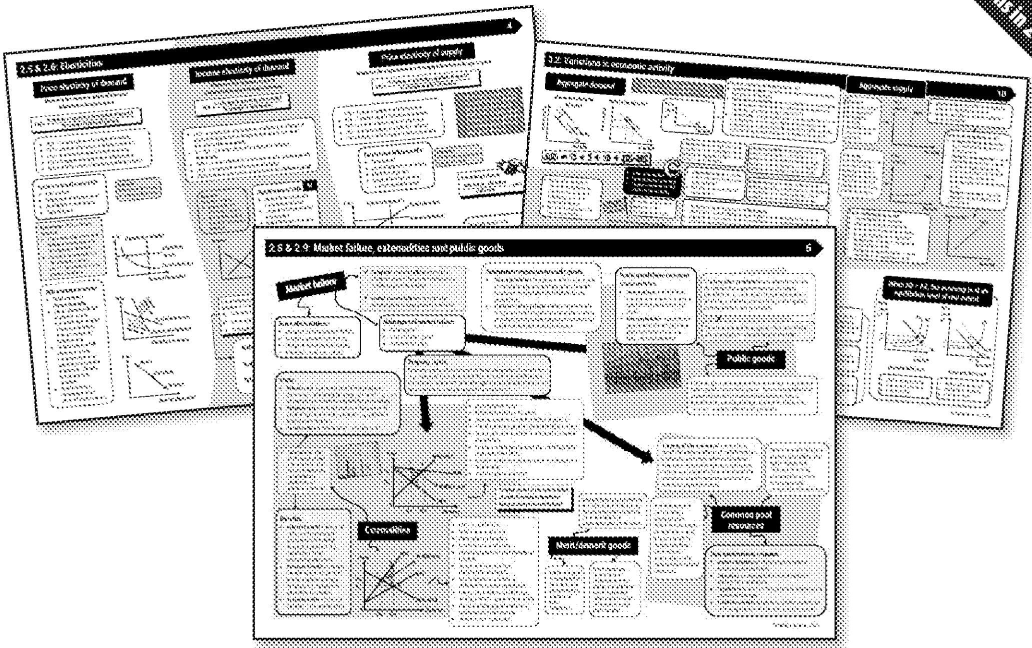
Economics

International Baccalaureate

2020 specification
first exams in 2022



Topic on a Page for IB Economics

Higher Level: Units 1-4

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POD 12340

Contents

Both the summary and activity pages are provided in A3 and A4 format.

Teacher's Introduction

This resource covers all content (higher and standard level) of the IB Economics specification. It provides 19 A3 posters, together covering all the subtopics.

It is intended as a summary of the material and focuses on the main points rather than the detail, so all important areas are covered, without going into too much depth. The posters can be displayed on classroom walls, or given to students to learn with in lessons or at home. The resource can be used to help students to revise at the end of a topic, or before a test or an exam.

The resource consists of:

- 19 completed mind maps which provide solutions to the activity mind maps, labelled 1 to 19
- 19 activity (partially complete) mind maps for students to complete, labelled 1 to 19

Both sets of mind maps are provided in A3 and A4 formats.

Activity versions of the posters are also included, where some of the sections are blank, so that the students can test their knowledge by completing these. Answers for these activities are on the summary sheets.

Different styles and layouts are used to help to make the information interesting, and to help the students engage with the information in a productive way.

If teachers wished to add extra annotations to clarify or add further information, they could do this as well.

Some of the subtopics are linked, and it will be helpful for students to view the whole of each poster to help them to make connections between concepts. However, posters have clear-cut divisions between subtopics, and the teacher could choose to give students part of a poster, if they wish to focus on a particular subtopic.

The symbol  is used to denote quantitative skills.

H Higher Level content is indicated like this.

D Glover, November 2023

1.1: What is economics?

These nine concepts will be a recurring theme in your study of economics. You will need to understand their relevance and evaluate their importance to strong economic performance.

- Scarcity
- Choice
- Efficiency
- Equity
- Well-being
- Sustainability
- Change
- Interdependence
- Intervention

✓ Economics is a social science because it is a study of society and human behaviour.

Economics as a social science

Microeconomics → Study of how resources are allocated by individuals and firms.

Macroeconomics → Study of how resources are allocated by governments and between economies.

Economic resources – all things that help us produce goods and services.

Economic resources come in four main categories:
1. Land
2. Labour
3. Enterprise
4. Capital

Land refers to all those natural raw materials that are found on land or under sea.

Enterprise refers to the risk-taking attitude that is required for a person to be able to run a business.

Capital – Technology or machinery to facilitate in converting raw materials into finished products.

Labour – Human workers.

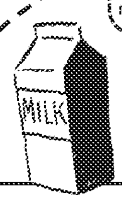
Main economi
- scarcity because reso
  while our **wants** are

PPCs and th problem of ch

Renewable resources rep quickly, e.g. sunlight.

Non-renewable resources not replenish quickly, e.g.

✓ PPC shows the opt combination of ... type of goods ... resources are utili



- **Consumer goods** are directly bought
- **Capital goods** are used to make consu
- So more capital goods help produce m

Scarcity requires us to th resources are scarce, the how they can be made to the benefit of future gener

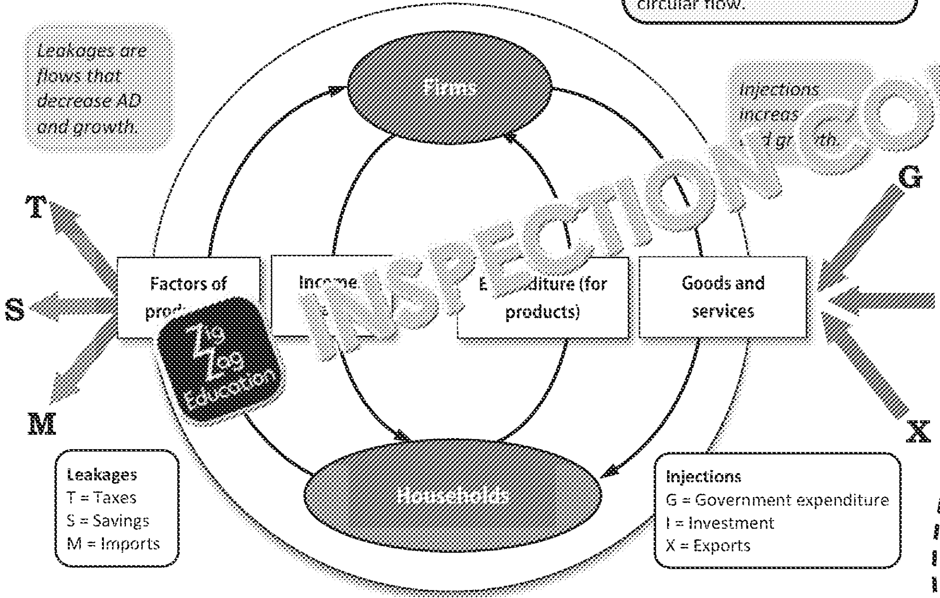
Circular flow of income

The **circular flow** model visualises the way that income flows in, out and around the economy.

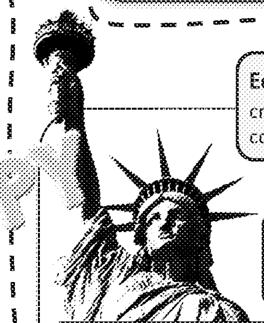
All economic actors are interconnected and play a role in injecting income into and leaking income from the circular flow.

Leakages are flows that decrease AD and growth.

Injections increase AD and growth.



Economi creating p consumer



Advant
- Effic
- Com

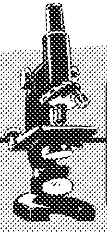
✓ Free market economy – where the economy is driven by the price mechanism.

Disadvantages:
- Market failure
- No public goods
- Bad for the environment
- High inequality

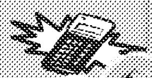
1.2: How do economists approach the world?

✓ Economics is a social science because it is a study of society and human behaviour.

In order to find a causal link between two variables, certain **assumptions** need to be made. These assumptions form the basis of predictions.



Unlike scientists, economists are usually unable to test hypotheses in a lab using controlled experiments. They mostly have to rely on evid... that is already avail...



Economists need to ... data ... graphs to ... models.

Process of creating economic models:
- Observation
- Forming hypothesis
- Forming predictions
- Testing predictions a... evidence
- If evidence supp... predictions, hypo... becomes theory.

...odology

- **Equality** = A positive goal in which people are verifiably treated the same.
- **Equity** = A normative goal of commitment to social justice and fairness.

...sitive statements → based on facts. Can be tested and proven true or false.

Normative statements → value judgments or subjective opinions, and cannot be proven true or false.

These value judgments may be used to influence certain economic decisions. For example, *in the case of a market failure, should the government intervene?*

Main 'assumption' in economics is:
ceteris paribus
= everything else remains constant.

Adam ...

✓ ...

Advan...
1. Effi...
2. Imp... gro...

Disadv...
1. Cou... relia...
2. Can... and...
3. This... une...

A short history of economics

The ideas of Adam Smith form the basis of classical economics, which is associated with free trade, limited government intervention and laissez-faire (meaning 'leave-alone') markets. This view believes that whatever is good for supply is also good for prosperity and thus well-being.

Classical economics led to widening inequality in society. In this context Marxism emerged, arguing that free market economies were not in the interests of working people.

The threat of Marxist revolut... encouraged governm...ts t... ake a more inter... ...ce ... ec... ...orc... ...re sufficient ... among the population.

Keynes argued for careful macroeconomic management of the economy, in order to encourage consumption and investment, and boost injections into the circular flow.

However, this model of economic management fell out of favour following multiple economic crises, leading to a resurgence of market-... macroeconomics that remains tod...

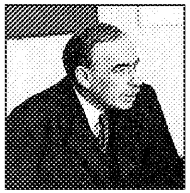
A ... re... 19... w... gl...

Jean-Baptiste S...

According to Say's law, increases in production lead to rising demand. In this view, it is the supply side that drives growth.

...rl Marx
- ...capitalism workers are exploited by property owners. Workers should resist and take control of their workplaces.
- Marxist economic thought inspires communist revolutions around the world.

John Maynard Keynes
- The economy should be stabilised and demand should be managed using government intervention.
- Ideas were popular in the post-war period, until the 1970s.

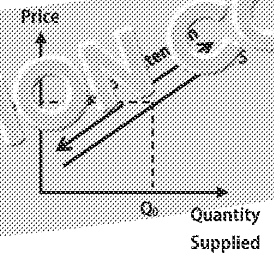


2.1-2.3: Supply, demand and market equilibrium

Supply

✓ Supply is the amount of a good or service that a firm wants to and is able to sell at a certain price, in a given time period.

Movement along supply curve:
Changes in price lead to movements along supply curve. For example, if price rises...



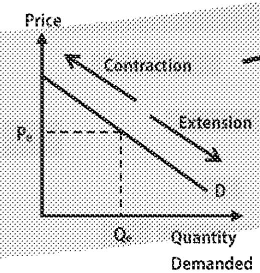
Shift in the supply curve res
- Subsidies provided by the g
- Indirect taxes imposed by th
- Changes in the number of fi providing a particular good
- Changes in technology
- Changes in costs, such as wa of capital goods
- Changes in the quantity of a emergence of a new gas fiel

Remember this does not inclu price variable.

Demand

✓ Demand is the amount of goods and services that consumers want and can afford to buy for a given price over a given time period.

Movement along demand curve:
Changes in price lead to movements along a demand curve. For example, if price rises, demand contracts.

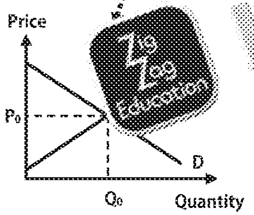


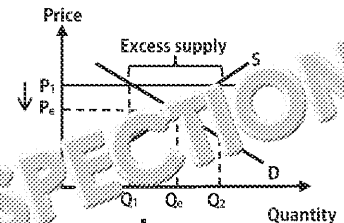
Shift in the demand curve result from
- Population size
- Advertising
- Tastes and preferences
- Income changes
- Others: price of complement/substitut

Remember this does not include changes price variable.

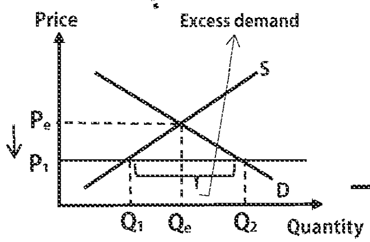
Market equilibrium

The point where demand and supply meet gives us the equilibrium price and quantity.





To eliminate **excess supply**, producers offer lower prices. Thus, demand rises and supply contracts until equilibrium is reached.



To eliminate **excess demand**, consumers offer higher prices. This allows producers to increase supply. Thus supply expands and demand contracts until equilibrium is reached.

✓ Community ... the sum of ... and produce...

Allocativ reached w... commun... maximise...

Mar... amo... to pa... a goo... the c... addi... equi...

Price elasticity of demand

Measures the responsiveness of demand following a change in price

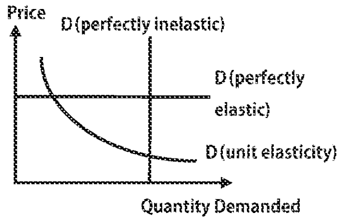
$$PED = \frac{\%\text{ change in quantity demanded of good A}}{\%\text{ change in price of good A}}$$

- PED > 1 means demand is relatively elastic.
- PED < 1 means demand is relatively inelastic.
- PED = 1 means demand has unit elasticity.
- PED = 0 means demand is perfectly inelastic.
- PED = infinity means demand is perfectly elastic.

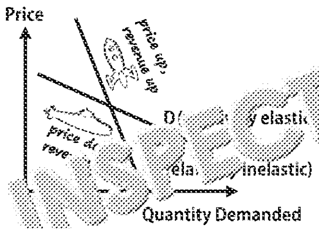
Factors that influence PED:
- Time period
- Proportion of income spent
- Availability of substitutes
- Type of good

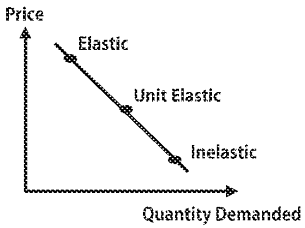
Example:
Price of car increases, its demand decreases

Remember: PED is always negative.
- This means that price and demand always move in the opposite direction.
- For ease we will refer to the absolute values, i.e. '-1' becomes '1' as we ignore the minus.



PED and total revenue:
- **Total revenue = Price × Quantity**
- Elastic demand → fall in price increases consumer spending by a larger proportion, thereby increasing total revenue.
- Inelastic demand → increase in price increases consumer spending by a smaller proportion, thereby increasing total revenue.
- Total revenue is maximised when demand is unit elastic.





Income elasticity of demand

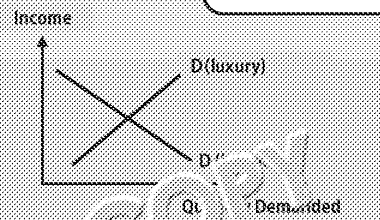
Measures the responsiveness of demand following a change in income

$$YED = \frac{\%\text{ change in quantity demanded}}{\%\text{ change in real income}}$$

- YED > 0 means demand is elastic/inelastic (i.e. change in income brings about a change in demand in the same direction). (**Normal good**)
- 0 < YED < 1 means demand is relatively inelastic. (**Necessity**)
- YED > 1 means demand is relatively elastic. (**Luxury good**)
- YED = 1 means demand has unit elasticity.
- YED < 0 means demand is elastic/inelastic. (**Inferior good**)

Example:
Income increases,
- demand for car increases (luxury)
- demand for public transport decreases (inferior)

Significance of YED: H
- Allows firms to decide what prices to keep
- Helps firms in predicting future sales
- Helps firms to strategise, e.g. diversification



Real income decreases from £3,000 to £2,000 a month and the Sainsbury's' own brand bread increases from 500 loaves to 1,700
a) Calculate the YED.
b) What type of good is this? **Inferior good**
c) Is the good relatively elastic or inelastic? **Relatively elastic**

$$\%change\,in\,demand = \frac{1700-500}{500} \times 100 = 240\%$$

$$\%change\,in\,income = \frac{3000-2000}{2000} \times 100 = 50$$

$$YED = \frac{240}{50} = 4.8\%$$

2.7: Role of government in microeconomics

Why do governments intervene?

Maintain consumption at economically beneficial levels.

Correct market failure and remove price distortions.

Earn revenue in order to provide public funds for a range of services.

Government intervention can sometimes lead to a misallocation of resources.

... firms which may require additional help to survive.

Influence ... levels in order to encourage d... market outcomes.

Limit poverty and inequality to levels which don't undermine social cohesion.

The ma... toward... distrib... withou... from g...

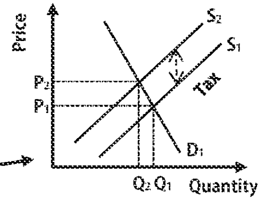
Government intervention

Because market failure can occur, governments will often need to intervene in the economy in order to make corrections or reduce externalities.

Types of government intervention:

- Taxation
- Expenditure
- Regulation

Indirect taxation is a way in which governments can try to reduce consumption of demerit goods.



State provision refers to public services funded by general taxation which are not run for ...

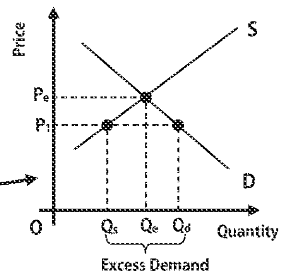
Subsidies can be used to give certain firms a competitive advantage, or used to boost capital investment in key strategic industries.

Because government interventions are often motivated by a range of different interests, this can impact on the effectiveness of the intervention, and influence the way in which resources are allocated.

Customer nud... H
...way governme... influence behaviour, by presenting information about choices in certain ways.

Regulation is a means by which government can control the activities of firms if their actions are contributing to market failure.

Price controls may be introduced by government to ensure certain goods or services are accessible to everyone.



Internatio...
Cooperatio... economy, ... requires co... border coo...

Monitoring... any regula... keep track ... global scal...

Enforceme... regulatory ... enforceme... standards ...

2.8 & 2.9: Market failure, externalities and public goods

Market failure

- ✓ **Complete market failure** refers to a situation where the price mechanism is unable to provide a good.
- ✓ **Partial market failure** refers to the misallocation of resources in a market.

Government responses to public goods

- **Direct provision:** The government may choose to control publ... ods themselves, in order to ensur... ble distribution to the p...
- C... to private sector: Alternatively, ...e government might outsource the running of public goods, under certain conditions that make competition more achievable.

Some abbreviations:

- Marginal private benefit (MPB)
- Marginal private cost (MPC)
- Marginal social benefit (MSB)
- Marginal social cost ...

Main types of mar... ...re

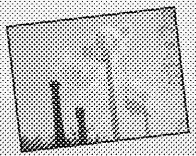
- Externali...
- ...lic g...
- ...ps

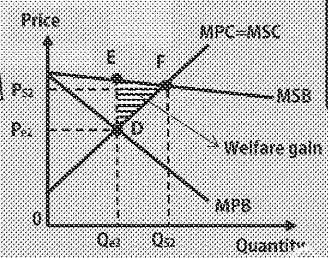
Property rights:
Property rights allows people to have ownership of something, e.g. a piece of land. As a result the resource is used efficiently. Conversely absence of property rights would lead to the misuse and overuse of a resource since no one owns it.

Costs:

- **Private cost** = personal cost to the producer (consumer) of making (buying) a product, e.g. cost of labour/raw materials needed for production.
- **External cost** = indirect cost to a third party of producing/consuming a product, e.g. pollution from power stations.
- **Social costs** = External costs + Private costs.

✓ Externalities refer to the good or bad consequences that occur following the consumption/production of goods and services.





- Zero external costs
- External benefits = DE units.
- Market equilibrium (MPC=MPB) at point D.
- Social optimum position (MSC=MSB) at point F.
- Social optimum position is different to market equilibrium.
- Hence, for marginal output (Q_{e2} and Q_{s2}), MSB is greater than MSC.
- Good is under-priced and under produced in a free market.
- Welfare gain = area DEF

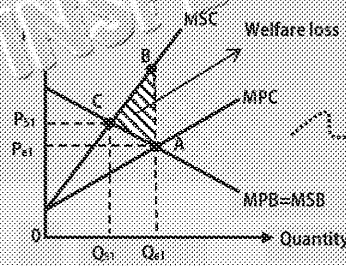
To what ext... ...e construction ... ...wa... t Heathrow ...kely ...d to market failure?

Demerit g... the individ... but are oft... often due t... informatio...

Benefits:

- **Private benefit** = personal utility to the producer (consumer) of making (buying) a product, e.g. satisfaction from consuming e...
- **External ben...** benefit to a t... producing/con... product, e.g. benefits of education to society.
- **Social benefits** = External benefits + Private benefits

Externalities



- ...C ...upply curve
- MPB = demand curve
- Zero external benefits
- External cost = AB units.
- Market equilibrium (MPC=MPB) at point A.
- Social optimum position (MSC=MSB) at point C.
- Social optimum position is different to market equilibrium.
- Hence, for marginal output (Q_{e1} and Q_{s1}), MSC is greater than MSB.
- Good is under-priced and over-produced in a free market.
- Welfare loss = area ABC

Merit/demeri...

Whether a good is considered to be a merit or a demerit good is a matter of value judgement.

Meri... usefu... indiv... socie... unde... often... infor... their...

2.4: Consumer behaviour and 2.10: Asymmetric information (HL)

✓ Some economists seek to understand consumer behaviour in order to determine what makes consumers more or less likely to engage in economic activity.

Profit maximisation
Conventional economics tends to assume that firms always prioritise profit maximisation, but other business objectives persist.

✓ Conventional eco... that rational econ... seek to maximise ...

Consumer behaviour

Business objectives

Utility maximisation
The view that consumers always seek the higher amount of utility possible from each purchase.

Utili...

The importance of the margin
- The margin is the ... it or ... from the consum... extra ...
- Conventional ec... that consumers rationally assess t... ore making economic decisions.
- Marginal benefit is also known as marginal utility. Consumers are assumed to assess the marginal utility of a good or service, relative to its price, before consuming.

Other objectives
- Some firms are focused on growing **market share** relative to competitors in order to become more dominant.
- Some firms seek to **satisfice**, meaning to maintain cost and revenue at a sufficient level just to continue trading.
- Some firms pursue **corporate social responsibility** – these are social or environmental non-economic goals.

- **Total utility:** The total amou... satisfaction a consumer derive... consumption of a good or serv...
- **Marginal utility:** The amoun... satisfaction a consumer derive... additional unit of a good or se...

Diminishing marg...
The theory that less ... from the consumptio... additional unit of a g...

Orthodox economics tell us that:
Individuals are rational economic actors

2.10

✓ **Conventional economics assumes that economic actors have perfect information – but this is often not the case.**

Nudges
A method of changing a consumer's behaviour by suggesting or encouraging the selection of a desired option.

Altruism
- Behaving with kindness or fairness.
- Humans are averse to unequal outcomes.
- Altruistic behaviour is not always behavio... from an individual point of view...

Asymmetric information

Asymmetric information
- When one economic actor has more information than the other.
- A producer will usually have a better idea of the true value of a good than a consumer.
- Asymmetric inform... hus lead to undesirab... outcomes, such as inefficient distribut... or other forms of marke... are.

Behavioural economics is an alternative economic approach which incorporates psychology to understand how economic a...

... a transaction may seek to overcome asymmetric information through **signalling**, whereby a seller provides information to a buyer, and **screening**, whereby a buyer extracts information from a seller.

- **Default choice:** An option that is chosen by a consumer on the basis th... they did not choose an alternative.
- **Restricted choice:** An option chose... by a consumer who is presented with... small range of options.
- **Mandated choice:** An option chose... by a consumer who was required to make a choice.

Key point: Consumers cannot make rational economic decisions if they do not have accurate or sufficient information available to them.

Governments may try to minimise asymmetric information through publicity, such as information campaigns, or regulation, such as advertising standards.

2.11: Market failure – market power (HL)

Remember: Firms seek profit maximisation
Profit is maximised when marginal revenue equals marginal cost

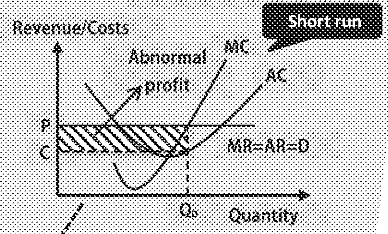
Perfect competition

Characteristics:
- Large number of small firms
- Homogenous products
- No barriers to entry or exit
- Perfect information
- Firms are price takers

...et,
...tural market

Horizontal AR

Short run



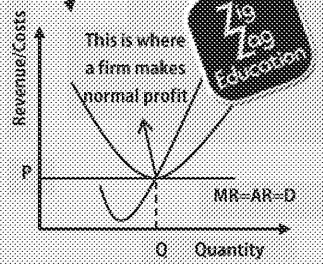
Firms can make abnormal profit/loss in the **short run** *but* not in the long run

Because of perfect information and no barriers to entry/exit

As new firms enter, prices fall and this eliminates any abnormal profit

Firms make normal profit in the **long run**. Long run equilibrium position is at AC = AR

Lo...



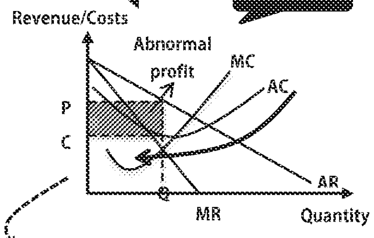
Monopolistic competition

Characteristics:
- Large number of small firms
- Similar products
- Low barriers to entry o...
- Imperfect i...
- Lim... ...luence ...

...ward-sloping AR and MR

Example: Newsagents

Short run



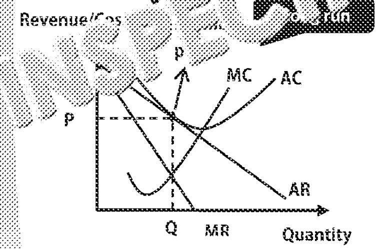
Firms can make abnormal profit/loss in the **short run** *but* not in the long run

Because of low barriers to entry/exit

As new firms enter, a firm's individual demand curve (AR) shifts to the left and eliminates an... abnor... ...t.

Firms make normal profit in the **long run**

...ong run



Not allocatively or productively efficient

Oligopoly

Downward-sloping AR and MR

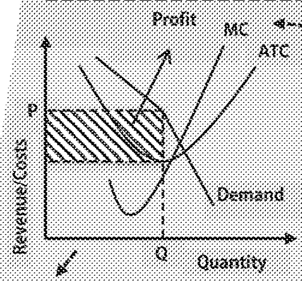
Example: supermar...

Characteristics:
- Small number of big firms
- Product differentiation
- High barriers to entry or e...
- Imperfect information
- Considerable influence ov...

Concentratio... ratio... ...ma... ...are th... ...ge... ...ns hold.

Calculating the 4-firm concentration ratio for the UK supermarket industry is simply done by adding the top four firms' market shares (28% + 16% + 16% + 10%). This gives us a concentration ratio of 70%.

Oligopolistic fi... **interdepende...** follow each ot... don't lose out... firm cuts its pr... have to follow... otherwise con... stop coming to...



Kinked demand c...

According to the kink... curve, firms operatin... oligopoly face an ela... at high prices and an... market at low prices... assumes that other fi... not copy a price incre... an oligopolistic mark...

Can lead to price wars

Types of price competition:
- **Price wars**: firms keep lowering prices below th... competitor's...
- **Preda...**: ...tiall... f... ...ke... ...ver... ...rices to s... ...ne... ...nts
- **Limi... pricing**: prices are so low that firms experience a short-run loss

Types of non-price comp...
- Offers (e.g. B-O-G-O-F...
- Branding and marketi...
- Customer service
- Product improvement...

Thus, firms mostly choose to collude.

Collusive oligopoly:
Dominant firms form a cartel. The cartel occupies monopoly power. Individual firms may agree to split profit or share technology, etc. but this is illegal.

Non-collusive oligop...
Informal collusion – a p... leader emerges and oth... follow. Technically illeg... very hard to control.

Because collusion is a well-known oligopolistic feature, the term 'oligopoly' is sometimes used to refer simply to price-setting behaviour, rather than a market structure.

Advantages
Enables innovatio...
Competitive
Price stability
Disadvantages
Enables collusion
Reduced choice
High barriers to e...

Not allocatively or productively efficient

3.1: Measuring economic activity

National income

✓ National income is the total income generated in the domestic economy

✓ Nominal income is the ... output in an ...

✓ Ra... co... income ... ation

✓ ...s real income helps show economic growth of a country

G = government spending
I = investment
X = exports
T = taxation
S = savings
M = imports

Injections = G + I + X
Withdrawals = T + S + M

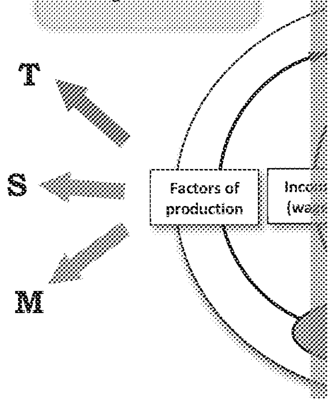
National income = national output = national expenditure

Circular flow of income

...onomies experience periodic fl... ...d contraction, often called **boo**...

- Macroeconomic management tra... maintain economic growth at a s... minimise these fluctuations and c... predictable economic environme...

Withdrawals decrease AD and growth



Measures of national income:

- GDP
- GNI

GDP is the value of all the goods and services produced in a country over a specified period of time.

GNI measure... of citizens of a ... earned both domestically and abroad.

✓ Economic growth is simply the increase in the number of goods and services ... in an econ...

Evidence suggests a positive relationship between income and happiness initally – however, after a certain point there is no clear link.

...ord... ...be...r understand ...andards and happiness, ...ome measures focus on **well-being** rather than pure economic growth.

...easures of well-being include:

- **OECD Better Life**: Combines 11 different living standard metrics, determining each country's ranking in various aspects of social-economic development, as well as producing an overall score.
- **Happiness Index**: An index based on self-reported happiness, in which respondents rate their own happiness on a scale of 1 to 10.
- **Happy Planet Index**: Combines measurements of life expectancy, ecological footprint and self-reported happiness to produce comparisons.

I... ...order to compare growth rates ...tween countries and over time i... better to use data that can be comparable, e.g. GDP per capita, rate of change of **real** GDP.

Year	Real GDP (£tr)
2000	1.5
2015	2.7

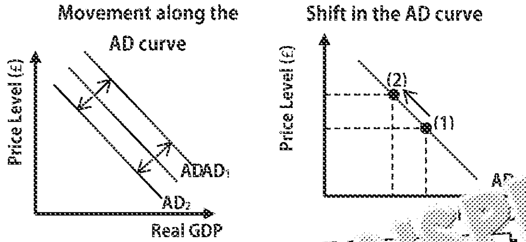
The above table show... for the years 2000 an...

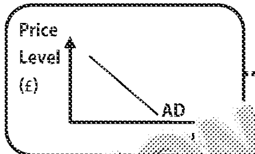
- what the growth r... two years
- what the GDP per ...

3.2: Variations in economic activity

Aggregate demand

✓ AD refers to the total demand for all the goods and services produced in an economy.





AD curve is downward sloping because of:

- **Real balance effect** – as prices rise, fewer people are able to buy goods and services.
- **International competitiveness** – if domestic prices are high, exports appear more expensive, while imports appear less expensive. So net exports fall, reducing AD.
- **Interest rates** – at high price levels, interest rates tend to get increases. Higher interest rates reduce investment and consumption (because firms and households are more likely to save than spend), thereby reducing AD.

AD = C + I + G + (X – M)

C

- C for consumption
- Total household spending
- Largest component of AD in the UK (about 60%)

If **interest rates** are high, consumers tend to save more than they spend because savings give a higher reward (utility) – and vice versa.

Consumer confidence also determines the level of consumption. If the economy is doing well and confidence levels are high about the future, consumers are likely to increase consumption – and vice versa.

- **Disposable income** is income that is left after all taxes have been deducted.
- This determines the level of consumption.

Wealth effects also matter. If the price of a person's asset (e.g. house) goes up, the person is more likely to increase spending. This is related to the consumer confidence idea.

- Marginal propensity to consume establishes how much extra is consumed following a rise in the disposable income.
- This tends to be higher for low-income families.

If households decide to **save** more, their consumption will fall.

In 2021, total consumer spending in the UK was £1,892 billion.

In 2022, 44.7% of UK's GDP was used in the form of government spending.

In 2022, UK was a net importer, with a trade gap of £62 billion.

G

- G for government spending
- Spending on welfare, health, education, etc.
- Forms about 25% of AD in the UK

- Government spending is a part of **fiscal policy**.
- Fiscal policy is about making changes to government spending and/or taxation.
- A government can adopt either a contractionary or an expansionary fiscal policy.
- Contractionary policy is about increased taxation and lower spending.
- Expansionary policy is about lowering taxation and increasing spending.

- Government spending depends on the **trade cycle**.
- When the economy is doing poorly, unemployment rises. So the government has to spend more on welfare, while the tax revenue it receives also falls.
- The opposite happens during an economic boom.

I

- I for investment
- Spending by firms on technology, infrastructure, etc.
- Forms about 15% of AD in the UK

- **Gross investment** refers to the total investment made in a period of time.
- **Net investment** = gross investment – depreciation of assets

Influences on investment:

- As the economy grows, more jobs are created and incomes rise. So to meet the increased demand, firms increase investment.
- Business confidence ... prospect of investi... economic conditions.
- High demand for exp... more investment to meet th... demand.
- If interest rates are high, investment will be low because the cost of borrowing would be high.
- If credit is easily accessible, investment will be high.
- Tight government regulation is likely to limit investment, e.g. high taxes.

X – M

- ... imports
- Forms about 2% of AD in the UK

Real incomes:
As real incomes rise, demand for imports rises. This decreases net trade (X – M). In other words it increases a country's current account deficit.

Non-price factors:
The exchange rate does not affect the quality of traded goods, and changes to exports/imports as a result of exchange rates changes could be mitigated if domestic goods are particularly high-quality or unique.

State of the world economy:
Recession is likely to affect a country's ability to trade. In a recession, inflation lowers, so exports may increase. However, if there is a global recession, other countries ... more imports. Thus, total volumes of exports and ... applies for a national/global boom.

Exchange rates:
If the value of the pound increases (appreciation), ... expensive. Thus, exports fall and imports rise, wh... trade, ceteris paribus. The opposite applies to de...

Degree of protectionism:
A country can try to protect its exports by subsid... and/or taxing imports (tariffs). This is likely to inc... appear cheaper than imports. However, if one co... barriers, others are likely to follow suit. This will r...

3.3: Macroeconomic objectives

Economic growth

Effects of growth:
- Economic growth can improve living standards by creating jobs, raising incomes and improving consumer choice.
- Growth increases tax revenues for the government, enabling more spending.
- Growth can also help government to service existing debts more quickly.
- However, growth is not distributed evenly and can create income inequality.
- Growth can create environmental damage and be unsustainable in the long run.
- Growth creates inflationary pressu...

- **Short-run growth** occurs when productivity from its existing resources improves.
- **Long-run growth** occurs when a country's productive potential increases.

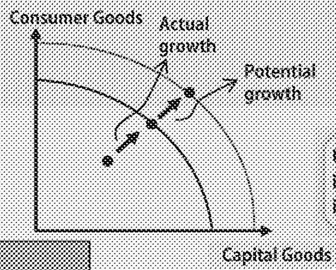
Causes of growth:

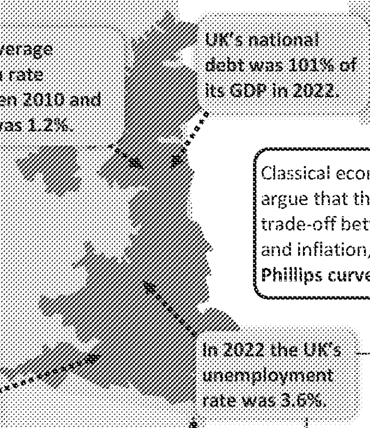
Demand-side factors:
- Increases in the components of AD will increase growth (C, I, G, X – M)

Supplу-side factors:
- Technological advancement
- Education and s...
- Dem... ...an... and migration
- ...nm... ...gulation

Measured ... calc... th... the ...

- **Actual econon...** ...s real growth measured using GDP figures.
- **Potential economic growth** is the overall capacity for growth in the economy. This may be higher than actual economic growth.





Classical econ... argue that the... trade-off betw... and inflation, ... **Phillips curve**...

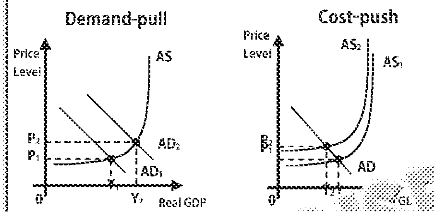
Inflation

- **Inflation** – increase in prices
- **Deflation** – fall in prices
- **Disinflation** – falling rate of increase

Inflation is measured using the **Consumer Price Index (CPI)**

CPI uses prices of a 'basket' of everyday goods that are compared over time.

Causes of inflation:
- **Demand pull** – demand pulls prices with it (i.e. a rise in demand pulls prices up).
- **Cost push** – high costs of production push prices up.
- **Growth in money supply** – increases demand for goods.



Limitations of CPI:
- Prices could change due to changes in quality.
- Temporary shocks can exaggerate inflation ...
- A typical 'basket' of goods could be ... ...ere... diffe...nt groups of consumers (e.g. st...ents, ...nsi...er...).
- Price rise for certa... ...s m... ...in...se a rise in demand for its subs...tu... ...t entirely captured by CPI.

...auses ...f...flation:
- ...ing aggregate demand, often associated with recessions.
- Falling costs of production, possibly due to low commodity prices, technological innovation or currency appreciation.
- Negative expectations: low consumer or business confidence.

Effects of inflatio...
- Creates uncert... ...mers ...ay be unwilling to spend → AD fall...
- Loss of internatio... ...titiveness → exports fall
- Savings are now worth less.
- People on fixed incomes will see purchasing power decline.
- Menu costs – firms need to update all prices.
- Shoe leather costs – consumers will have to spend more time and energy trying to find cheaper options.

Effects of deflation:
- Deferred consumption – people do not spend as prices fall.
- The real value of debt begins to increase.
- Creates uncertainty for firms and policymakers.
- Creates recessionary pressures, leading to bankruptcies and unemployment.

Ca...

Immi... the s... host ... need...

3.4: Inequality and poverty

Inequality – the difference in income, wealth and power between different groups in society.

Inequity – the idea that society is structured in an unfair way which disadvantages certain groups.

Causes of inequality:
- Regressive tax system
- Weak trade unions
- Unfair pension scheme
- Lack of social security
- Level of education
- Employment/inheritance laws, etc.
- Globalisation and tech[illegible]ical c[illegible]
- Discrimination a[illegible] group[illegible]
- Market-orientat[illegible] [illegible]olicie[illegible]

Absolute poverty refers to a situation where a person is denied basic needs over a long period of time (e.g. food, shelter and clothing).
Measured by calculating the proportion of people living under some income threshold – around $2 a day.

Relative poverty occurs when a perso[illegible] can [illegible]et ba[illegible] but earns considerably less than t[illegible] [illegible]try [illegible]ge person.

In Britain any pers[illegible] [illegible] les[illegible] [illegible] of the median income is co[illegible] [illegible]or.

Wealth inequality refers to the extent of the difference in the value of assets that people in a country own.

Income inequality is the extent of the difference in the amount people in a country earn.

Wealth = stock concept = asset, e.g. house
Income = flow concept = liquid money

Causes of changes in poverty:
- High growth → decreases ab[illegible] creation of jobs
- High growth → increases ave[illegible] increase in relative poverty
- More FDI → more jobs → de[illegible]
- More trade → more jobs → [illegible]
- Increased income tax → redu[illegible]

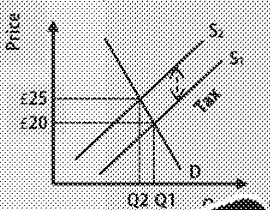
Policies:
- Transfer payments are dire[illegible] government which can allev[illegible]
- Government spending on p[illegible] help to reduce inequality a[illegible]
- Minimum wages reduce inc[illegible]
- Investment in education cre[illegible]
- Legislation banning discrim[illegible]
- Policies which reduce discri[illegible] inequality between socio-e[illegible]
- A universal basic income co[illegible] standard of living for all.

Direct Taxation
- Direct taxation is often applied to any regular income that is received, such as wages, profits or rents.
- The most common example of direct taxation is income tax, which is deducted from people's wages.
- Other examples include corporation tax, National Insurance contributions, and a wealth tax.

Indirect Taxation
- Indirect taxation is often applied to irregular forms of spending, and often consumption on demerit goods.
- The most common example of indirect taxation is value added tax (VAT), which is added on to most consumption.
- Other examples include duties on demerit goods such as alcohol and tobacco.

Alleviating inequality and poverty with taxation
Taxation has a critical role to play in reducing inequality and poverty. Primarily, taxation acts as a means of income and wealth redistribution in society. It redirects resources away from wherever they are being accumulated, and towards wherever they are most needed. The effectiveness of taxation at reducing inequality and poverty is highly dependent on the kind of taxation system that is being implemented. So[illegible]e taxation systems, such as marginal taxes, [illegible] better at reallocating resour[illegible] th[illegible] [illegible]uch as average taxes. The effe[illegible]vene[illegible] of t[illegible] [illegible] also depends o[illegible] [illegible] tax [illegible] [illegible]s spent.

Taxation
- **Progressive taxation** [illegible] earners more, reducin[illegible]
- **Regressive taxation** c[illegible] all, which can increase[illegible]
- **Proportional** and **indi**[illegible] increase inequality if [illegible]



Indirect taxation results in a leftward shift of the supply curve

Since 2022, the World B[illegible] global poverty line as a[illegible] $2.15 a day. Those earn[illegible] regarded as living in ab[illegible]

[illegible]	[illegible]ate
[illegible]10,[illegible]00[illegible]	0%
[illegible],001 – 25,000	20%
25,001 – 40,000	40%
40,001 +	50%

Marginal tax rates: [illegible]s allocate different rates of ta[illegible] [illegible]evels of income. This means a higher r[illegible] tax is paid on the income received over a certain threshold.

Average tax rates: average tax rates are simply the total amount of tax paid, divided by the total income earned.

Calculate the average tax rate on an income of £37,000

$$\frac{\text{total taxes paid}}{\text{total income}} \times 100$$

Difficulty measuring poverty
- It is hard to measure many asp[illegible] poverty, such as a lack of oppo[illegible]
- There is no universal agreeme[illegible] what poverty means.
- Indices which rely on averages [illegible] overlook the impoverishment [illegible]
- Getting accurate data on those [illegible] under poverty lines is difficult.
- Poverty can vary wildly in diffe[illegible] contexts and locations.

3.5 & 3.6: Demand-side policies

Goals of fiscal policy
- A primary aim is to reduce the extent of fluctuations in the business cycle
- Reducing unemployment
- Maintaining economic stability
- Reducing inequality
- Maintaining financial equilibrium with other economies
- Low and stable in[…]

Strengths of fiscal policy
- Can be used in a countercyclical way to maintain stability in the economy, tempering boom periods and alleviating recessionary periods.
- Particularly effective when it comes to an industrial strategy – can be […]t specific sectors of the economy to achieve specific results.
- Fiscal stimulus is often effective at boosting growth, e[…]t, l[…]tandards, etc.
- Fiscal measures are often effective at reduc[…]qua[…] ar[…]ng poverty.

Weaknesses of fiscal policy
- Subject to time l[…]sults […] a long time from initial investment – and effective[…]nde[…]d by political considerations.
- F[…]tt[…] […]re costly and can substantially add to government debt.
- […] economists argue that public investment leads to 'crowding out' of private investment, though others argue that the two are complementary.

Others goals [of monetary] policy
- To maint[…] the mone[…]
- To ensure[…] stability r[…] currencie[…]
- To monit[…] the finan[…] act as len[…]

Fiscal policy […] revenue through taxes or revenue from government assets, and engages in either current or capital expenditure. Where fiscal deficits arise, borrowing occurs.

Macroeconomic policies designed to influence aggregate demand

Fiscal policy

Fiscal policy may be **expansionary**: designed to stimulate aggregate demand through spending and low taxation, or **contractionary**, seeking to lower aggregate demand through spending reductions and low taxation.

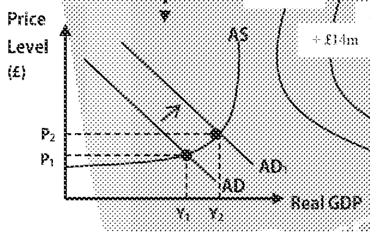
Fiscal policy refers to the use of taxes and government spending by the state to influence the economy.

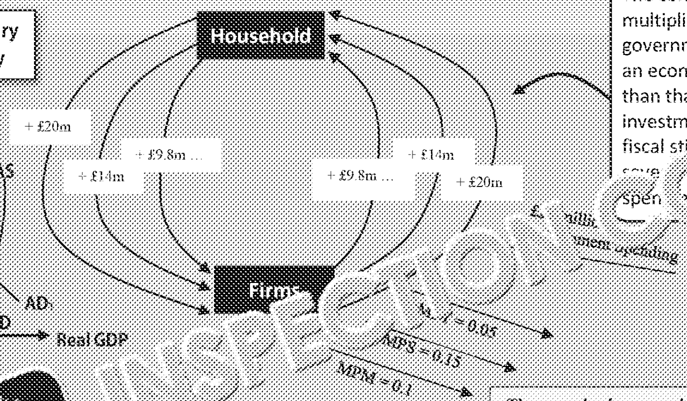
Mone[tary policy] use o[…] suppl[…] influe[…]

Keynesian multiplier **H**
The concept of the multiplier states that any government spending yields an economic return greater than that of the initial investment. This i[…] be[…]use fiscal stimul[…] […] save […] furt[…]r spen[…].

- **Real interest r[ate]** The rate of int[…] adjusted for in[…]
- **Nominal inter[est rate]** The interest ra[…] inflation is tak[…] account.

Effect of an expansionary fiscal/monetary policy





[T]he multiplier can be calculated using the formula **H**

$$\frac{1}{(1-MPC)}$$

H

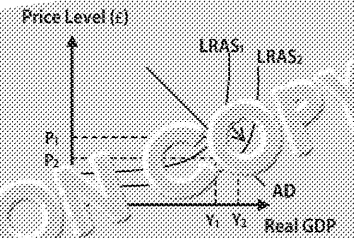
The marginal propensity to consume (MPC) – *the proportion of income that will be injected by consumer spending*

The marginal propensity to save (MPS) = *the proportion of income that will be leaked by saving*

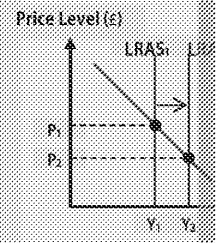
The marginal propensity to tax (MPT) = *the proportion of income that will be leaked due to taxes*

The marginal propensity to import (MPM) = *the proportion of income that will be leaked by buying imports*

Equil[ibrium]
- Ide[…] eco[…] int[…]
- Th[…] po[…] the[…]



Effect of supply-side policies on Keynesian diagram



Effect of supply-side policies on a Classical d...

Supply-side improvements refer to factors that increase the level of supply in the private sector, e.g. greater investment and productivity. Supply-side improvements may help to achieve supply side policies.

Supply-side policies are any policies that increase AS.

Supply-side policies

- On the demand side, government spending and tax reductions both increase aggregate demand.
- On the supply side, investment, R&D, incentives and improved human capital all result in increased efficiency and productivity which increases aggregate supply.

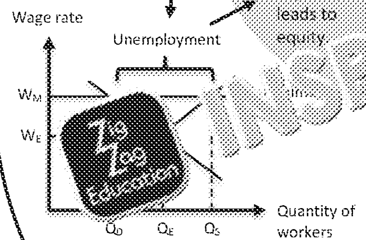
Goals of supply-side policies

- Increase the productive capacity of the economy
- Incentivise technological innovation
- Improve international competitiveness
- Increase the efficiency of the market
- Improve labour and capital productivity
- Generate more market competition
- Boost employment by reducing the cost of labour

Strengths	Weak...
• Can reduce inflation • Create more jobs • Lead to international competitiveness • ...e longer-term bas... for growth	• Longer ti... • Large op... cost • Slow and... data coll... lead to i... decisions

- May also cause inflation.
- Local/foreign firms may relocate abroad (job losses).

But arguably leads to equity.



Minimum wage is set above the equilibrium wage rate.

Minimum wage is imposed to avoid very low wages for workers.

- **Impr... ...frastructure** = investment in transport links, communication ..., and housing, etc. can help to increase AS, as it reduces costs of production.
- **Research and technology** = investment in R&D can make production more efficient, cheaper (in the long-run) and quicker.
- **Increase incentives** = raising minimum wages or providing perks can increase the supply of labour.
- **Increasing competition** = e.g. preventing monopolies will allow more firms to enter the market, increasing AS.
- **Reforming labour market** = e.g. abolishing the minimum wage or trade unions will allow firms to hire more workers.
- **Human capital** = providing vocational training and subsidising education can create more skilled workers.

4.1–4.4: International trade

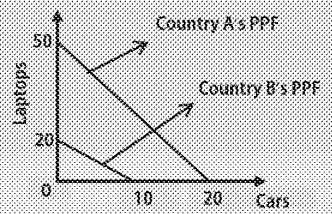
Impacts of international trade:

Positive	Negative
• Increase in consumer choice • Low prices for consumers • Improved living standards • Access to cheap factor inputs for businesses • Firms can make higher profits due to access to a bigger market • Encourages specialisation → increased efficiency • Reduction in unemployment	• Increased environmental degradation/pollution • Increased interdependence → recession in one country spreads quickly • Access to cheap labour abroad → local unemployment will rise

Advantages of trade and specialisation	Disadva
• Greater choice for consumers • Cheaper goods for consumers • Greater efficiency • Firms experience econom[illegible] • Wider market → [illegible] • Increas[illegible] + hi[illegible] andar[illegible] of living	• Countries becor • Terms of trade r goods and expor • Over-reliance or • Countries lacking • Unwanted good low prices, whic • May widen the r • Bad for '**infant i**

[illegible] about a country producing goods in which it has comparative advantage

	Cars production	Laptops production
Country A	20	50
Country B	10	20



Country A has **absolute advantage** in the productio of both goods (i.e. it can produce more of both good *cheaply* using the same resources than country B).

Country B has **comparative advantage** in the production of cars (i.e. it can produce cars at a lower opportunity cost than country A).

Country A needs to forego 2.5 units of laptops to produce 1 car (20:50). Country B needs to give up 2 units of laptops to produce 1 car (10:20).

- The **World Trade** [illegible] (**WTO**) [illegible] otes free trade by following a policy of **trade liberalisa**[illegible] a platform for trade negotiations and settlement of any [illegible] ween member countries.
- Conflict between WT[illegible] gional trade agreements → latter lead to trade diversion, which decreases trade elsewhere and undermines comparative advantage.

Trade blocs + WTO

Bilateral – Preferential trade between two countries
Regional – Preferential trade within a geographic area
Multilateral – An international trade organisation

Types of trade blocs:

1. **Free Trade Area (these can be bilateral or regional)**
   - Free movement of goods and services
   - Each member can set their own trade barriers for non-members
2. **Customs union**
   - Member countries have a joint trade policy for all non-members
3. **Common market**
   - Free movement of factor inputs
4. **Monetary union**
   - Single currency – as in the **Eurozone**
   - Conditions necessary for success include:

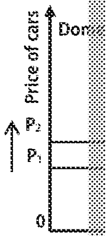
   H
   - Similar growth patterns and **business cycles** of member countries
   - Similar cultures to decrease barriers to free movement
   - Increase spending in adversely affected (by this mov[illegible]

Advantages and di[illegible] vanta[illegible] [illegible] blocs

Advantag[illegible]	Di[illegible] vantages
• No transaction cos[illegible] • Greater market acc[illegible] economies of scale [illegible] lower costs • Stronger bargaining power in multilateral organisations • Attract FDI → good for growth • International cooperation increases political stability	• [illegible] ransition costs, e.g. **menu costs** • Loss of sovereignty • Undermine multilateral arrangements (such as WTO) **H** • No control over monetary policy (in monetary unions)

- Tariff increase on the price of imports → lower demand
- Revenue for government (ABCD)
- Domestic consumer surplus increased by P_1P_2DE
- Welfare loss (ADE + BCF)

[illegible] protection



Monetary unions **H**

Advantages
Reduce exchange rate costs, eliminate currency risk, more efficiency, greater information, boosts investment and growth

Disadvantages
Loss of monetary independence can exacerbate economic crises, leading to higher inflation and/or unemployment

Reasons for restrictions on free trad

1. Protecting local industries:
   - Infant industries are new industries that ne time to mature out
   - Sunset industries are firms in decline but th may be useful
   - Countries need to be self-sufficient in indus such as defence and energy
2. Preventing 'dumping' from very cheap imports
3. Protecting jobs
4. Diversification of underdeveloped economy
5. Correcting current account deficit
6. Avoiding unfair competition
7. Retaliation against trade restrictions

4.5 & 4.6: Exchange rates and Balance of payments

Balance of payments (BOP)

- Current account (C/A)
  - Trade in goods/services → Exports minus imports
  - Primary income → Inflow of income minus outfl...
  - Secondary income → Loans/grar... rece... ...nts
- Capital account
  - Capital investment
  - Financial investment
  - Speculative capital f...
- Financial accou...
  - FD...
  - ...ve assets
  - Speculative capital flows

...of C/A deficit	Effects of C/A surplus
• Greater foreign ownership of domestic assets • Excessive borrowing can be unsustainable and lead to downgraded credit ratings • A large deficit may cause currency appreciation, pushing up inflation • This in turn may increase interest rates, making borrowing harder • Increases the national debt	• A surplus may indicate strong domestic consumption and investment • It may also indicate highly competitive exports • Both of these can be expected to drive economic growth and reduce unemployment • But they may also lead to higher inflation • A current account surplus may indicate an undervalued currency, aiding export competitiveness

Significance of trad... imbalances:

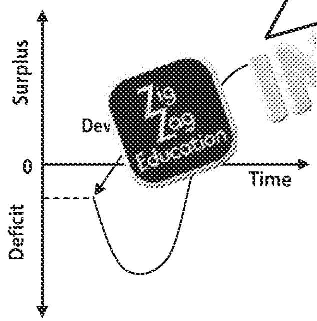
- The accounts on the balance of payments are interdependent – all credits are matched by debits and all deficits by surpluses. For example, a deficit on the current account will be zeroed by borrowing on the financial account.
- As a negative trade balance increases, it becomes more and more difficult to finance. Hence, loans have to be taken out. This is because a negative current account implies a positive capital account.
- Government spending may fall significantly to repay those loans.
- Also, if exports outstrip imports, domestic consumers may be faced with limited choice.
- Trade imbalances also lead to massive currency fluctuations → affects global trade.

Reducing current account imbalances: H

1. **Expenditure-reducing policies**
   Policies that reduce AD, e.g. increasing income tax → reduces disposable income → demand for imports decreases.
   + Also effective at tacking infla...
   – May harm growth an... ...nt
2. **Expenditu...re-s... ...ching ...li...**
   Poli... ...af... ...d... ...and for imports, i.e. trade ...e... ...imposing tariff → imports become ex... ...e → demand for imports falls.
   + Effective in short term to protect industries
   – Could lead to trade retaliation
3. **Supply-side policies**
   Policies that affect demand for exports, e.g. increasing spending on education → improves labour productivity → improves quality/quantity of exports → demand for exports rises.
   + Useful for solving long-term structural issues
   – Can come with significant time lags
4. **Doing nothing**
   Due to the downsides of the policies mentioned above, some countries may opt to do nothing

Current account (C/A) H

1. **The Marshall-Lerner condition** posits that depreciation only leads to a C/A improvement if ($PED_{exports} + PED_{imports} > 1$).
2. **The J curve** suggests changes in the ER have time lags. Initially C/A deteriorates because in the short run exports and imports have inelastic demands. Later, as demands become more elastic, we see an improvement.



Value de...
Value in...

Forces o... supply a... value of...

Factors i...

- **Relativ...** If relati... encour... higher ... increas...
- **Relativ...** If relati... more e... → £ de...
- **Specul...** If peop... they wi... higher ... depreci...
- **State o...** Econom... → dem...
- **Deman...** The exc... domes...
- **Remitt...** Direct ...
- **Foreig...** FDI can... develo...

Growth an... ER deprecia... creation → e...

Living sta... ER deprecia... expensive →...

Growth an... ER deprecia... creation → r...

4.7: Sustainable development

Sustainable Development

✓ **Sustainability** is the ability to maintain a system over a long period of time – specifically to maintain the natural environment for future generations.

✓ **Development** is the process of industrialisation and gro[illegible] standards that [illegible] [illegible]con[illegible]

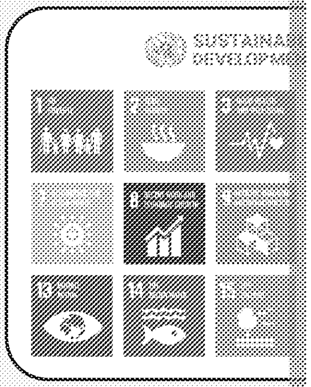
✓ [illegible] it is a wa[illegible] socio-economic [illegible]ent without damaging the environment for future generations.

✓ 17 goals set by [illegible] United Natio[illegible] General Assem[illegible] in 2015

Sustainability [illegible]overty

H

- Impoverished people are overwhelmingly involved in the primary sector of the global economy, meaning they are most affected by the depletion of natural resources and extreme weather.
- Unequal societies rely on economic growth to maintain living standards, which often leads to resource depletion.
- The more unequal a society is, the less the voices of those who depend on the natural world are heard as the economy grows.
- Thus, policymakers are concerned to treat sustainability and poverty as a single issue.

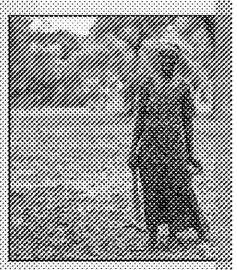


Microgrids: Solar in Yemen

- Goal 5: Gender Equality
- Goal 8: Decent Work and Growth
- Goal 7: Affordable Clean Energy
- Goal 11: Sustainable Communities

- Yemen is one of the world's most impoverished countries. The [illegible] country has been plunged into a humanitarian crisis due [illegible] running civil war.
- Yemen's energy supply – produced from [illegible] and g[illegible] – d[illegible] not meet demand, meaning many [illegible] wit[illegible] reliable source of energy to meet their da[illegible]
- The Enhan[illegible] en[illegible] in Yemen (ERRY) project grants mo[illegible] predom[illegible] women to help them start a business [illegible]
- Parti[illegible]ts are provided with a mini solar farm sufficient to generate enough energy for a small neighbourhood, and trained in maintenance
- They are then able to generate an income by selling energy to local households and businesses
- In the areas where microgrids have been installed, unemployment and poverty have fallen drastically. Living costs have fallen due to a cheap and sustainable local source of energy. Prejudice against women has also reduced after local communities have seen them operate as trained solar engineers.

Regenerative Farm[illegible]



- Goal 2: Zero Hung[illegible]
- Goal 5: Gender Eq[illegible]
- Goal 13: Climate A[illegible]
- Goal 15: Life On La[illegible]

4.8 & 4.9: Development

Measures of development

Happy Planet Index: Combines life expectancy, ecological footprint and a happiness survey.

Inequality-adjusted HDI (IHDI): Also measures the distribution of health, education and income around the population

Gender Inequality Index: Measures female participation in society.

Single indicators, such as:

- *Number of people with access to clean water*
- *[illegible] of people [illegible] ss to [illegible] hones*

Human development index (HDI) is a composite measure of development

$$HDI = \sqrt[3]{\text{education index} \times \text{life expectancy index} \times \text{income index}}$$

Education Index Average + expected years of schooling

Life expectancy index Life expectancy at birth

Income index GNI per person

Benefits of HDI	Draw[illegible]
• Multidimensional • Uses two measures for education	• Ignor[illegible] as it [illegible] • Missi[illegible] happ[illegible]

Geo[illegible]

Barriers to grow[th and] developme[nt]

Economic factors

Cycle of poverty:
- Poverty is often a self-reinforcing phenomenon – those living in poverty lack the opportunity to extract themselves from it.
- Limited education → lack of skills → low-value work → unable to save → children forced to work → limited education, etc.

Capital flight:
- This is about people saving their money in foreign banks, which are more secure and/or have a higher interest rate
- Thus, developing countries are deprived of savings → lack of investment in capital → low growth

Informal economy: Large informal sector means economic activity is taking place outside the legal system and tax structure, meaning the full welfare gain is not captured.

Primary product dependency:
- Primary products = commodities (generally low-valued)
- Hence, countries dependent on primary products tend to remain poor
- Demand is income inelastic, whic[h] [illegible] rising incomes [illegible] increase deman[d] [illegible] same extent
- Such countries export low-valued goods, while importing high-value goods, leading to falling terms of trade

Volatility of [illegible] prices: Inel[astic] [illegible] and su[pply] [illegible] overall economic instability (high inflation, unemployment, etc.)

Abs[ence of] [pro]per[ty rights]: [Pro]per[ty rights] [g]ive a sense [of] cert[ai]nty, which is good for investment/borrowing and growth. However, developing countries lack some property rights.

Access to credit:
- Essential for doing business
- Countries that lack such facilities (e.g. microfinance) limit growth, as people are unable to escape poverty

Education: Developing countries tend to [illegible] the appropriate educational infrastructure

Infrastructure: Poor infrastructure makes trad[e] very costly → discourages FDI

Debt: Developing countries tend to [illegible] debt. While their government[s] [illegible] build infrastructure and creat[e] [illegible] current generation, it is often [illegible] generation that has to pay ba[ck] [illegible] and becomes visibly worse of[f]

4.10: Strategies influencing growth and development

Privatisation:
- This is about selling state-owned firms to the private sector because the latter is more efficient.
- Efficiency translates into lower prices for consumers and higher profits for firms. This leads to increased consumer spending and investment, which results in higher growth.

Microfinance schemes:
- This is about providing small loans to poor people, who are unlikely to get loans from big banks th[illegible] re th[illegible] provision of collat[illegible]
- Loans are given to [illegible] repayment is guara[illegible]
- This helps poor peop[illegible] poverty.

Market mechanism of demand and supply affect growth and development

Market-orientated strategies

Floating exchange rate:
Switching to a floating regime will demand that demand and supply will decide the value of the currency, which means the currency is likely to depreciate. Thus, imports become expensive while exports become cheap. Thus, local industries will flourish, leading to higher growth.

Removal of regulation:
- Regulations lead to inefficiency
- Removing regulations increases competitiveness → increases productive / allocative efficiency
- Competitiveness means lower prices → more consumption
- However, regulation is intended to prevent negativ[illegible] ies

Trade liberalisation:
- This is about reducing [illegible] barriers
- Free trade promotes growth by creating jobs
- Free trade leads to greater allocative efficiency
- But this could reduce growth if a country is flooded with cheap imports

Foreign direct investment (FDI):
- Creates jobs → more consumer spending → higher AD → [illegible]
- Countries can ben[illegible] expertis[illegible] ations
- F[illegible] av[illegible] on local [illegible] ure

Social enterprise:
- A business that uses the market in order to achieve social or environmental goals, as well as profit.
- Encouraging social enterprises can maximise the social welfare of economic activity.

Aid:
- Devel[illegible] humanitarian or [illegible] ment[illegible] order to invest in the [illegible] process.
- [illegible] oped nations may also choose to write off debts that developing countries owe in order to enable them to better manage their resources.

Corruption:
- Political and judicial refo[illegible] designed to [illegible] ut structures an[illegible] dividuals who are enabling the corrupt capture of public resources.

Other strategies

Wom[illegible]
- E[illegible] th[illegible] br[illegible] a[illegible]

Land ri[illegible]
- The [illegible] deve[illegible] the l[illegible] citize[illegible] prec[illegible] sust[illegible]

Market-orientated	Interven[illegible]
• Free global trade drives down costs by eliminating extra fees and time associated with bureaucracy, and improves living standards by widening consumer choice and encouraging foreign direct investment. • Market-based approaches maximise efficiency by forcing less efficient firms to modernise and innovate. • Comparative advantage ensures that economies focus on economic sectors in which they are best placed to maximise efficiency. • Market-based approaches avert the risk of government failure, which is common as governments have more limited information than markets on which to base economic decisions.	• Interventionist approache[illegible] domestic production from [illegible] monopolising global force[illegible] unemployment and aiding [illegible] • An interventionist approac[illegible] term sustainable growth, [illegible] • Diversification as an indus[illegible] advisable to reduce risks a[illegible] impact an economy focuse[illegible] • Interventionist approache[illegible] reduce the risk of various [illegible] as monopolisation, the pr[illegible] and economic and social i[illegible]

Trade strategies

Import Substitution:
A government introduces trade barriers in order [illegible] protect d[illegible] industrie[illegible] from [illegible] etiti[illegible] [illegible] ch is geared towards domestic production for domestic consumption.

Ex[illegible] t Promotion:
A go[illegible] rnment may take advantage of cheap labour and/or an undervalued currency to produce cheap consumer goods for export around the world. The export market maintains employment and the export revenue is used to fund economic development.

Multilateral development

International Monetary Fund (IMF): Gives short-term grants/loans to countries, mainly to maintain stability, improve trade deficit, etc.

World Bank: Gives long-term grants/loans (humanitarian aid to developmental loans) to countries

Official Development Assistance (ODA): Targeted funding provided by the UK or other governments to aid development.

NGOs: [illegible] profit o[illegible] range i[illegible] at any l[illegible] concern[illegible] based [illegible]

1.1: What is economics?

These nine concepts will be a recurring theme in your study of economics. You will need to understand their relevance and evaluate their importance to strong economic performance.

- Scarcity
- Choice
- Efficiency
- Equity
- Well-being
- Sustainability
- Change
- Interdependence
- Intervention

✓ Economics is a social science because it is a study of society and human behaviour.

Economics as a social science

Define macroeconomics and microeconomics ?

Microeconomics →

Macroeconomics →

Economic resources – all things that help us produce goods and services.

What are the four factors of production? ?

_______ refers to all those natural raw materials that are found on land or under sea.

_______ refers to the risk-taking attitude that is required for a person to be able to run a business.

_______ – Human workers.

_______ – Technology or machinery to facilitate in converting raw materials into finished products.

Main economi

- scarcity because reso while our **wants** are

PPCs and th problem of ch

Renewable resources rep quickly, e.g. sunlight.

Non-renewable resources not replenish quickly, e.g.

✓ PPC shows th combination types of good resources are

Fill in the blanks ?
- Consumer goods
- Capital goods

- _______ are directly bought
- _______ are used to make
- So more _______ help produce

Scarcity requires us to resources are scarce, th how they can be made to the benefit of future gen

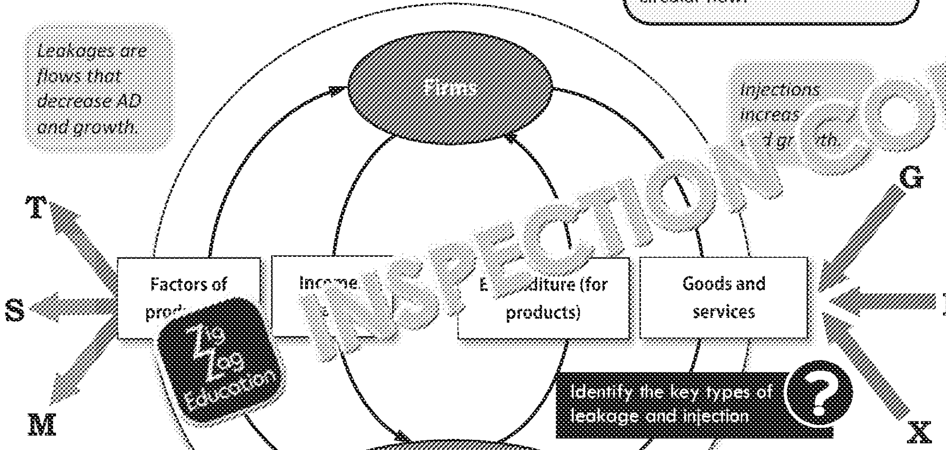
Circular flow of income

The **circular flow** model visualises the way that income flows in, out and around the economy.

All economic actors are interconnected and play a role in injecting income into and leaking income from the circular flow.

Leakages are flows that decrease AD and growth.

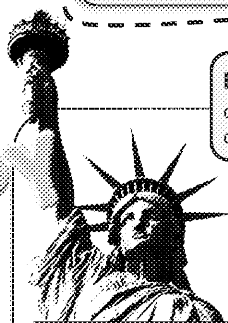
Injections increase AD and growth.



Identify the key types of leakage and injection ?

Leakages
T = _______
S = _______
M = _______

Injections
G = _______
I = _______
X = _______



Economi creating p consumer

Advanta
- Effic
- Com

✓ Free market economy

Disadvantages:
- Market failure
- No public goods
- Bad for the environment
- High inequality

1.2: How do economists approach the world?

✓ Economics is a social science because it is a study of society and human behaviour

In order to find a causal link between two variables, certain **assumptions** need to be made. These assumptions form the basis of predictions.

Process of creating economic models:
- Observation
- Forming hypothesis
- Forming predictions
- Testing predictions against evidence
- If evidence supports predictions, hypothesis becomes theory.

Main 'assumption' in economics is:
ceteris paribus
= everything else remains constant.

Unlike scientists, economists are usually unable to test hypotheses in a lab using controlled experiments. They mostly have to rely on evidence that is already available.

Economists need to use data to create graphs to create models.

Methodology

Positive statements →

Normative statements → value judgments or subjective opinions, and cannot be proven true or false.

These value judgments may be used to influence certain economic decisions. For example, *in the case of a market failure, should the government intervene?*

- **Equality** = A positive goal in which people are verifiably treated the same.
- **Equity** = A normative goal of commitment to social justice and fairness.

Define 'positive statements' ?

Identify two advantages of specialisation, and two disadvantages of the division of labour ?

Adam

✓ Spe...

Advan...
1.
2.

Disadv...
1. Cou... relia...
2. Can... and...
3. This... une...

A short history of economics

The ideas of Adam Smith form the basis of classical economics, which is associated with free trade, limited government intervention and laissez-faire (meaning 'leave-alone') markets. This view believes that whatever is good for supply is also good for prosperity and thus well-being.

Classical economics led to widening inequality in society. In this context Marxism emerged, arguing that free market economies were not in the interests of working people.

The threat of Marxist revolution encouraged governments to take a more interventionist stance to ensure economy worked for sufficient ... among the population.

Keynes argued for careful macroeconomic management of the economy, in order to encourage consumption and investment, and boost injections into the circular flow.

However, this model of economic management fell out of favour following multiple economic crises, leading to a resurgence of market-... macroeconomics that remains tod...

A ... re... 19... wi... gl...

Jean-Baptiste Say

According to Say's law, increases in production lead to rising demand. In this view, it is the supply side that drives growth.

Describe two ideas associated with Karl Marx ?

Karl Marx

1.

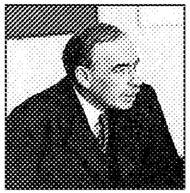
2.

Describe two ideas associated with John Maynard Keynes ?

John Maynard Keynes

1.

2.

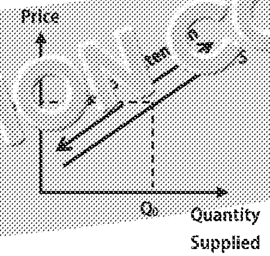


2.1-2.3: Supply, demand and market equilibrium

Supply

Define supply

Movement along supply curve:
Changes in price lead to movements along supply c... exam... ral...



Provide any three factors that will cause the supply curve to shift

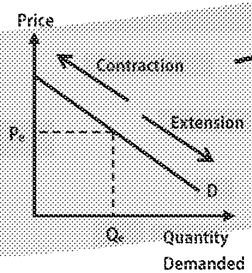
Shift in the supply curve res...
1.
3.

Remember this does not inclu... price variable.

Demand

Define demand

Movement along demand curve:
Changes in price lead to movements along a demand curve. For example, if price rises, demand contracts.



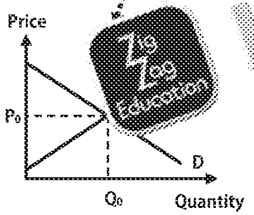
Shift in the demand curve result from...

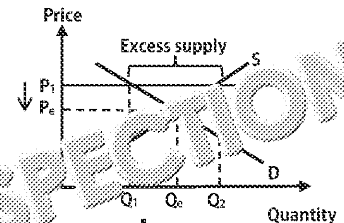
- Population size
- Advertising
- Tastes and preferences
- Income changes
- Others: price of complement/substitut...

Remember this does not include changes ... price variable.

Market equilibrium

The point where demand and supply meet gives us the equilibrium price and quantity.

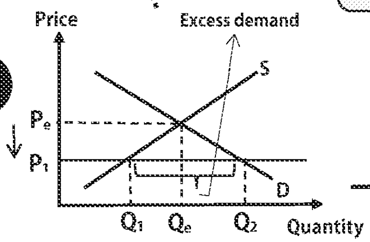




Fill in the blanks

To eliminate **excess supply**, producers ________________. Thus, demand ________ and supply contracts until ____________ is reached.

To eliminate excess de..., consumers off... pr...es. This allo... ...cer... ...crea... su...ly. Th... ...ly expands and de... ...ontracts until equilibrium is reached.



Community ... the sum of ... and produce...

Allocative effic... reached when ... community su... maximised and ...

Mar... amo... to pa... a goo... the c... addi... equil...

2.5 & 2.6: Elasticities

Price elasticity of demand

PED= % change in quantity demanded of good A

Fill in the missing elements of the formulae ?

- PED > 1 means demand is relatively ________.
- PED < 1 means demand is relatively ________.
- PED = 1 means demand has unit ________.
- PED = 0 means demand is perfectly ________.
- PED = infinity means demand is ________.

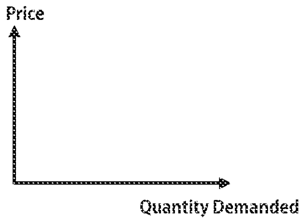
Fill in the blanks ?

Example:
Price of car increases, its demand decreases

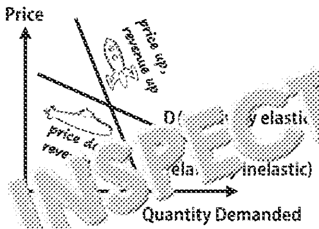
Factors that influence PED:
- Time period
- Proportion of income spent
- Availability of substitutes
- Type of good

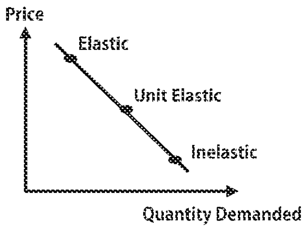
Remember: PED is always negative.
- This means that price and demand always move in the opposite direction.
- For ease we will refer to the absolute values, i.e. '-1' becomes '1' as we ignore the minus.

Draw and label the following demand curves on the diagram:
a) Perfectly elastic
b) Perfectly inelastic
c) Unit elastic ?



PED and total revenue:
- **Total revenue = Price × Quantity**
- Elastic demand → fall in price increases consumer spending by a larger proportion, thereby increasing total revenue.
- Inelastic demand → increase in price increases consumer spending by a smaller proportion, thereby increasing total revenue.
- Total revenue is maximised when demand is unit elastic.





Income elasticity of demand

Define each

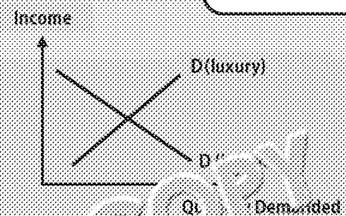
YED = % change in quantity demanded

Fill in the blanks ?

- YED > 0 means demand is ________________ (i.e. change in income brings about a change in demand in the same direction). **(Normal good)**
- 0 < YED < 1 means demand is relatively ____________. **(Necessity)**
- YED > 1 means demand is relatively ______. **(Luxury good)**
- YED = 1 means demand has unit ____________.
- YED < 0 means demand is ________. **(Inferior good)**

Example:
Income increases,
- demand for car increases (luxury)
- demand for public transport decreases (inferior)

Significance of YED: H
- Allows firms to decide what prices to keep
- Helps firms in predicting future sales
- Helps firms to strategise, e.g. diversification



Work out the following question on YED. Please show your workings

... income decreases from £3,000 to £2,000 a month and the ... Sainsbury's' own brand bread increases from 500 loaves to 1,70...

a) Calculate the YED.

b) What type of good is this? ____________

c) Is the good relatively elastic or inelastic? ____________

2.7: Role of government in microeconomics

Why do governments intervene?

Correct market failure and remove price distortions.

Earn revenue in order to provide public funds for a range of services.

Government intervention can sometimes lead to a misallocation of resources.

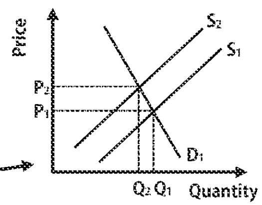
Maintain consumption at economically beneficial levels.

... firms which may require additional help to survive.

Influence ... levels in order to encourage ... market outcomes.

Limit poverty and inequality to levels which don't undermine social cohesion.

Identify the tax on the diagram below ?



Fill in the blanks ?

________________ is a way in which governments can try to reduce consumption of demerit goods.

Because market failure can occur, governments will often need to intervene in the economy in order to make corrections or reduce externalities.

Government intervention

________________ refers to public services funded by general taxation which are not run for ...

Types of government intervention:

- Taxation
- Expenditure
- Regulation

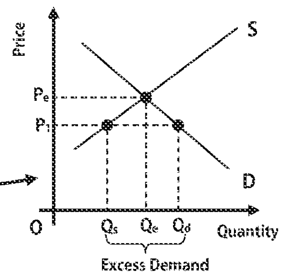
Because government interventions are often motivated by a range of different interests, this can impact on the effectiveness of the intervention, and influence the way in which resources are allocated.

________________ can be used to give certain firms a competitive advantage, or used to boost capital investment in key strategic industries.

Customer nudge ... way government ... influence behaviour, by presenting information about choices in certain ways.

________________ is a means by which government can control the activities of firms if their actions are contributing to market failure.

________________ may be introduced by government to ensure certain goods or services are accessible to everyone.



The ma... toward... distrib... without... from g...

Define the ... challenges

International Cooperation

Monitoring

Enforcement

2.8 & 2.9: Market failure, externalities and public goods

Market failure

- ✓ **Complete market failure** refers to a situation where the price mechanism is unable to provide a good.
- ✓ **Partial market failure** refers to the misallocation of resources in a market.

Some abbreviations:
- Marginal private benefit (MPB)
- Marginal private cost (MPC)
- Marginal social benefit (MSB)
- Marginal social cost (MSC)

Main types of market failure:
- Externalities
- Public goods
- Information gaps

Government responses to public goods
- **Direct provision:** The government may choose to control public goods themselves, in order to ensure equitable distribution to the public.
- **Contracted out to private sector:** Alternatively, the government might outsource the running of public goods, under certain conditions that make competition more achievable.

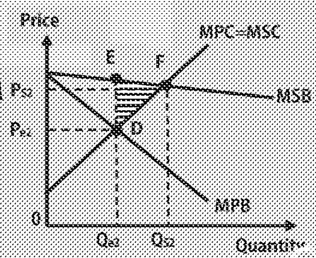
Property rights:
Property rights allows people to have ownership of something, e.g. a piece of land. As a result the resource is used efficiently. Conversely absence of property rights would lead to the misuse and overuse of a resource since no one owns it.

Explain terms associated with market failure ?

Costs:
- **Private cost =**
- **External cost =**
- **Social costs =**

Label welfare loss and welfare gain on the diagrams below ?

- ✓ Externalities refer to the good or bad consequences that occur following the consumption/ production of goods and services.

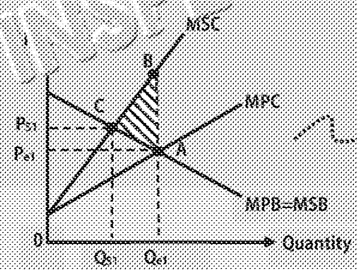


- Zero external costs
- External benefits = DE units.
- Market equilibrium (MPC=MPB) at point D.
- Social optimum position (MSC=MSB) at point F.
- Social optimum position is different to market equilibrium.
- Hence, for marginal output (Q_{e2} and Q_{s2}), MSB is greater than MSC.
- Good is under-priced and under produced in a free market.
- Welfare gain = area DEF

To what extent is the construction of a third runway at Heathrow likely to lead to market failure?

Benefits:
- **Private benefit** = personal utility to the producer (consumer) of making (buying) a product, e.g. satisfaction from consuming education.
- **External benefit** = benefit to a third party from producing/consuming a product, e.g. benefits of education to society.
- **Social benefits** = External benefits + Private benefits

Externalities



- MPC = supply curve
- MPB = demand curve
- Zero external benefits
- External cost = AB units.
- Market equilibrium (MPC=MPB) at point A.
- Social optimum position (MSC=MSB) at point C.
- Social optimum position is different to market equilibrium.
- Hence, for marginal output (Q_{e1} and Q_{s1}), MSC is greater than MSB.
- Good is under-priced and over-produced in a free market.
- Welfare loss = area ABC

Merit/demerit

Demerit goods ... the individual ... but are often ... often due to ... information ...

Whether a good is considered to be a merit or a demerit good is a matter of value judgement.

Merit ... useful ... individual ... society ... under... often ... information ... their ...

2.4: Consumer behaviour and 2.10: Asymmetric information (HL)

✓ Some economists seek to understand consumer behaviour in order to determine what makes consumers more or less likely to engage in economic activity.

Consumer behaviour

Business objectives

Profit maximisation
Conventional economics tends to assume that firms always prioritise profit maximisation, but other business objectives persist.

Utility maximisation
The view that consumers always seek the highest amount of utility possible from each purchase.

✓ Conventional economics ... that rational ... seek to maximi...

Utili...

The importance of the margin
- The margin is the ... it or ... from the consum... extra ...
- Conventional ec... that consumers rationally assess t... ore making economic decisions.
- Marginal benefit is also known as marginal utility. Consumers are assumed to assess the marginal utility of a good or service, relative to its price, before consuming.

...er objectives
- Some firms are focused on growing **market share** relative to competitors in order to become more dominant.
- Some firms seek to **satisfice**, meaning to maintain cost and revenue at a sufficient level just to continue trading.
- Some firms pursue **corporate social responsibility** – these are social or environmental non-economic goals.

Define total utility and marginal utility ?
- **Total utility:**
- **Marginal utility:**

Diminishing marg...
The theory that less ... from the consumptio... additional unit of a g...

Orthodox economics tell us that:
Individuals are rational economic actors

2.10

✓ **Conventional economics assumes that economic actors have perfect information – but this is often not the case.**

Nudges
A method of changing a consumer's behaviour by suggesting or encouraging the selection of a desired option.

Altruism
- Behaving with kindness or fairness.
- Humans are averse to unequal outcomes...
- Altruistic behaviour is not always behavio... i... from an individual point of view...

✓ ...ural economics is an alternative ... approach which incorporates ...ology to understand how economic actors ...

Asymmetric information

Asymmetric information
- When one economic actor has more information than the other.
- A producer will usually have a better idea of the true value of a good than a consumer.
- Asymmetric inform... thus lead to undesirab... outcomes, such as ... inefficient distribut... or other forms of marke...are.

Fill in the gaps ?
...ic... a transaction may seek to overcome asymmetric information through ______________, whereby a seller provides information to a buyer, and ______________, whereby a buyer extracts information from a seller.

Define default, restricted and mandated choice ?
- **Default choice:**
- **Restricted choice:**
- **Mandated choice:**

Key point: Consumers cannot make rational economic decisions if they do not have accurate or sufficient information available to them.

Governments may try to minimise asymmetric information through publicity, such as information campaigns, or regulation, such as advertising standards.

2.11: Market failure – market power (HL)

Remember: Firms seek profit maximisation
Profit is maximised when marginal revenue equals marginal cost

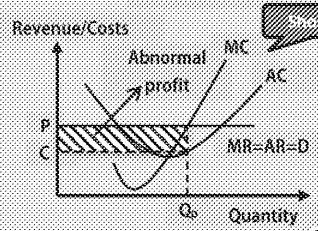
Perfect competition

Characteristics:
1.
2.
3.
4.

Horizontal AR

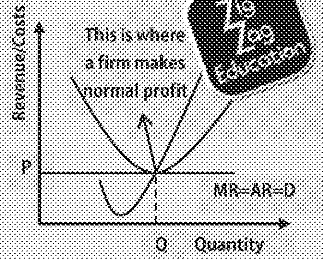
...et,
...tural market

Short run



Explain why firms in a perfectly competitive market can make abnormal profit in the short run but not the long run

Lon...



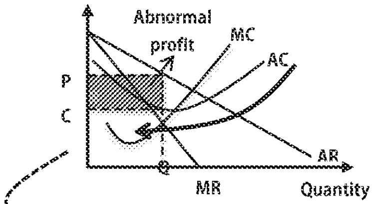
Monopolistic competition

Characteristics:
1.
2.
3.
4.

...ward-sloping AR and MR

Example: Newsagents

Short run



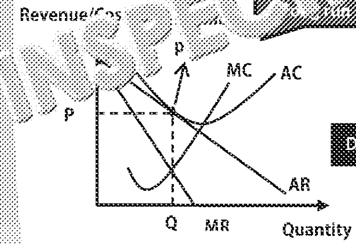
Firms can make abnormal profit/loss in the **short run** *but* not in the long run

Because of low barriers to entry/exit

As new firms enter, a firm's individual demand curve (AR) shifts to the left and eliminates any abnor... ...t.

Firms make normal profit in the **long run**

...g run



Not allocatively or productively efficient

Oligopoly

Downward-sloping AR and MR

Example: supermar...

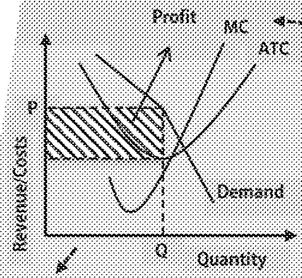
Characteristics:
1.
2.
3.
4.

Concentratio... ratio... ...ma... ...are th... ...ge... ...ns hold.

Calculating the 4-firm concentration ratio for the UK supermarket industry is simply done by adding the top four firms' market shares (28% + 16% + 16% + 10%). This gives us a concentration ratio of 70%.

Oligopolistic fi... **interdepende...** follow each ot... don't lose out... firm cuts its pr... have to follow... otherwise con... stop coming t...

Kinked demand c...



According to the kink... curve, firms operating... oligopoly face an ela... at high prices and an... market at low prices... assumes that other fi... not copy a price incre... an oligopolistic mark...

Can lead to price wars

Types of price competition:
- **Price wars**: firms keep lowering prices below th... competitor's
- **Predator...** ...tiall... f... ...ke... ...ver... ...rices to s... ...ne... ...nts
- **Limi... pricing**: prices are so low that firms experience a short-run loss

Types of non-price comp...
- Offers (e.g. B-O-G-O-F...
- Branding and marketi...
- Customer service
- Product improvement...

Thus, firms mostly choose to collude.

Collusive oligopoly:

Non-collusive oligop...

Define collusive and non-collusive oligopoly

Because collusion is a well-known oligopolistic feature, the term 'oligopoly' is sometimes used to refer simply to price-setting behaviour, rather than a market structure.

Not allocatively or productively efficient

Advantages
- Enables innovatio...
- Competitive
- Price stability

Disadvantages
- Enables collusion
- Reduced choice
- High barriers to e...

3.1: Measuring economic activity

National income

✓ National income is the total income generated in the domestic economy

✓ Nominal income is the ... output in an ...

Real income ... income ... inflation

... real income helps show economic growth of a country

Label the leakages and injections ?

G =
I =
X =
T =
S =
M =

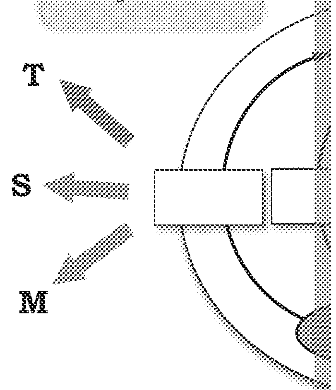
Injections = G + I + X
Withdrawals = T + S + M

National income = national output = national expenditure

Circular flow of income

...onomies experience periodic fl... ...d contraction, often called boo...
- Macroeconomic management tra... maintain economic growth at a s... minimise these fluctuations and c... predictable economic environme...

Withdrawals decrease AD and growth



Define GDP and GNI ?

GDP

GNI

Measures of national income:
- GDP
- GNI

✓ Economic growth is simply the increase in the number of goods and services ... in an econ...

Evidence suggests a positive relationship between income and happiness initially – however, after a certain point there is no clear link.

...ord... b...r understand ...andards and happiness, some measures focus on **well-being** rather than pure economic growth.

...easures of well-being include:
- **OECD Better Life**: Combines 11 different living standard metrics, determining each country's ranking in various aspects of social-economic development, as well as producing an overall score.
- **Happiness Index**: An index based on self-reported happiness, in which respondents rate their own happiness on a scale of 1 to 10.
- **Happy Planet Index**: Combines measurements of life expectancy, ecological footprint and self-reported happiness to produce comparisons.

I...order to compare growth rates ...tween countries and over time i... better to use data that can be comparable, e.g. GDP per capita, rate of change of **real** GDP.

Year	Real GDP (£tr)
2000	1.5
2015	2.7

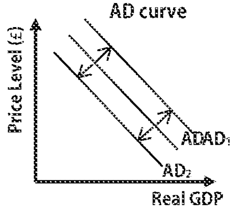
The above table show... for the years 2000 an...
- what the growth r... two years
- what the GDP per ...

3.2: Variations in economic activity

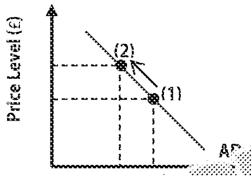
Aggregate demand

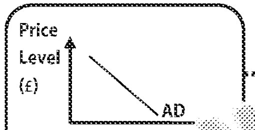
✓ AD refers to the total demand for all the goods and services produced in an economy.

Movement along the AD curve



Shift in the AD curve





AD curve is downward sloping because of:

- **Real balance effect** – as prices rise, fewer people are able to buy goods and services.
- **International competitiveness** – if domestic prices are high, exports appear more expensive, while imports appear less expensive. So net exports fall, reducing AD.
- **Interest rates** – at higher price levels, interest rates tend to increase. Higher rates reduce investment and consumption (because firms and households are more likely to save than spend), thereby reducing AD.

Complete the statement ?

If interest rates are high, consumers tend to…

Consumer confidence also determines the level of consumption. If the economy is doing well and confidence levels are high about the future, consumers are likely to increase consumption – and vice versa.

AD = C + I + G + (X – M)

?

- C for ___________
- **Total household spending**
- **Largest component of AD in the UK (about 60%)**

C

- **Disposable income** is income that is left after all taxes have been deducted.
- This determines the level of consumption.

Wealth effects also matter. If the price of a person's asset (e.g. house) goes up, the person is more likely to increase spending. This is related to the consumer confidence idea.

- Marginal propensity to consume establishes how much extra is consumed following a rise in the disposable income.
- This tends to be higher for low-income families.

If households decide to **save** more, their consumption will fall.

In 2021, total consumer spending in the UK was £1,892 billion.

In 2022, 44.7% of UK's GDP was used in the form of government spending.

In 2022, UK was a net importer, with a trade gap of £62 billion.

- Government spending is a part of **fiscal policy**.
- Fiscal policy is about making changes to government spending and/or taxation.
- A government can adopt either a contractionary or an expansionary fiscal policy.
- Contractionary policy is about increased taxation and lower spending.
- Expansionary policy is about lowering taxation and increasing spending.

Fill in the blank ?

- G for ___________
- **Spending on welfare, health, education, etc.**
- **Forms about 25% of AD in the UK**

G

- Government spending depends on the **trade cycle**.
- When the economy is doing poorly, unemployment rises. So the government has to spend more on welfare, while the tax revenue it receives also falls.
- The opposite happens during an economic boom.

Fill in the blank ?

I

- I for ___________
- **Spending by firms on technology, infrastructure, etc.**
- **Forms about 15% of AD in the UK**

- **Gross investment** refers to the total investment made in a period of time.
- **Net investment** = gross investment – depreciation of assets

Influences on investment:

- As the economy grows, more jobs are created and incomes rise. So to meet the increased demand, firms increase investment.
- Business confidence – if firms feel the prospect of investing is good given economic conditions.
- High demand for exports requires more investment to meet the demand.
- If interest rates are high, investment will be low because the cost of borrowing would be high.
- If credit is easily accessible, investment will be high.
- Tight government regulation is likely to limit investment, e.g. high taxes.

X – M

Exports minus imports

Forms about 2% of AD in the UK

Real incomes:

As real incomes rise, demand for imports rises. This decreases net trade (X – M). In other words it increases a country's current account deficit.

Non-price factors:

The exchange rate does not affect the quality of traded goods, and changes to exports/imports as a result of exchange rates changes could be mitigated if domestic goods are particularly high-quality or unique.

State of the world economy:

Recession is likely to affect a country's ability to trade. In a recession, inflation lowers, so exports may increase. However, if there is a global recession, other countries demand more imports. Thus, total volumes of exports and … applies for a national/global boom.

Exchange rates:

If the value of the pound increases (appreciation), … expensive. Thus, exports fall and imports rise, … trade, ceteris paribus. The opposite applies to de…

Degree of protectionism:

A country can try to protect its exports by subsid… and/or taxing imports (tariffs). This is likely to inc… appear cheaper than imports. However, if one co… barriers, others are likely to follow suit. This will r…

3.3: Macroeconomic objectives

Effects of growth:
- Economic growth can improve living standards by creating jobs, raising incomes and improving consumer choice.
- Growth increases tax revenues for the government, enabling more spending.
- Growth can also help government to service existing debts more quickly.
- However, growth is not distributed evenly and can create income inequality.
- Growth can create environmental damage and be unsustainable in the long run.
- Growth creates inflationary pressu…

Complete the sentences ?

- **Short-run growth** occurs when…
- **Long-run growth** occurs when…

Causes of growth:

Demand-side factors:
- Increases in the components of AD will increase growth (C, I, G, X – M)

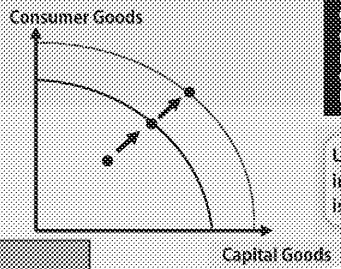
Supply-side factors:
- Technological advancement
- Education and s…
- Dem… … and migration
- … …gulation

Measur… …g th… …DP.

Economic growth

Define th… ?

- **Actual econom…**
- **Potential economic growth**



Label actual growth and potential growth on the PPF diagram ?

UK's average growth rate between 2010 and 2020 was 1.2%.

UK's national debt was 101% of its GDP in 2022.

UK's target inflation rate is 2%.

In 2022 the UK's unemployment rate was 3.6%.

Classical econ… argue that the… trade-off betw… and inflation, … **Phillips curve**…

Inflation

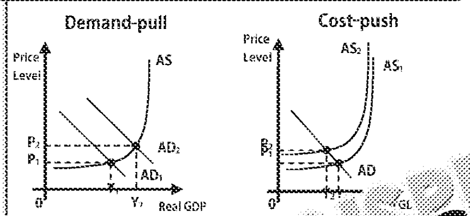
- **Inflation** – increase in prices
- **Deflation** – fall in prices
- **Disinflation** – falling rate of increase

Inflation is measured using the **Consumer Price Index (CPI)**
CPI uses prices of a 'basket' of everyday goods that are compared over time.

Causes of inflation:

Label each type of inflation ?

- ____________ – demand pulls prices with it (i.e. a rise in demand pulls prices up).
- _________ – high costs of production push prices up.
- **Growth in money supply** – increases demand for goods.



Limitations of CPI:
- Prices could change due to changes in quality.
- Temporary shocks can exaggerate inflation …
- A typical 'basket' of goods could be … differ… for different groups of consumers (e.g. st…ents, …nsi…er…).
- Price rise for certa… …ds m… in… …e a rise in demand for its subst…, … …t entirely captured by CPI.

Causes … …flation:
- …ing aggregate demand, often associated with recessions.
- Falling costs of production, possibly due to low commodity prices, technological innovation or currency appreciation.
- Negative expectations: low consumer or business confidence.

Effects of inflatio… ?

1.

2.

3.

Effects of deflation:
- Deferred consumption – people do not spend as prices fall.
- The real value of debt begins to increase.
- Creates uncertainty for firms and policymakers.
- Creates recessionary pressures, leading to bankruptcies and unemployment.

Ca…

Immi… the s… host … need…

3.4: Inequality and poverty

Inequality – the difference in income, wealth and power between different groups in society.

Inequity – the idea that society is structured in an unfair way which disadvantages certain groups.

Define absolute poverty

Define relati

What is the difference between wealth inequality and income inequality?

Causes of inequality:

List four causes of inequality

1.

2.

3.

4.

Causes of changes in poverty:

- High growth → decreases ab creation of jobs
- High growth → increases ave increase in relative poverty
- More FDI → more jobs → de
- More trade → more jobs →
- Increased income tax → redu

Policies:

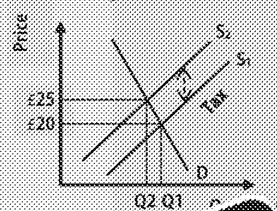
- Transfer payments are dire government which can alle
- Government spending on p help to reduce inequality a
- Minimum wages reduce in
- Investment in education cr
- Legislation banning discrim
- Policies which reduce discr inequality between socio-e
- A universal basic income co standard of living for all.

Direct Taxation

- Direct taxation is often applied to any regular income that is received, such as wages, profits or rents.
- The most common example of direct taxation is income tax, which is deducted from people's wages.
- Other examples include corporation tax, National Insurance contributions, and a wealth tax.

Indirect Taxation

- Indirect taxation is often applied to irregular forms of spending, and often consumption on demerit goods.
- The most common example of indirect taxation is value added tax (VAT), which is added on to most consumption.
- Other examples include duties on demerit goods such as alcohol and tobacco.



Indirect taxation results in a leftward shift of the supply curve

Alleviating inequality and poverty with taxation
Taxation has a critical role to play in reducing inequality and poverty. Primarily, taxation acts as a means of income and wealth redistribution in society. It redirects resources away from wherever they are being accumulated, and towards wherever they are most needed. The effectiveness of taxation at reducing inequality and poverty is highly dependent on the kind of taxation system that is being implemented. Some taxation systems, such as marginal taxes, better at reallocating resources th such as average taxes. The effe of t also depends o tax spent.

Taxation

- **Progressive taxation** earners more, reducin
- **Regressive taxation** c all, which can increase
- **Proportional** and **indi** increase inequality if

Since 2022, the World B global poverty line as a $2.15 a day. Those earn regarded as living in ab

Marginal tax rates: allocate different rates of tax levels of income. This means a higher tax is paid on the income received over a certain threshold.

Average tax rates: average tax rates are simply the total amount of tax paid, divided by the total income earned.

[illegible]	[illegible]
[illegible]	0%
[illegible],001 – 25,000	20%
25,001 – 40,000	40%
40,001 +	50%

Calculate the average tax rate on an income of £37,000

$$\frac{\text{total taxes paid}}{\text{total income}} \times 100$$

Difficulty measuring poverty

- It is hard to measure many asp poverty, such as a lack of opp
- There is no universal agreeme what poverty means.
- Indices which rely on average overlook the impoverishment
- Getting accurate data on those under poverty lines is difficult.
- Poverty can vary wildly in diffe contexts and locations.

3.5 & 3.6: Demand-side policies

Identify three strengths of fiscal policy ?

Strengths of fiscal policy
1.

2.

3.

Weaknesses of fiscal policy
- Subject to time lag – … a long time from initial investment – and effective… … by political considerations.
- Fisc… …tly and can substantially add to government debt.
- … economists argue that public investment leads to 'crowding out' of … private investment, though others argue that the two are complementary.

Goals of fiscal policy
- A primary aim is to reduce the extent of fluctuations in the business cycle
- Reducing unemployment
- Maintaining economic stability
- Reducing inequality
- Maintaining financial equilibrium with other economies
- Low and stable in…

Others goals … policy
- To maint… the mone…
- To ensure… stability r… currencie…
- To monit… the finan… act as len…

Fiscal policy … revenue through taxes or revenue from government assets, and engages in either current or capital expenditure. Where fiscal deficits arise, borrowing occurs.

Macroeconomic policies designed to influence aggregate demand.

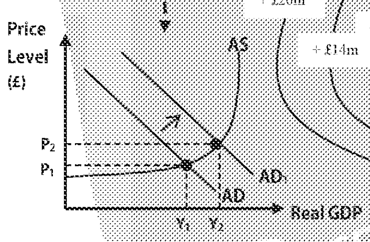
Define fiscal policy ?

Fiscal policy

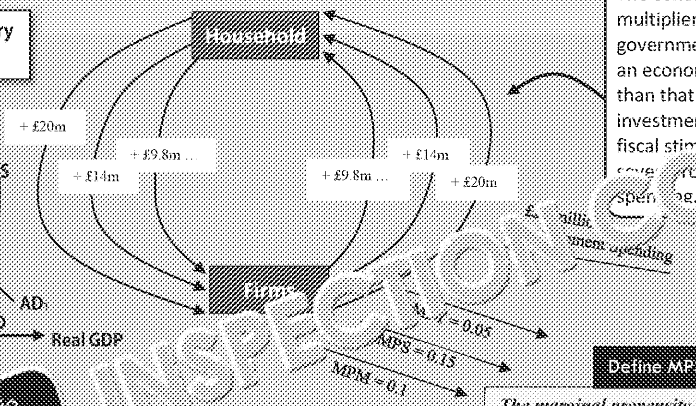
Define…

Fiscal policy may be **expansionary**: designed to stimulate aggregate demand through spending and low taxation, or **contractionary**, seeking to lower aggregate demand through spending reductions and low taxation.

Effect of an expansionary fiscal/monetary policy



Keynesian multiplier H
The concept of the multiplier states that any government spending yields an economic return greater than that of the initial investment. This is because fiscal stimul… … seve… … furt… spen…ng.



- **Real interest r…**
- **Nominal inter…**

Define real and nominal interest r…

Define MPS, MPT, MPM ?

H

The marginal propensity to consume (MPC) = *the proportion of income that will be injected by consumer spending*

The marginal propensity to save (MPS) =

The marginal propensity to tax (MPT) =

The marginal propensity to import (MPM) =

H
The multiplier can be calculated using the formula

$$\frac{1}{(1-MPC)}$$

Equili…
- Ide… eco… int…
- Th… po… the…

3.7: Supply-side policies

Draw and label a Keynesian diagram showing the effects of supply-side policies ?

Draw and label a [illegible] diagram showing [illegible] supply-side policie[illegible]

Supply-side improvements refer to factors that increase the level of supply in the private sector, e.g. greater investment and productivity. Supply-side improvements may help to achieve supply side policies.

Supply-side policies are any policies that increase AS.

- On the demand side, government spending and tax reductions both increase aggregate demand.
- On the supply side, investment, R&D, incentives and improved human capital all result in increased efficiency and productivity which increases aggregate supply.

Supply-side policies

Identify four goals of supply-side policies ?

Goals of supply-side policies

1.

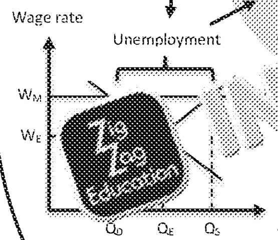
2.

3.

4.

Strengths	Weak[illegible]
1.	1.
2.	2.
	3.

- May also cause inflation.
- Local/foreign firms may relocate abroad (job losses).



But arguably leads to equity.

Minimum wage is set above the equilibrium wage rate.

Minimum wage is imposed to avoid very low wages for workers.

- **Improve infrastructure** = investment in transport links, communication [illegible] and housing, etc. can help to increase AS, as it reduces costs of production.
- **Research and technology** = investment in R&D can make production more efficient, cheaper (in the long-run) and quicker.
- **Increase incentives** = raising minimum wages or providing perks can increase the supply of labour.
- **Increasing competition** = e.g. preventing monopolies will allow more firms to enter the market, increasing AS.
- **Reforming labour market** = e.g. abolishing the minimum wage or trade unions will allow firms to hire more workers.
- **Human capital** = providing vocational training and subsidising education can create more skilled workers.

4.1–4.4: International trade

Give three positive and three negative impacts of international trade

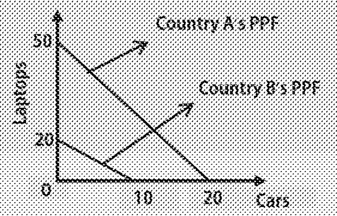
Impacts of international trade:

Positive	Negative
1.	1.
2.	2.
3.	3.

Advantages of trade and specialisation	Disadva…
• Greater choice for consumers • Cheaper goods for consumers • Greater efficiency • Firms experience economi… • Wider market → … • Increas… + hi… …andar… of living	• Countries becom… • Terms of trade r… goods and expor… • Over-reliance on… • Countries lacking… • Unwanted goods… low prices, which… • May widen the r… • Bad for **'infant i…**

…is about a country producing goods in which it has a comparative advantage

	Cars production	Laptops production
Country A	20	50
Country B	10	20



Country ____ has **absolute advantage** in the production of both goods (i.e. it can produce more of both goods *cheaply* using the same resources than country B).

Fill in the blanks

Country _____ has **comparative advantage** in the production of cars (i.e. it can produce cars at a lower opportunity cost than country A).

Country A needs to forego 2.5 units of laptops to produce 1 car (20:50). Country B needs to give up 2 units of laptops to produce 1 car (10:20).

Draw…

W… the … …ation (WTO) do?

- The **World Trade** … (WTO) …
- Conflict between WT… …gional trade agreements → latter lead to trade diversion, which decreases trade elsewhere and undermines comparative advantage.

Trade blocs + WTO

Bilateral – Preferential trade between two countries
Regional – Preferential trade within a geographic area
Multilateral – An international trade organisation

List and explain the four main types of trade blocs

Types of trade blocs:

1.

2.

3.

4.

- Tariff increase on the price of imports → lower demand
- Revenue for government (ABCD)
- Domestic consumer surplus increased by P_1P_2DE
- Welfare loss (ADE + BCF)

…protection

Advantages and di…vanta… …bo… …ocs

Advantag…	Disadvantages
• No transaction cos… • Greater market acc… economies of scale s… lower costs • Stronger bargaining power in multilateral organisations • Attract FDI → good for growth • International cooperation increases political stability	• …ransition costs, e.g. **menu costs** • Loss of sovereignty • Undermine multilateral arrangements (such as WTO) H • No control over monetary policy (in monetary unions)

Monetary unions H

Advantages
Reduce exchange rate costs, eliminate currency risk, more efficiency, greater information, boosts investment and growth

Disadvantages
Loss of monetary independence can exacerbate economic crises, leading to higher inflation and/or unemployment

Reasons for restrictions on free trad…

List at least five reasons for a country wanting t… restrict free trade

1.

2.

3.

4.

5.

4.5 & 4.6: Exchange rates and Balance of payments

Fill in the determinants of the current account

Balance of payments (BOP)

Name the other two accounts of the BOP

Current account (C/A)

Capital investment | Financial investment | Speculative capital fl...

FD... | ...ve assets | Speculative capital flows

Exports minus imports

Inflow of income minus outfl...

Loans/grar... rece... ...d, ...nts

...dentify three effects of a current account deficit and three effects of a surplus

Effects of C/A deficit	Effects of C/A surplus
1.	1.
2.	2.
3.	3.

Significance of tra... imbalances:

- The accounts on the balance of payments are interdependent – all credits are matched by debits and all deficits by surpluses. For example, a deficit on the current account will be zeroed by borrowing on the financial account.
- As a negative trade balance increases, it becomes more and more difficult to finance. Hence, loans have to be taken out. This is because a negative current account implies a positive capital account.
- Government spending may fall significantly to repay those loans.
- Also, if exports outstrip imports, domestic consumers may be faced with limited choice.
- Trade imbalances also lead to massive currency fluctuations → affects global trade.

Current account (C/A) H

1. **The Marshall-Lerner condition** posits that depreciation only leads to a C/A improvement if $(PED_{exports} + PED_{imports} > 1)$.
2. **The J curve** suggests changes in the ER have time lags. Initially C/A deteriorates because in the short run exports and imports have inelastic demands. Later, as demands become more elastic, we see an improvement.

Surplus

0

Time

Deficit

Reducing current account imbalances: H

1. **Expenditure-reducing policies**
   Policies that reduce AD, e.g. increasing income tax → reduces disposable income → demand for imports decreases.
   + Also effective at tacking infla...
   – May harm growth an... ...nt
2. **Expendit...re-s... ...ching ...li...**
   Polic... ...af... ...and for imports, i.e. trade ...e... ...imposing tariff → imports become ex... ...e → demand for imports falls.
   + effective in short term to protect industries
   – Could lead to trade retaliation
3. **Supply-side policies**
   Policies that affect demand for exports, e.g. increasing spending on education → improves labour productivity → improves quality/quantity of exports → demand for exports rises.
   + Useful for solving long-term structural issues
   – Can come with significant time lags
4. **Doing nothing**
   Due to the downsides of the policies mentioned above, some countries may opt to do nothing

Value ... Value ...

Factors ...
- Relativ... If relat... encou... higher ... increas...
- Relativ... If relat... more e... → £ de...
- Specul... If peop... they w... higher ... depreci...
- State o... Econom... → dem...
- Deman... The ex... domes...
- Remitt... Direct ...
- Foreig... FDI can... develo...

Growth an... ER deprecia... creation → ...

Living sta... ER deprecia... expensive → ...

Growth an... ER deprecia... creation → ...

4.7: Sustainable development

Define sustainability

Sustainable Development

Define development

✓ [illegible] development that is a way of achieving socio-economic [illegible] ent without damaging the environment for future generations.

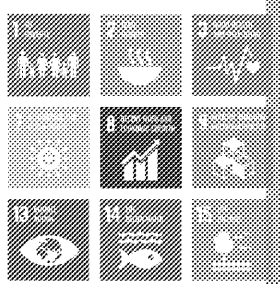
✓ 17 goals set by the United Nations General Assembly in 2015

Fill in the gaps

H

Sustainability and poverty

- Impoverished people are overwhelmingly involved in the ___________ sector of the global economy, meaning they are most affected by the depletion of __________________ and extreme weather.
- Unequal societies rely on ______________________ to maintain living standards, which often leads to resource depletion.
- The more unequal a society is, the less the voices of those who depend on the natural world are heard as the economy grows.
- Thus, policymakers are concerned to treat sustainability and poverty as a ____________________.



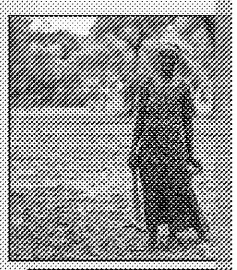
Microgrids: Solar in Yemen

Which SDGs does this meet?

-
-
-
-

- Yemen is one of the world's most impoverished countries. The country has been plunged into a humanitarian crisis due to a long-running civil war.
- Yemen's energy supply – produced from oil and gas – does not meet demand, meaning many are left without a reliable source of energy to meet their demands.
- The Enhanced [illegible] in Yemen (ERRY) project grants money to [illegible] women to help them start a business [illegible]
- Participants are provided with a mini solar farm sufficient to generate enough energy for a small neighbourhood, and trained in maintenance
- They are then able to generate an income by selling energy to local households and businesses
- In the areas where microgrids have been installed, unemployment and poverty have fallen drastically. Living costs have fallen due to a cheap and sustainable local source of energy. Prejudice against women has also reduced after local communities have seen them operate as trained solar engineers.

Regenerative Farm



Which SDGs does this

-
-
-
-

4.8 & 4.9: Development

Identify two more measures of development ?

Measures of development

________________: Combines life expectancy, ecological footprint and a happiness survey.

Inequality-adjusted HDI (IHDI): Also measures the distribution of health, education and income around the population

________________: Measures female participation in society.

Single indicators, such as:

Name t… …me…

Human development index (HDI) is a composite measure of development

HDI = $\sqrt[3]{\text{education index} \times \text{life expectancy index} \times \text{income index}}$

Benefits of HDI	Draw…
• Multidimensional • Uses two measures for education	• Ignor… as it … • Missi… happ…

What are the three components of HDI, and what do they measure? ?

Barriers to grow… developme…

Cycle of poverty:
- Poverty is often a self-reinforcing phenomenon – those living in poverty lack the opportunity to extract themselves from it.
- Limited education → lack of skills → low-value work → unable to save → children forced to work → limited education, etc.

Capital flight:
- This is about people saving their money in foreign banks, which are more secure and/or have a higher interest rate
- Thus, developing countries are deprived of savings → lack of investment in capital → low growth

Economic factors

Education: Developing countries tend to … the appropriate educational infrastructure

Infrastructure: Poor infrastructure makes trad… very costly → discourages FDI

Absence of property rights: Property rights give a sense of entitlement, which is good for investment/borrowing and growth. However, developing countries lack some property rights.

Volatility of … prices: Inelastic … supply … overall economic instability (high inflation, unemployment, etc.)

Debt: Developing countries tend to … debt. While their government… build infrastructure and create… current generation, it is often … generation that has to pay bac… and becomes visibly worse off…

Name and explain three economic factors that influence growth and development in the blank boxes. ?

4.10: Strategies influencing growth and development

Explain the following market-orientated strategies of influencing growth and development: 'privatisation' and 'removal of regulation'

Privatisation:

Microfinance schemes:
- This is about providing small loans to poor people, who are ... to ge... loans from big ban... the provision of collat...
- Loans are given to ... repayment is guaran...
- This helps poor people escape poverty.

Market mechanism of demand and supply affect growth and development

Market-orientated strategies

Floating exchange rate:
Switching to a floating regime will demand that demand and supply will decide the value of the currency, which means the currency is likely to depreciate. Thus, imports become expensive while exports become cheap. Thus, local industries will flourish, leading to higher growth.

Removal of regulation:

Foreign direct investment (FDI):
- Creates jobs → more consumer spending → higher AD → ...
- Countries can ben... expertise o... ations
- F... ... on local ... ure

Trade liberalisation:
- This is about reducing ... barriers
- Free trade promotes growth by creating jobs
- Free trade leads to greater allocative efficiency
- But this could reduce growth if a country is flooded with cheap imports

Social enterprise:
- A business that uses the market in order to achieve social or environmental goals, as well as profit.
- Encouraging social enterprises can maximise the social welfare of economic activity.

Corruption:
- Political and judicial refo... designed to ... out structures and ...dividuals who are enabling the corrupt capture of public resources.

Wom...
- En... th... br... an...

Aid:
- Devel... ...d humanitarian or ...omenta... order to invest in the ... process.
- ...oped nations may also choose to write off debts that developing countries owe in order to enable them to better manage their resources.

Other strategies

Land rig...
- The ... deve... the l... citiz... prec... sust...

Identify three strengths of the market-b... and three strengths of the interventionist ...

Market-orientated	Interven...
1.	1.
2.	2.
3.	3.

Import Substitution:

Trade strategies

E... d... ...

...t Promotion:

What is the difference between the World Bank and the International Monetary Fund (IMF)?

Multilateral development

International Monetary Fund (IMF):

World Bank:

Official Development Assistance (ODA): Targeted funding provided by the UK or other governments to aid development.

NGOs: ... profit o... range i... at any l... concern... based ...