, reduce conflict, make negotiations more effective • A union have more power than 1 worker - take industrial action to support working condition improvement 	<ul style="list-style-type: none"> • Union might bring workers on strike, reduce wages, reduce living standard
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Collective bargaining: process of trade union representatives negotiating on behalf of their worker with employer representatives for better pay & condition

Industrial action: measure taken by group of workers as a result of major disagreements with employers

Types	Definition	Impact
Strike	Stop working	<ul style="list-style-type: none"> • X output • Workers X paid
Sit-in	Present but don't work	
Work-to-rule	Work to fulfil min. requirement	<ul style="list-style-type: none"> • ↓ productivity
Go-slow	Work slowly	

3.5 Firms

Measurements of size of firm

1. No. of employees
2. Market share - measures firm's sales revenues as a proportion of industry's sales revenue
3. Market capitalization of firm

$$\text{stock market value} = \text{total no. of shares in business} \times \text{current share price}$$
4. Sales revenue of firm

Explain influences on size of firm

- Size of market - increase demand, increase size
- Availability of capital - increase profit for expansion

Private sector Aim: earn profit

Sole trader	Business owned & controlled by a person
Partnership	<ul style="list-style-type: none"> • Owned by 2-20ppl with share ownership • Easy to set up
Private limited company	<ul style="list-style-type: none"> • Owned by shareholders • More complex set up → require legal doc. • Unable to buy/sell shares with agreement with other shareholders
Public limited company	<ul style="list-style-type: none"> • A company whose shares are traded on a stock exchange • These shares can be bought & sold by public • The company has limited liability • Owned by shareholders
Co-operative	<ul style="list-style-type: none"> • Working tgt to share profits according to amount that consumers had spent

- The owners of a co-operative are the members. This gives them voting rights but each member only has one vote

Public sector - owned by gov Aim: provide services

Small firms

Adv	Dis
<ul style="list-style-type: none"> • To compete with larger firms by providing goods that can't be bought in larger firms • May located in a remote area and be the only firm that sell goods • Provide personal shopping experience for customers, more contact with consumers - meet specific needs • Adapt quickly to changing consumer tastes • Better communication with workforce coz simple structure of firm 	<ul style="list-style-type: none"> • Limited start-up capital → hard to raise finance to establish business • Limited finance available → hard to expand business • ↑ risk of business failure • ↑ cop → unable to exploit benefits of large-scale production, lower price of goods • (Dis of sole trader)

Sole trader (sole proprietor)

- Owner runs & controls business
- Held responsible for its success or failure
- Set up with little capital – obtain for personal savings / borrowing

Adv	Dis
<ul style="list-style-type: none"> • Respond to changes in demand quickly coz one person makes all the decisions • Easy to set up coz less paperwork needed • Provide a personal service get to know customers personally • Profit incentive owner will get all the profits • Sole trader has total control of deciding e.g. hours of work, holidays • May have good relationships with staff coz less industrial disputes 	<ul style="list-style-type: none"> • Limited start-up capital → difficult to secure funds beyond personal saving • ↑ workload & stress → lack of labour

Primary sector: extractive industry where raw materials are collected eg agriculture

Secondary sector: manufacturing or construction sector where raw materials are turned into goods eg car production

Tertiary sector: service sector of the economy eg education

Causes of growth of firms

Internal growth - when firms expand using own resources by increasing no. of branches in more countries → ↑ market share

External growth - when expansion involves another firm

- **Mergers** - 2+ firms join together to form one firm
- **Takeovers** - a firm take over by another firm, can be hostile (doesn't agree) or agreeable
- **Franchising** - an individual or firm buy licence to trade using another firms name

Types of merger

- **Horizontal merger** - firms in same industry join together eg 2 banks

Adv	Dis
<ul style="list-style-type: none"> • ↑ market share - reduce competition • Gain skilled employees from each other • Operate with fewer employee coz no need to hire two departments • → ↓ cop • Take adv of econ of scale eg bulk-buying - reduce average costs, reduce cop and increase profit • Allow firm rationalise to cut out duplication - reduce cop 	<ul style="list-style-type: none"> • Duplication of resources • Firm experience disecon of scale eg communication problem - increase average cost • Increase market share, reduce competition, make demand price-inelastic, increase price

Vertical mergers - firms in different industries join together eg tea company take over tea plantation

- a. **Backward vertical merger** - firm from tertiary sector joins secondary / primary

Adv	Dis
<ul style="list-style-type: none"> • Firm in secondary sector has control over quality of raw materials supplied - ensure adequate supply of raw material • Price of raw material decrease coz manufacturer doesn't have to pay another firm for raw materials 	<ul style="list-style-type: none"> • Cost of running farm in primary sector increase total cost coz increase in factors of production • Transport cost increase coz raw material delivered by external firm

- b. **Forward vertical merger** - firm from primary sector joins secondary / tertiary

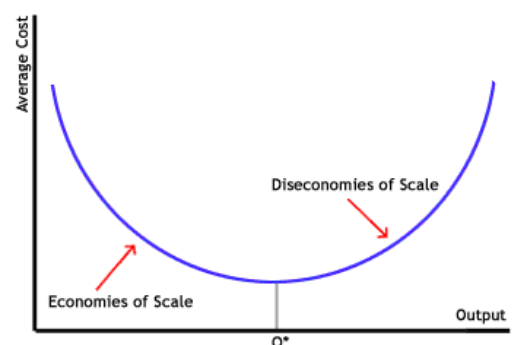
- Allow firms to control sale of product
- **Conglomerate merger** - firm from unrelated areas of business join eg India company Tata which produces motor vehicles & tea
- Increase range of products produced

Adv	Dis
Take adv of econ of scale	Too diverse

Economies and diseconomies of scale

Economies of scale - ↑ output ↓ costs of production

Internal econ of scale - ↑size ↑cost saving



Bulk-buying	Bought in ↑ quantities ↓ cost
Technical	Purchase equipment
Financial	Ability to borrow money
Managerial	Employ specialist manager
Risk-bearing	Produce range of products & operate in many locations
Research & development (R&D)	Fund R&D
Marketing	↑ advertising budgets

External econ of scale - arise from external factors

Being near to related firms	easy to access & ↓ transportation cost
Availability of skilled labour	easy to employ labour, ↓ costs for firms
Reputation of area	many ppl go there
Access to transportation networks	easy to trade

Diseconomies of scale - ↑ size ↑ cop

Why?

Internal

Communication problems	<ul style="list-style-type: none"> firm too large/diverse, ↓ control & communicate, slower decision making & responding to changes in market conditions ineffective management as management becomes more complex
Demerge	
Employ more labours or build new factories	↑ cop
Workers in large firms don't feel part of firm	↓ motivation & productivity

External

- Traffic congestion
- ↑ competition for resources / ↑ price of labour

3.6 Firms and production

Derived demand: demand of fop depends on demand of goods/services

Derived demand depends on cost, quantity, productivity

Labour-intensive production: an industry which has a high proportion of labour compared with proportion of other fop used

Cause of increase

- Improve education, workers more skilled, produce higher output per hour
- Adv tech
- Better working condition - content workers be productive
- High wages - motivate workers

- Derived demand - demand of fop depends on demand of goods, increase demand increase workers employed
- Production method - if production is labour intensive, increase demand

Adv	Dis
<ul style="list-style-type: none"> Labour cheap coz increase supply decrease wages Employees can be creative and use their own initiative Labour is usually readily available No need expensive equipment 	<ul style="list-style-type: none"> Expensive & takes time to recruit, select & train employees Employees require specialised skills which can take time to learn Quality of work can vary depending

Capital-intensive production: an industry which has a high proportion of capital compared with proportion of other fop used

Adv	Dis
<ul style="list-style-type: none"> Advances in technology Increased productivity Greater output Improved quality Lower cost per unit 	<ul style="list-style-type: none"> Cost of equipment Cost of making workers redundant Increased training costs More skilled workers required May be reduced morale

What to choose?

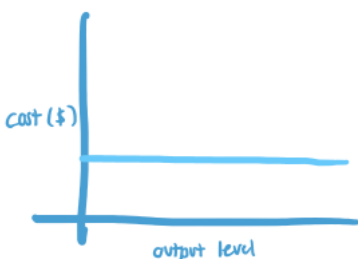
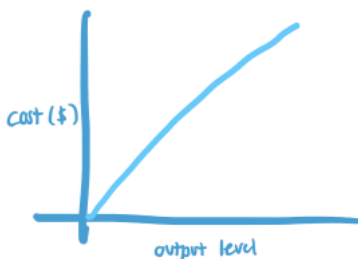
Factors - size of market, firm's objective, cost of labour vs capital

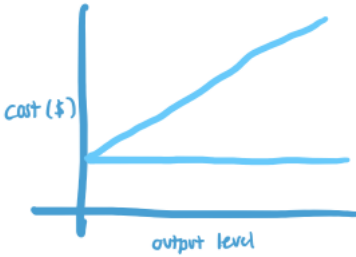
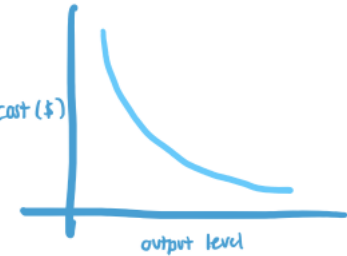
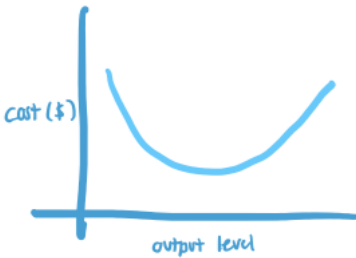
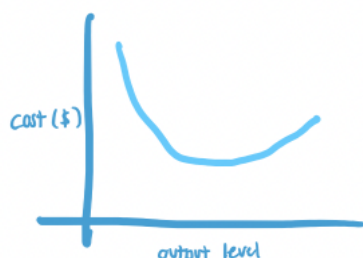
Production: total output per period of time

Productivity: output produced per factor eg per worker, per period of time

3.7 Firms' costs, revenue and objectives

Cost of production: payments made by firms in production process

Types	Graph	Definition/formula
Fixed cost (FC)		<ul style="list-style-type: none"> Cost that firm pay no matter how much it sell Eg salaries
Variable cost (VC)		<ul style="list-style-type: none"> cost charges when output level changes Eg Wages

Total cost (TC)		$TC = FC + VC$
Average fixed cost (AFC)		$AFC = \frac{FC}{\text{output level}}$
Average variable cost (AVC)		$AVC = \frac{VC}{\text{output level}}$
Average total cost (ATC)		$ATC = \frac{TC}{\text{output level}}$

Revenue: income earned by business

Types	Formula
Total revenue (TR)	$\text{Price} \times \text{quantity}$
Average revenue (AR)	$AR = \frac{TR}{\text{quantity sold}}$

Objectives of firms

1. Profit maximisation

- Seek earning as much profit as possible
- $\text{Profit} = TR - TC$
- Profit maximisation is greatest difference between TR & TC
- Profit used for reinvestment or pay high individuals

2. Sales maximisation - ↑market share

3. Growth maximisation - ↑revenue & market share

4. Social/environmental concern - better treatment to workers, better public perceive

3.8 Market structure

Perfect Competitive markets

Characteristics

1. **Many firms**
2. **Price takers** - set price according to market price
3. **Sell homogeneous products** (same goods)
4. **Produce differentiated products** (eg different brands)
5. **High level of competition**
6. **Many buyers & sellers**
7. **Free entry & exit**
8. **Perfect information**

Monopoly markets

Characteristics

1. **Single supplier** - increase price
2. **Price maker** - increase price
3. **Imperfect knowledge** - to protect trade secret
4. **High barriers to entry** - limit competition

Adv	Dis
<ol style="list-style-type: none"> 1. Take adv from econ of scale, lower average cop eg bulk-buying, decrease price 2. Have financial resources from profits to innovate - increase quality 3. Eliminate wasteful competition eg wraps 4. Compete internationally, reduce price 5. High barriers to entry & exit - protect any profits it makes, encourage to produce high quality products 	<ol style="list-style-type: none"> 1. Inefficient allocation of resources, increase price, reduce supply due to dis econ of scale eg communication problems, increase cop and price, reduce quality 2. Lack of competition , inelastic demand increase price, price maker reduce supply, less innovation, reduce quality and choice 3. Imperfect knowledge - irrational consumer choice

Exam questions

- 4 Trade union membership is decreasing in some countries, but it is increasing in China. Industrial action by workers is becoming more common in China, with workers seeking higher wages. Recently there was a strike at a car factory in South China, owned by a Japanese multinational company.
- (a) Define 'multinational company'. [2]
- (b) Explain why governments may discourage strikes. [4]
- (c) Analyse **three** reasons why trade union membership may decrease in a country. [6]
- (d) Discuss whether a rise in the wages a firm pays would reduce its profits. [8]
- 4 (a) Define 'multinational company'. [2]
- a company that has its headquarters/is based in a country (1) but produces in a number of countries (1)
- (b) Explain why governments may discourage strikes. [4]
- strikes disrupt output/service provision (1) this may result in customers being lost (1)
 - increase firms' costs of production (1) and lose international competitiveness (1)
 - lower output/incomes/GDP (1) and therefore lower living standards (1)
 - may reduce exports (1) and so harm the balance of payments position (1)
 - may cause unemployment (1) leading to higher spending on welfare benefits (1)
 - may discourage FDI (1) and job opportunities (1)
 - lower output will reduce tax revenue (1) and so reduce the government's ability to spend (1)
- (c) Analyse **three** reasons why trade union membership may decrease in a country. [6]
- trade union subscriptions may increase (1) making it more expensive for people to join a trade union (1)
 - legislation may reduce the power of trade unions (1) this would make membership less valuable (1)
 - employers may not recognise trade unions/be reluctant to employ members of trade unions (1) this may make people reluctant to join as it would reduce their employment opportunities
 - unemployment may mean that there are fewer people in employment to belong to trade unions (1) it will weaken the power of trade unions (1)
 - in a boom period/high level of economic activity (1) workers may gain wage rises/better working conditions without belonging to a trade union (1)
 - workers may be satisfied with pay and conditions (1) may not agree with actions of trade union (1)
 - government action to improve the pay and/or conditions of workers e.g. introduction of national minimum wage (1) reduces the need for collective bargaining (1)

(d) Discuss whether a rise in the wages a firm pays would reduce its profits. [8]

Up to 5 marks for why it might:

- higher wages will mean a higher wage bill (1) if output does not increase by more than wages, labour costs per unit will increase (1) costs of production will increase (1) profit is revenue minus costs (1) with higher costs and the same revenue, profit will fall (1)

Up to 5 marks for why it might not:

- paying higher wages may prevent strikes (1) this can reduce costs of production (1)
- higher wages may motivate workers (1) this can increase productivity (1) reduce costs of production (1)
- higher wages may make it easier to recruit workers (1) this can reduce costs of production (1)
- higher wages may make it easier to recruit skilled workers (1) this will raise productivity (1) reduce costs of production (1)
- other costs may be falling (1) e.g. rent, corporation tax (1)
- demand for the firm's products may be increasing (1) this will raise revenue (1)
- higher wages may be paid to a smaller labour force (1) reducing the wage bill (1)

- 7 In 2014 Cuban doctors were given pay rises that significantly increased their salaries. This made doctors' pay more than twice that received by nurses. Cuba is devoting more resources to both medical care and tourism, altering the country's production possibility curve. Living standards are increasing in the country but at a slower rate than some other nearby countries.

(a) What is meant by a production possibility curve? [2]

(b) Explain, giving examples, **two** factors of production used in the tourism industry. [4]

(c) Analyse why doctors are paid more than nurses. [6]

(d) Discuss whether living standards are always lower in developing countries than in developed countries. [8]

(c) Analyse why doctors are paid more than nurses. [6]

- Doctors need higher qualifications (1) take longer to train (1) reduces supply (1) makes supply more inelastic (1).
- Doctors are more skilled (1) more productive / efficient (1) in higher demand (1).
- Doctors may have a more powerful professional organisation / trade union (1) giving them greater bargaining power (1).
- Doctors maybe a different gender to nurses (1) discrimination may occur (1)

(d) Discuss whether workers benefit from specialising.

[8]

Up to 5 marks for why they might:

- their specialism may be in high demand (1) leading to good employment opportunities (1) high wages (1)
- specialisation allows workers to develop their skills (1) increasing their productivity/efficiency (1) which enables employers to pay them more (1) for the value of their extra output (1)
- enable workers to concentrate on areas they most enjoy (1) e.g. history lecturers specialising in particular periods of history (1)
- specialised jobs may be less demanding (1) may need less training (1)

Up to 5 marks for why they might not:

- demand for specialism may decrease (1) leading to unemployment (1) may be difficult to get another job (1) specialists have low occupational mobility (1)
- time has to be spent acquiring specialist skills (opportunity cost) (1) this time could have been spent earning money (1)
- doing the same task may be boring (1) reducing the quality of life (1)
- alienation reduces productivity (1) reducing the amount firms are able to pay workers (1)
- may not find out what other talents they have (1)
- specialist tasks can depend heavily on other workers (1) if those workers perform badly then productivity falls (1) and wages may fall (1)