Result: people have to trade to get other goods and services that they don't produce themselves.

The main function of money is to be a medium of exchange.

5 characteristics of money:

1. Divisible.
2. Portable.
3. Durable.
4. Recognizable.
5. Scarce.

Barter trade: swap goods/services in exchange for other goods/services.
Double coincidence of wants: the problem with barter trade; you cannot trade with everyone because not everyone has the good/service you need. Trading options are limited.

Functions of Money

1. Medium of Exchange: used to swap goods/services in exchange for money.
2. Unit of Account: used to account for the value of goods/services.
    - Makes it possible to compare values of goods/services.
3. Store of Value: money is used to save/store your wealth.
    - Wealth can be stored in valuables like gold, jewelry, property or money.
    - Banks offer services to store your wealth with them.
4. Standard for deferred payment: money can be used to pay off debts.

Types of Money:

- Cash money.
- Liquid assets: financial assets that can be quickly turned into cash money (ATM).
- Bank deposits.

Supply of Money: individuals and organizations (firms/governments) who put their money on a bank account.
Demand for Money: individuals and organizations (firms/governments) who need money to finance their expenditure.

Role of Banks:

- Paying interest for deposits and charging interest on loans.
- Charging fees for provision of other financial services.
- Making investments.

Central Bank:

- Issuing notes and coins.
- Managing payments for government.
- Managing national debt.
- Supervising all other banks.
- Lender of last resort.
- Managing gold and foreign currency reserve.
- Operating government’s monetary policy.

Internal EOS: decreasing unit costs due to a firm growing internally.

Purchasing Economies: lower costs because firm buys in bulk quantities and receives a discount.
Marketing Economies: advertisement costs are lower because its spread over large output.
ex. Coca-Cola produces thousands of bottles each day so their average marketing costs are low.
Financial Economies: large firms can borrow more at lower interest rates because banks trust them more.
Technical Economies: large firms have more money to buy better equipment and hire researchers. This better equipment lowers costs. The researchers can develop new technology which lowers costs as well.
Risk-bearing Economies: large firms produce a large amount of different goods/services. The loss of one good can be compensated by profits on another good.

External EOS: decreasing unit costs due to whole industries/markets growing.

Skilled workforce: if the industry grows more skilled, workforce will be available and it will be cheaper to find skilled labor. When the industry is small, firms had to train themselves.
Ancillary firms: if the industry grows, supplying firms will be attracted to grow as well.
ex. automobile industry and tire industry.
Joint marketing benefits: because Samsung became a popular smartphone brand, other Android phone producers benefited from this.
Shared infrastructure: if industry grows, investment in infrastructure grows and other firms benefit. *ex. Rotterdam port.*

Diseconomies of Scale: if firm grows too much their average costs may increase. The organization is too large to work efficiently.

- Average costs increase due to an increase in output.

Why does this happen?

- Management difficulties: large firm gets chaotic; difficult to coordinate.
- Motivation difficulties: employees get bored or demotivated because they don't enjoy work anymore in the large organization. Productivity decreases.
- Supply problems: large quantities of raw materials are needed. Their price goes up hence production costs rise.

Why do some firms remain small?

- Market size is small. ex. wedding dress industry.
- Access to financial capital is limited.
- New technology to replace them.
- Firm owner prefers to remain small.

Competition

Reasons to compete:

- Increase their customer base.
- Increase sales.

- Lower tax revenue due to economic crisis.
- Bad governance or corruption.
- Other Crisis such as war on natural disasters.

<u>Government must take action to generate extra income:</u>
- Raise taxes.
- Lower public expenditure.
- Borrow from other parties.
- Sell government assets (public firms).

Monetary Policy

Monetary policy: government measures involving changing the money supply and interest rates to achieve economic objectives.
- Money printed by Central Bank goes to commercial banks.
- Money supply mostly comes from the Central Bank.
- The amount of money supply determines how much economic activity takes place.

Interest: cost of borrowing money for borrowers. It is the reward for people who save their money and for those who lend it out.
- Savers lend their money to commercial banks, who then lend it out to others.

Expansionary Monetary Policy: increased money supply.
- More money available in the economy.
- More spending by firms and households.
- More aggregate demand.
- More production by firms so they need more workers.
- Output rises.

  <u>Results:</u>
  - Lower unemployment.
  - Economic growth.

Expansionary Monetary Policy: reduce interest rates.
- Households and firms borrow more for spending.
- Consumption and investment goes up.
- Aggregate demand rises.
- More output produced.
- Rise in output creates jobs.

  <u>Results:</u>
  - Economic growth.
  - Unemployment falls.

Contractionary Monetary Policy: decrease in money supply.
- Less money is available in the economy.
- Spending by firms and households falls.
- Less aggregate demand.

4 levels:
1. Very high human development.
2. High human development.
3. Medium human development.
4. Low human development.

Ranking in 2015:
1. Norway.
2. Australia.
3. Switzerland.
4. Denmark.
5. The Netherlands.

Reducing Poverty:
- Improving education.
- Increasing aggregate demand (expansionary policies).
- National minimum wage.
- Invite and encourage more multinational firms to come to the country.
- Providing more or higher social welfare benefits like unemployment benefits.
- Development aid from western countries.

Population

Population growth is a non-price determinant. More population means more demand for goods/services, more labor available and it could stimulate economic growth.

Negative sides of population:
- Overpopulation: too many people with insufficient resources.
- Famine.
- More crime/violence.
- Unemployment.

Population consists of different groups:
- Elderly/retired/disabled.
- Below working age.
- Working population.

Dependent Population: part of population that does not work and depends on the working population to survive.
- Working population must earn income and produce goods/services needed by the rest of the population.

Dependency Ratio: $\frac{\text{dependent population}}{\text{working population}}$

DP: 30 million people
WP: 10 million people
Dep. R.= 3

BOP Deficit: credit < debit

Balanced BOP:
- In theory, a BOP is always balanced.
- A deficit on the Financial Account means more is invested in foreign countries.
- However, this generates income and surplus on the Current Account.

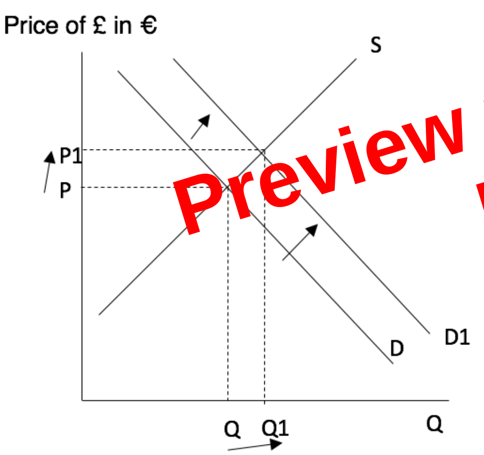
Exchange Rate

International Trade: to exchange goods and services across borders.
- Money needed.
- Each country has different currencies.
- Must exchange currency first.

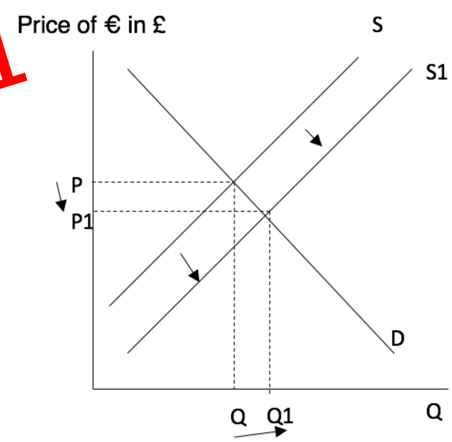
Problem: each currency has a different value.

Exchange Rate: price of a currency in terms of another currency.
- Mainly determined by supply and demand for the currency.

Buying a currency = Demand for currency
Selling a currency = Supply of a currency
- When a currency is bought, another currency is sold.



NL imports from the UK.
- Dutch pay in £.
- They buy £ and sell €.
- Demand for £ rises.
- Value of £ rises.
- Supply of € rises.
- Value of € decreases.
- £ became more expensive for the Dutch.
- € became cheaper for the British.



Money flowing into a country:
- Currency gets bought.
- Demand for currency rises.
- Exchange rate rises.

Money flowing out of country:
- Currency gets sold.
- Supply of the currency rises.
- Exchange rate falls.

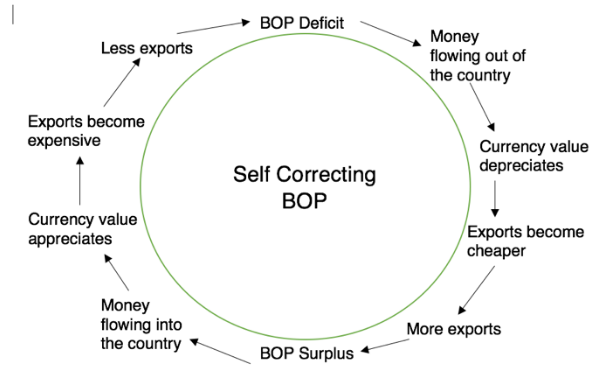
Factors affecting demand/supply for a currency:
- Tastes and preferences for a country's goods/services.
- Investment and loans.

Advantages:

- Central Bank does not need to intervene to keep rate stable.
- BOP can correct itself.

Disadvantages:

- Exchange rate may be very volatile.
- Creates uncertainty for import and export prices.



Fixed ERS: exchange rate is fixed at a certain rate against another currency (usually against \$ or €). *ex. \$1 = €1*

- If the exchange rate changes, the Central Bank intervenes by using Forex (foreign currency) Reserve.

  How?

  - If exchange rate falls (\$1=€0.50), the US Central Bank must intervene.
  - They will buy \$ with € from their Forex Reserve.
  - They will do this until the exchange rate is back at \$1=€1.
  - And if \$1=€1.50? They will buy the € and sell the \$.

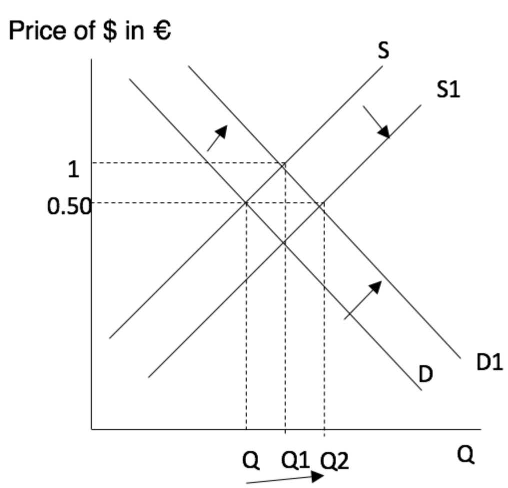
Advantages:

- Keeps exchange rate stable and may prevent import push inflation.
- Creates certainty about export and import prices (good for trade).

Disadvantages:

- Central Bank has to intervene regularly.
- Central Bank must keep a large Forex Reserve.
- BOP cannot correct itself.

Central Bank intervening in Fixed ERS



Demand Shift: if the currency drops below the fixed rate.

- US CB will buy \$ with € from Forex Reserve.
- Demand for \$ rises.
- \$ rises to previous rate.

What if the currency keeps on changing?

- Central Bank may run out of Forex Reserve.
- Intervention my not be sustainable.