Economics Notes for IGCSE

Unit 1: The Basic Economic Problem: Choice and the allocation of resources

1.1 The Economic Problem

The **Economic Problem** is that humans have **unlimited wants** but **limited resources.** Resources are **scarce** so we have to make sacrifices when making a choice on how a resource will be used. There are 3 types of resources

Natural: Soil, climate, water, minerals, forests and fisheries
Man-made: Machinery, buildings and equipment
Human: People and their skills

1.2 Factors of Production

There are 4 Factors of Production

Land: all natural resources
Labour: physical and mental contributions of an employee
Capital: all items that go into producing others
Enterprise: the factor that brings all other factors together to make profit

Factors of production are **combined** to made goods. **Enterprise** brings together **land, capital and labour.**

1.3 Opportunity Cost

Opportunity cost is the next best alternative that is sacrificed in making an economic choice. The opportunity cost is the real cost of any economic decision. Purchasing decisions and decisions about how to make use of time involve an opportunity cost.

1.4 Opportunity Cost in Action

The main groups that make up the economy are:
Consumers: people who buy goods and services
Producers: people who make and sell goods and services
The government: which acts as both producer and consumer and a lawmaker

Consumers

Consumers use opportunity cost when **deciding what to purchase with a limited amount** of money
E.g. spending $5 on a cup of coffee or buying 2 pens of $2.50

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Producers

Producers have to decide **what to produce and where to produce.**
E.g. farmers have to decide to produce onions or carrots
Deciding where to locate production, is important. Producers consider wage costs and whether there is a lot of labour in the area. The opportunity cost of producing in one area is not producing in another. Businesses are often criticised for failing to consider how opportunity cost and their decisions affect others. E.g. the opportunity cost of creating pollution is the clean environment that would exist.

Governments

Governments have to decided how to organise and designate areas of their income (in the form of tax).
E.g. Allocating 50% of the income received from taxes to health care instead of allocating it to education

Definitions for TOPIC 1

Choice: Opportunity to select from alternative end products and between alternative actions.
Economic problems: Issues that arise from balancing the uses of scarce resources and goods. An opportunity cost is involved.
Factors of production: Resources used in production: land, labour, capital and enterprise.
Labour: The human resource enabling both physical and intellectually work
Land: A term used to describe the gifts of nature, including farmland or oil.
Opportunity cost: The next best alternative when a decision is made.
Scarce: A resource or good in limited supply compared with the demand use it.

Unit 2: Allocating Resources: The Market at work and Market failure

2.1 Allocating Resources in an Economy

Resources can be used to make goods. Some are provided by nature and some are man made. Some decisions that involved are:

- What resources will be used to produce goods and services
- How the resource will be used
- Who decides how the resources will be used
- Who benefits from the use of the resources

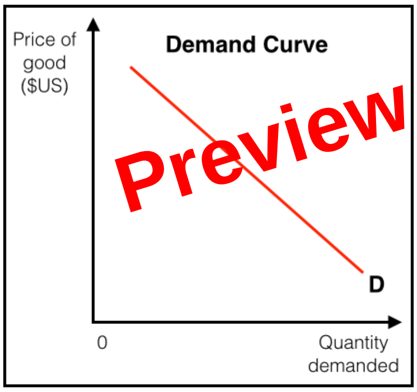
Planned Economy — **Mixed Economy** — **Market Economy**

Prices act as signals to **buyers and sellers.**
Government influence on decision making: the levels of government interference can determine the type of economy a country has.
In a Market Economy goods and services are freely exchanged and prices are decided by individual suppliers. Buying and selling decisions are made by buyers and sellers. Prices act as a guide:

- If prices are high enough, suppliers will be willing to supply to the market. High prices create profit and increased supply.
- If buyers think that prices give good value for money, they will buy goods. The lower the price, the more customers will buy.

In a **MARKET ECONOMY,** buyers and sellers interact and this decides how resources are allocated.
In a **MIXED ECONOMY,** decisions are made by a combination of the government and the market.
In a **PLANNED ECONOMY,** the government has complete control of what is supplied and the prices for goods. The market has no control in what is sold.

2.2 Demand



Effective demand for a good or service is a want supported by the money to purchase it.

If a **good** is in **great demand,** there will be a lot of people wanting to buy it at the current price.
Businesses use demand as a factor in setting prices.

If prices are **too high,** less people will want to buy the good/service.
If prices are **too low,** not enough revenue will be made.

Larger quantities of goods are **bought at lower prices** and **lower quantities of goods** are bought at **high prices.**

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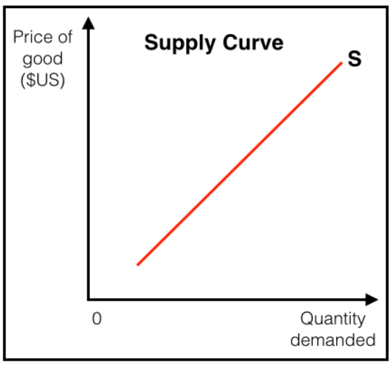
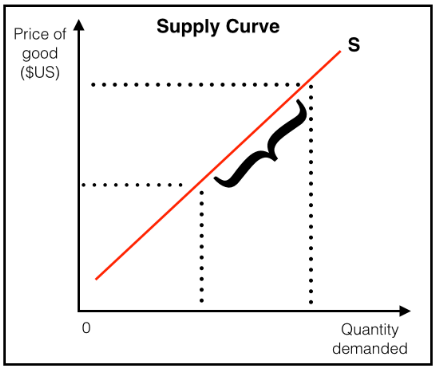
2.3 Supply



The **supply** of a product is the **quantity** that a **supplier is willing to provide** at different prices. Suppliers supply more at higher prices, higher prices enable producers to **cover costs and make increasing profits.**
Extensions and contractions in supply result from **changes in the price** of a product.
Extensions and contractions in demand result from **changes in the quantity demanded** of a product resulting from changes in the price of a good.



long period, others have **grown rapidly.** Multinationals are able to **buy labour** and **raw materials** in **more countries** and can **sell** to a much **larger market.**

The **size** of **multinational companies** can be measured by:
- **Number of operating countries**
- **Value of all of the shares in the business**
- **Number of employees**
- **Range of products**

Benefits and disadvantages of operating in many countries:

Advantages:
- Access to natural resources that may be in limited supply in their own domestic market.
- A source of labour that may be cheaper in the home country.
- The opportunity for a global market.

Disadvantages:
- There may be different tastes, requirements and legal standards.
- This could make it more costly to produce different models and varieties of products.

Benefits and disadvantages of host countries:

Advantages:
- Employment, new products and new technology is brought to the host countries.
- The presence of multinationals can speed up development.

Disadvantages:
- They may not pay enough for raw materials and employee wages.
- They may cause pollution and environmental damage

4.5 Cooperatives

'Cooperation' means **working together** in **agreement.** A cooperative is a **group of employees, sellers** and **producers** who have banded together to **buy, sell** and **market** their products or services. In a **cooperative** people **join together** to **make decisions, work** and **share profits.** The members are **cooperators.** The cooperators often **elect a committee** to represent them. Cooperators **jointly share** in the **benefits** from working together. The **three** types of cooperatives are: **farming** cooperatives, **production** cooperatives and **retailing** cooperatives.

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Farming cooperatives

Individual farmers want to **sell their produce** to the market at the **best possible price.** Cooperators set up **large store units** so that farmers can sell their produce **slowly.** If all the produce was sold **at once,** the market would be **flooded** and they would be **sold** at a **low price.** The cooperative shares money from sales between the farmers. The **amount** they **receive** is determined by the number of **good quality products** they deliver to the warehouse.

Production cooperatives

Production cooperatives AKA **workers cooperatives,** employ **all or most** of its members. This cooperative's purpose is to **generate benefits** for its members who will:
- Share responsibility for the success and failures of the enterprise
- Work together
- Take decisions together
- Share profits and losses

Shares in the cooperative are held by the **workforce.** Most of the workers **own shares.** Workers choose a body to represent them **by election.** The board then hires managers. Members of the cooperative meet to **discuss** major decisions. The main advantage is that members **work together** and **share the benefit.** The disadvantage is that there are **more decisions makers** which can **slow down** and **complicate decision making.**

Retailing cooperatives.

The owners of the cooperative are the members who usually pay a minimum set subscription. This gives them voting rights to choose how the cooperatives should run and what types of goods to stock. Cooperatives typically have strong social principles. They only buy from suppliers who sell products at fair prices. Most retail cooperatives believe in the principles of fair trade.

4.6 Public Corporations

profit because large profits for the business mean **large dividends for shareholders.** The **profit maximising point** is when there is the **greatest difference** between **total revenue** and **total cost.** Businesses may have **other goals** for example: draw attention away from their **high profit** because the government and regulating bodies may question how such large profits were made. A business may also want to make products which are: **safe, of a high quality, have a good reputation** and **reduce the sales of their competitors.**

4.14 Price and Output in Perfect Competition

Price competition: Businesses compete with each other to make sales. The greater the competition the closer the prices charge by rivals.

Perfect competition

The idea of **perfect competition** help economists to understand what an **absolutely competitive** market would be like. **Perfect competition** does not exist in a **pure form** because there are always differences between sellers e.g. one seller may be **more friendlier** than another. **Perfect competition** would work based on the fact that:

- There would be lots of firms competing with each other.
- Each firm would produce an identical product.
- Each firm would know exactly what the others were producing and the prices they were charging.
- There would be no barriers to new firms entering the market, and no barriers to exit, so that firms could enter or leave the industry easily.
- Each firm would only produce a very small percentage of the overall production in the industry, because consumers could easily switch to a cheaper supplier.
- There would be lots of buyers, each of whom would know all the prices charged by different sellers.

Given these condition, economists believe that:

- Businesses would all charge the same price.
- This price would be the minimum they could charge without going out of business.
- The price would be equivalent to the lowest average cost of producing goods.
- At the market price the average cost of production would be the same as average revenue for selling.
- No firm would risk charging more than the market price, because they would make no sales if they did.

Price takers and Price makers

In **perfect competition** businesses and suppliers would be **price takers**, it would take its price from the market. The alternative is a **price maker**, when businesses choose at what price to sell its products. Businesses would produce at the point where: **Output x Average Revenue = Output x Average Cost**

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4.15 Price and Output policies in Monopoly

Monopolies are the **opposite of perfect competition.** In a **pure monopoly,** there is only **one firm** in the **industry,** so there is **no competition.** There are **very few pure monopolies** in the world. Sometimes there are businesses **so large** that they can **benefit** from the **same advantages** as **monopolies.** In some countries, **government owned public corporations** have **monopoly powers.** A **lack of competition** can enable companies to benefit from **monopoly-like powers.** A monopolist would **set prices** at the **profit maximising point.** Monopolists would choose the price where the difference between cost and revenue is **maximised.** Monopolists charge prices that are **higher** than the **average cost** of making that output of goods. The monopolist is therefore making **profit over and above normal profit.** Monopolists can choose **price** or **output** supplied but not both because they are the suppliers.

The features of a monopoly:

- There is only **one firm** in the industry and it **controls** the market.
- It is **very difficult** for firms **to enter** the new industry
- The monopolist is the **price maker**, the setter of prices.
- Monopolists make profits over and above normal profit.

How do monopolies occur:

- **The government may give a business the legal right** to be the only one in the industry. E.g. energy companies, water suppliers and other important public services.
- **Through first mover advantage:** a business may be the first to enter an industry, be very efficient and quickly develop a monopoly. It may build up a reputation and position that are difficult for others to match. E.g. Google

Takes a greater proportion of income from a wealthy person that from a poor person.
Regressive tax:
The poor pay a higher percentage of their income in tax than the rich. This happens when the government imposes a tax at a set rate of money.
Proportional tax:
A situation in which tax rises in proportion to the income of the taxpayer.

__Common taxes:__
Taxes that are common to most countries include the following:
A tax on incomes: This is often a progressive tax. Higher income earners pay a larger percentage of income tax. It is a *direct tax.*
A tax on company profits: This is a *direct tax.* The government can make it progressive by increasing the rate as profits increase.
A tax on purchasing: E.g. Value Added Tax. Producers and sellers of goods pay tax to the government as a percentage of the value they add in the production of an item. The shop then makes the customer pay the tax. The tax is thus *indirect.* If the government taxes goods that are bought buy the rich more than those bought by the poor, the purchase tax system would be progressive.
Taxes on imports: These are *indirect* as they are passed onto consumers.
Taxes on specific products: E.g. cigarettes, alcohol and petrol. These are *indirect.* They may be regressive if they hit the poor harder than the rich.
Direct taxes are paid directly to the government. Indirect taxes are paid through an intermediary rather than the person on whom the burden of the tax falls.

5.9 Government Influence on Private Producers: Regulation

Regulations are **rules.** They can be **rules imposed** by a **government backed up by penalties.** In the world of business the aim of regulations is to **influence the behaviour** of **firms** and **individuals** in the private sector. **Regulations** are designed to **modify the behaviour** of businesses and individuals in ways that **benefit society.** Regulations can impose **costs and time burdens** on **private businesses.**

Area covered by regulation	Examples
Methods of production	Management of waste and pollution, rules protecting the health and safety of production workers.
Setting up a new business	Paperwork to be filled in to register the business rules protecting shareholders, filing of tax returns.
Rules about prices	Prices that can be charged for supplying certain products.
Product standards	Quality of food products labelling of contents of a product.
Disclosure of information	Information that companies must produce in reports to shareholders, information about how certain products can be used.
Providing goods on credit	Information that must be given about the cost of the credit to the borrower, rules setting out the possibility of the borrower pulling out of a credit agreement.
Providers of certain products and services	Who can supply certain products such as repairs to gas pipes, building construction.
Supply of harmful products	Health warnings on cigarettes.

Regulations can be in the form of **laws governing the actions of private firms** and **individuals.** They can also be created by **granting licences** and **permits** to firms that meet certain conditions. Inspection by qualified inspectors can then make sure that the businesses are **complying** with the regulations. **Failure to do so** can result in **fines** or **loss of the licence.** Regulations are designed to **modify** the behaviour of **businesses** and **individuals** in ways that **benefit society.**

__The benefits of regulations:__
Governments use regulations to **improve efficiency** and **redistribute income.** Governments **regulate firms** and **industries** where there are **monopoly powers.** Monopolists may **restrict output** or artificially

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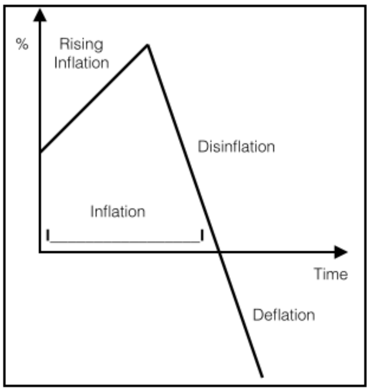
Changes in the exchange rate between countries can have a major impact on business costs, people may have to pay more for imported goods.

Demand pull inflation:

This occurs when rising demand pushes up the price of goods. This happens when people have more to spend. This is most likely when an economy is near to full employment. Businesses compete for resources and this will lead to a rise in prices.

6.3 Consequences of Inflation

Inflation is a sustained rise in the general level of price. Mild inflation of one or two percent is not harmful because it encourages producers to supply more to the market. When inflation rises more quickly it can disrupt economic decision making because it become difficult for businesses government and even ordinary people to make plans. Inflation results in a loss of value of units of currency. The reverse of inflation is deflation, when prices start to fall. Deflation (negative inflation) discourages businesses who may restrict supply to the market. When prices rise rapidly governments are often tempted to print more money. When the quantity of money increases people lose confidence in it and businesses push up prices because they see money as being less valuable. The government is forced to print more money, but it becomes worthless.



Income level	Effect of inflation
Low income	They can **afford fewer goods,** including basic necessities. People resort to buying the **lowest priced products** available.
Fixed income	There is a **fall in real income** (what can be afforded with money coming in). Because **money loses value,** people on fixed incomes **save less** and **spend more.**
High income	There is **less income** to spend on some **luxury goods.** People may switch to **cheaper alternatives** and cut back on **extravagant purchases**. They may **save less** and **spend more.**

Who loses out in a period of inflation:

The poor:

Poor people are the **first to suffer** in times of inflation. If there are **food shortages** then the government has to buy **expensive imports** which will **push up inflation** and poor people will **not be able** to meet their **needs.**

People on fixed incomes:

Their incomes have to rise to keep up with inflation but because their incomes are fixed they are not able to save more, they have to spend more.

Savers:

Many people like to save some money each month for future needs. Their savings may be deposited in a bank or kept in a safe place. However during a period of inflation savings lose their value. When the money comes to be spent it is not worth as much as when it was first saved. Similarly money saved in a pension scheme can lose value by the time a saver becomes old enough to use it. These are usually unskilled workers with less bargaining powers who don't belong to a trade union. Skilled workers could negotiate wage increases.

Businesses:

A lot of business activity involves supply goods on credit perhaps to other businesses. When money starts to lose value quickly, businesses become reluctant to supply on credit. In contrast, people who borrow money are likely to gain. When they come to pay back the sum they have borrowed the value of their repayment will have fallen.

Mild inflation:

Gently rising prices encourage businesses to supply more to the market and to help increase profits. This can have a positive effect on business confidence.

Deflation:

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Fluctuations in exchange rates are caused by **changes in the supply and demand** of international currencies. **Changes in demand and supply** for currencies results from the **demand and supply** of currencies for **trade purposes** and for **capital flows. Speculation** can lead to **unsettling changes** in the **price of foreign exchange.**

8.5 Consequences of Exchange Rate Fluctuations

Fluctuating exchange rates
Changing exchange rates affect those most concerned with the trading process, exporters and importers. They also have knock on impacts on the economy e.g. prices changes.

Home currency appreciates, gets stronger. External value of the currency goes up.	Exports from home country become **more expensive** to customers from other countries, therefore more difficult to sell. Exporters will sell less and make less profit. Value of exports decreases.	Imports from other countries become cheaper, including raw materials and finished goods. Importers will find goods from other countries cheaper to buy so they can sell more in the home country, enabling them to make more profit. Value of imports increases.
Home currency depreciates, gets weaker. External value of the currency goes down.	Exports from home country become **less expensive** to customers from other countries, therefore easier to sell. Exporters will sell more and make more profit. Value of exports increases.	Imports from other countries become more expensive, including raw materials and finished goods. Importers will find goods from other countries more expensive to buy so they can sell less in the home country, enabling them to make less profit. Value of imports decreases.

PED for export and imports
The consequences of exchange rate fluctuations depend on the price elasticity of demand for traded goods. Inelastic demand for goods lead to higher revenues. If the demand for a currency is inelastic then the strength of the currency is strong.

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The consequences of depreciating a currency
This can help you sell more while leading to a fall in imports. If the demand for exports is elastic a fall in currency will lead to a greater than proportional increase in sale of exports. If the demand for imports is also elastic, a depreciating currency could lead to a more than proportional fall in imports.

8.6 Methods of Protection

Trade protection is **restricting the entry of foreign goods** into a **domestic market** or **imposing a tax** to **raise the price** of **imports. Protectionism** is the means by which a government **protects its economy.**
Limiting numbers or prices: To protect domestic industries a government can **restrict** the number of imports allowed into its country. It can make **imports more expensive** by taxing them. Another way of restricting imports is to limit the availability of foreign exchange required to purchase them.

Types of trade protection:

Import tariffs: Taxes on types of imports. Tariffs increase the cost of importing and increase the price of imported goods in domestic markets. This method protects domestic industries by making the prices of domestic products more competitive.

Import quotas: Quotas set a physical limit on the number of imports. Restricting quantities will also most likely make imports more expensive. This also protects domestic industries.

Import licensing: Governments can grant licences for the import of certain good. Not granting a license is a type of protection.

Administrative complexity: The government may require importers to fill in time consuming paperwork. This creates a burden that can be seen as a cost and therefore a discouragement for importers.

Subsidies: Payments to a domestic producer. The effect is to make domestic goods cheaper to produce often enabling them to be sold at a lower price than imports making them competitive. Export subsidies are the opposite of tariffs. The involve a direct payment to the exporter.

Exchange control: Governments preventing or limiting the amount of foreign exchange to which importers have access.