- Economies of scale
- Political links may prevent wars
- Competition gives greater efficiency and reduces the power of the monopoly producer

Division of labour

Division of labour is a special type of specialisation. The production of a good is spilt into many tasks which can be undertaken by different people. There are three types of division of labour:

1. Specialisation of people in trades or professions (e.g. milkmen)
2. Specialisation by process (e.g. jam making)
3. Specialisation by area (e.g. Silicon Fen, Cambridge)

Advantages

1. Time saving
2. Increase in output due to productivity gains from increased economic organisation
3. Improvement in quality of goods because specialists can perform better
4. Makes the best use of natural abilities
5. Reduction in costs because people work faster
6. Automation as the use of machinery takes over repetitive tasks

Disadvantages

1. Mental disadvantages on workers of low job satisfaction
2. Strikes and absenteeism
3. Immobility of labour

Limits to the division of labour

- Some trades, such as handmade craft trades, are not suitable for specialisation.
- Large scale sales are needed for division of labour
- Management may not be efficient

1. Trade journals
2. Independent Research

Disintegration

1. Ancillary trades
2. Service trades

Diseconomies of scale

When a firm grows excessively large it may experience diseconomies of scale. These are:

1. Coordination - firms find it difficult to manage dependencies between activities.
2. Communication - management and the workforce find it difficult to communicate.

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- Menu costs
- Redistribution
- Uncertainty and lack of investment
- Balance of payments
- Income and Substitution Effects

Measures to deal with Inflation

- Supply-Side
- Demand-Side
    - Monetary
    - Fiscal
    -

Savings and Inflation

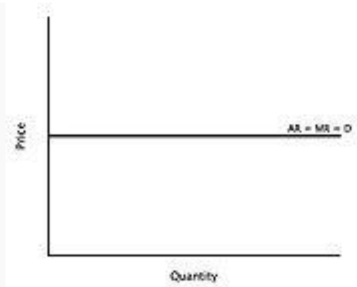
Most studies found a positive correlation between **savings** and **inflation**. However, there are differing explanations:

1. **Deaton (1977)**: suggests that it is *unanticipated* inflation that matters. Consumers initially underestimate the average price level, and shocked by the "excessive" rise in prices cut their consumption in response until they recognise the higher price levels.
2. **Buckley (1981)**: suggests that even if inflation fully anticipated, the savings ratio will increase as long as anticipated inflation is itself increasing.
3. **Cuthbertson (1982)**: suggests that, due to inflation, the real rate of interest (nominal – inflation) often zero or negative, so real purchasing power of a given stock of liquid assets (notes/coins/bank deposits & other short-term assets) falls. Consumers, seeking to maintain the real value of their liquid assets for reasons of security or flexibility, thus have to reduce consumption of current real disposable income/increase saving to do so.

4. Revision:Unemployment

5. **Unemployment**
6. • Low levels of unemployment is one of the main macroeconomic goals of every government.

40. **Corruption and war** – bribery, extortion, diversion of resources by government – this is an inefficient allocation of resources and restrains development. Government officials embezzle money rather than spend it on public services or investment. This will deter aid. Civil war means government resources are diverted towards arms, e.g. Sudan and DRC, disrupting growth and development, destroying infrastructure and people. War and corruption also deter investment.
41. **Population growth** - rapid population growth in poorest countries e.g. Malawi. This means income per capita falls. Malthus said at the end of the 18th C that famine was inevitable because population would increase geometrically, but food production could only increase arithmetically. However, since then technology has disproved this. Poorer countries have high birth rates and slowing death rates.
42. **HIV/AIDS** – Reduced working population – the working population suffer, so there is a loss of highly skilled workers. Zambia now loses 2/3 of teachers to AIDS. In Swaziland, life expectancy is just 31. Productivity declines because of illness, tax revenue to government falls. Labour becomes more expensive, so higher CoP, and can attract less FDI. Sub-Saharan Africa has 2/3 of the world's AIDS sufferers. Resources diverted from growth to treating AIDS.
43. **Education** - a huge investment in human capital through education has allowed China to shift out its PPF. Countries with little education investment and low school enrolment are likely to have low productivity and little economic growth. It will mean more FDI in the future as firms will not have to train workers.
44. **Debt servicing** - LEDCs borrowed in 1980s. Since then, fall in value of their currency, compared to $, so have to pay back more; oil prices have increased.
45. **Capital flight** – companies and individuals place cash, buy shares and assets abroad, contributing to savings gap, and reduces tax to government.
46.



Main article: Perfect competition

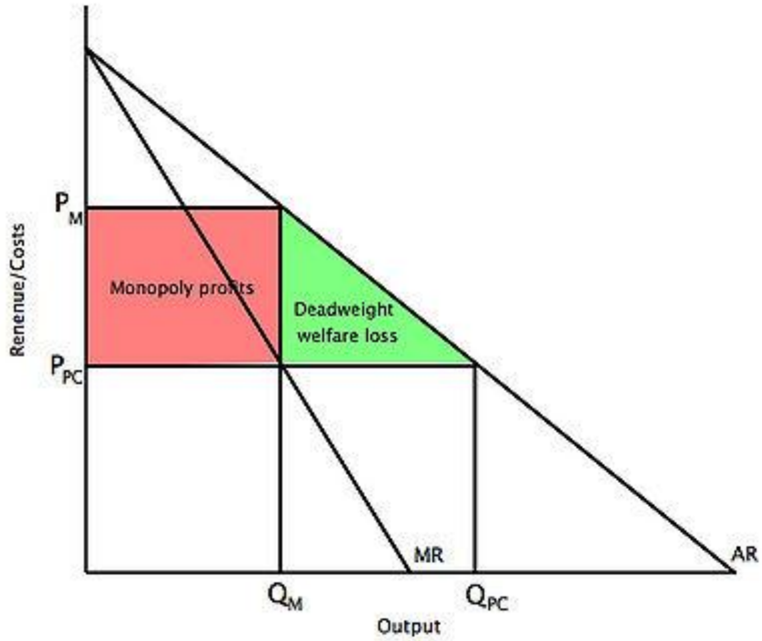
Under perfect competition, each firm has an elastic PED. This is because in a perfectly competitive market, the firm is a price taker.

When AR is horizontal, MR=AR.

Monetarism and Keynsianism

Issue	Keynesianism	Monetarism
Phillips curve	Unit elasticity causing a payoff between unemployment and inflation	Vertical long-run Phillips curve (completely inelastic) - explains stagflation
Savings	Savings lower AD, causing less investment (despite cheaper loans)	.
Quantity theory of money	Wrong because not all the extra money is spent - velocity is may slow down.	MV = PT • M is the supply of money • V is the velocity of transactions • P is the average price • T is the total number of transactions V is believed to be

Comparison with perfect competition



The price is higher and the output is lower than under perfect competition. The consumer loses consumer surplus (shaded areas in the diagram).

Perfect competition

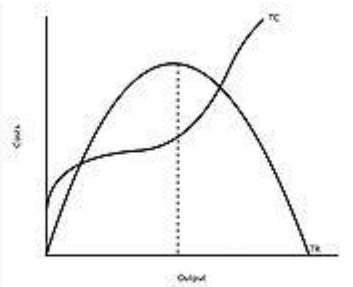
Perfect competition is a model of a market structure where allocative and productive efficiency are achieved (long run). A number of assumptions are made:

1. Many small firms (no monopoly power)
2. Many individual buyers (no monopsony power)
3. No barriers to entry or exit
4. Homogenous products (no product differentiation)
5. Perfect knowledge (no asymmetric information)
6. No externalities

Perfect competition graphically

In perfect competition, firms are price takers. If they charged a price other than the market price they would either:

Revenue maximisation



The point when MR = 0 and the firm is producing at the point where TR is maximised. The profits will not be maximised. Output will be larger than under profit maximisation.

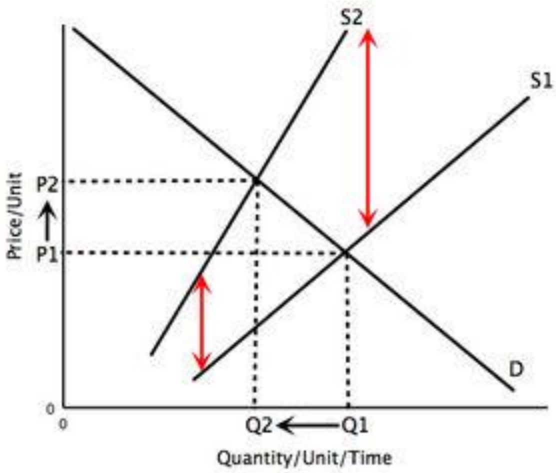
Specialisation and Trade

Specialisation is when a factor of production is devoted to a specific job. This applies to all factors of production - land, labour, capital and enterprise. By specialising and trading, countries can increase overall output.

Absolute and comparative advantage

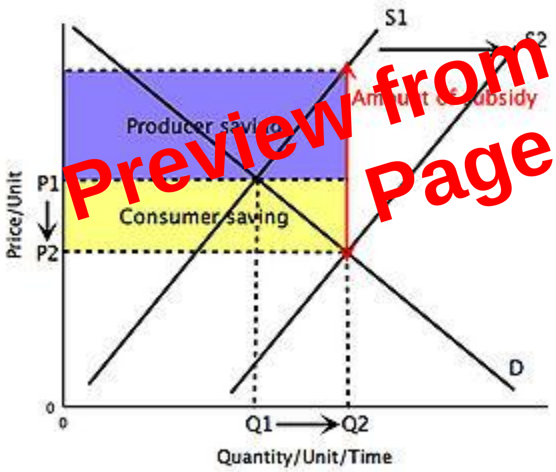
When a country can produce more of a product per unit resource than its rivals can, it has absolute advantage. The country can produce at a lower factor cost.

More important, however, is Ricardo's idea of comparative advantage. The producer with the lowest opportunity cost of production for a particular product has comparative advantage. For example, Portugal can produce more wine and cloth than England per unit resource (it has absolute advantage in both). Compared with Portugal, England is bad at producing cloth, but terrible at producing wine. Therefore England should specialise in cloth and Portugal in wine, because the opportunity cost of Portugal producing extra cloth is greater than producing extra wine.



Ad valorem taxes, such as VAT, are a fixed percentage of the price of the good, so the amount of tax (indicated by the red arrow) increases as the price increases.

Subsidies



Subsidies act in the opposite way to taxes. They encourage greater production of a good, shifting the supply curve to the right.

It is mainly goods with elastic PEDs which are subsidised as this ensures most of the cost saving is passed on to the producer.

A2 Economic Rent and Transfer Earnings

- Transfer earnings are the minimum payment required to keep a factor of production in its present use. It is the opportunity cost an individual forgoes when deciding to work in one job rather than the next best alternative.

  Example - a man may decide to work as a shop assistant because they pay is better than if he was a waiter. By making this decision he forgoes the opportunity to work at, for example, Pizza Express. The opportunity is seen in terms of this forgone alternative. If Pizza Express were to raise its wage rates in order to attract more staff, there would come a point where the shop assistant might reconsider his decision and decide to be a shop assistant after all, as the opportunity cost of being a shop assistant has risen.

- Economic rent is a payment received by a factor of production over and above what would be needed to keep it in its present value. i.e. it is the amount which someone can earn which is in excess of their transfer earnings (what they could earn elsewhere). It is a demand determined reward to labour and will be earned when labour is to some degree in inelastic supply.

  Example – doctors are in almost perfectly inelastic supply because the number of places available to study medicine is determined by the government and the profession. To the extent that the demand for doctors exceeds the supply, they will be able to negotiate higher salaries than most could earn as research scientists or in other occupations

- The factor that determines the level of economic rent in comparison to transfer earnings is the elasticity of supply of labour. The more inelastic the supply, the greater proportion of total earnings that is made up of economic rent and therefore there are fewer transfer earnings. Conversely, the more elastic the labour supply is, the more transfer earnings make up of total earnings, and so the economic rent is less.

  Example – The difference in the earnings of two jobs, for example surgeons and shop assistants demonstrates the importance of supply.

World Bank

This consists of two organisations now, although when it was set up it was an organisation designed to relieve the short term BoP problems of LDCs. It now has 184 member countries contributing to it and deciding how the money is spent. The two parts are -

International Bank for reconstruction and development - IBRD

This part is responsible for the funding of various projects in cooperation with the local government. It lends out money either directly to private firms or to the government to do so at commercial interest rates.

International Development Association - IDA

This part lends money to the poorest LDCs to tackle BoP problems and the like on concessionary terms, ie long repayment periods and very low or zero interest rates. These are called soft loans.

A third organisation called the International financial corporation (IFC) is closely linked with the world bank and gives a type of aid without going through the local government - hence less likely to be affected by corrupt government officials, although more risky financially, since they buy into shares of firms or lend directly to them if the IFC believes that this will lead to higher levels of development.

IMF - international monetary fund

Bad ass press! Similar to the IDA in that it gives loans to governments although these are conditional loans - the loan has structural adjustment policies attached (SAPs). These are pretty set regardless of the country they're being used for and are also pretty harsh as they push the economy too hard to change and try to bypass 'take off'. They all too often lead to short and medium term rises in poverty although they tend to be successful for both growth and

Formulae

PED

- $\frac{\%\text{change in quantity}}{\%\text{change in price}}$
- $\frac{\text{change in quantity}}{\text{original quantity}} \times \frac{\text{original price}}{\text{change in price}}$
  $\frac{\Delta Q}{Q} \times \frac{P}{\Delta P}$

  - $\frac{\Delta Q}{Q1+Q2} \times \frac{P1+P2}{\Delta P}$
    - PED >1 elastic
    - PED <1 inelastic
    - PED =1 unitary

PES

$PES = \frac{\%\text{change in quantity supplied}}{\%\text{change in price}}$

YED

- $\frac{\%\text{change in quantity}}{\%\text{change in income}}$
  $\frac{\%\Delta Q}{\%\Delta Y}$

  - $\frac{\Delta Q}{Q1+Q2} \times \frac{Y1+Y2}{\Delta Y}$
    - positive = normal good
    - negative = inferior good
    - YED > 1 = luxury good

XED

- $\frac{\Delta Qy}{\Delta Px}$
  - Substitutes: XED > 0
  - Complements: XED <0

Macroeconomics