Edexcel Economics B Course Companion

Theme 2: Wider Economic Environment

zigzageducation.co.uk
POD 5868

Contents

Teacher's Introduction

Economic impact comes in all shapes and sizes and so, when studying the economy, it is important to look at the whole picture, from the largest market to the individual consumer.

This resource has been written to support the learning of Theme 2: The Wider Economic Environment, which forms part of the Edexcel Level 3 Advanced GCE in Economics B. It gives an in-depth view of the new qualification, presenting what specification points students need to know, plus extras along the way for extended learning.

At the beginning of this resource you will find a list of contents showing every specification point that is covered. There are also questions at the end of each topic, with answers at the end of the resource, to help students apply their knowledge to real-life economic contexts. Key terms are revised as a glossary at the end of the resource.

Students are given information about and opportunities to practise quantitative skills in this resource, including all nine of the listed skills from Appendix 3 of the AS specification.

While extremely valuable to a student's revision, this resource should be treated as a companion to the many other textbooks and activity guides available. As with any subject, it is good to read as widely as possible!

The notes included in this resource can be given to students before a lesson as preparation for a topic, afterwards in order to help consolidate their knowledge, or can be used by teachers as a supplement to in-class exercises and activities.

It is hoped that this resource, as well as offering support for teaching the essential elements of the Edexcel examination, will help students build on their research and dissemination skills. The world of economics is a constantly changing one, full of fascinating stories. This resource attempts to utilise some of these stories as a basis for teaching in the most interesting way possible, meanwhile encouraging further study by the next generation of economic analysts!

January 2016

*A webpage containing all the links listed in this resource is conveniently provided on ZigZag Education's website at **zzed.uk/5868***

You may find this helpful for accessing the websites rather than typing in each URL.

2.1 Business Growth and Competitive A

2.1.1 Growth

Why Businesses Grow

There are many reasons why a business may wish to grow. Primarily, a business w profit for the owner. The owner of a firm may be an individual, such as a corner-s have issued shares, in which case each shareholder is part-owner of the company. entrepreneur offers a share in their company (gives part control to the dragon) fo owner is an individual, partner or shareholder, the ultimate focus is to obtain an i income they receive can be done in various ways.

Growing a business can help it gain more control over the market. The firm can th benefits. Growth indicates more customers and more sales, which will generate m benefit from economies of scale, allowing them to lower costs and increase profit increase revenue.

Some Businesses Choose Not to Grow

Successful businesses are able to grow and expand and so choose to do so; howe unsuccessful and so remain stuck or even diminish in size.

Then, there are firms that are happy with their size and worry that growth will onl shopkeeper, for instance, may have no interest in expanding their business and s customers and income they generate. Since business expansion generally require appear quite risky to owners, especially when considering any interest on loans o

Objectives of Growth

Most companies look to grow, but not every company has the same objective wh

Economies of Scale

Economies of scale are a long-run phenomenon that refer to the decrease in the grows. There are two types of economies of scale: *internal* and *external*.

Internal Economies of Scale

These refer to the decrease in the long-run average costs when a firm itself grows

- **Bulk buying:** This refers to the ability of large firms to buy their raw material them to buy them at a cheaper price. These cheap raw-material prices transl the firm. Smaller firms cannot take advantage of bulk buying to the same ext large quantities of raw materials.
- **Financial economies:** These refer to the ease with which large firms are able t rate. In other words, they can take advantage of borrowing at lower costs. Ban to large firms because such firms have shown themselves to be successful – an
- **Technical economies:** Large firms are in a position to buy costly equipment, help run the business more efficiently and at lower costs. A local grocery sto afford refrigerated vans even though they have obvious benefits. However, a invest in these vans. These will have a high one-off cost but will thereafter re stocks will not get [illegible].
- **Managerial economies:** Large firms are able to employ experts across the b and productivity. These experts tend to demand high salaries, which makes it them and benefit from their expertise.
- **Marketing economies:** Large firms are able to use their existing marketing i new products as well. This means that these new products do not require fu marketing. And this, in turn, lowers the long-run average cost of a firm.
- **Risk-bearing economies:** These refer to the ability of large firms to produce The benefit of this is that if the sales for one item fall, a firm can rely on othe large product portfolios are, therefore, able to withstand economic downtur so, as they lack the finances to invest in a variety of products.

Let's use another example:
2000 Teas Ltd is a beverage company that specialises in producing high-quality te its classic breakfast tea, which it buys from one main supplier in India. The cost of 1 kg. 2000 Teas Ltd sells its breakfast tea to supermarkets for £200 per 100kg.

The calculation to find the selling price for 1 kg of breakfast tea is:

$$\text{Selling Price of 1 kg} = \frac{\text{Selling Price of 100 kg}}{100}$$

$$\text{Selling Price of 1 kg} = \frac{200}{100}$$

$$\textbf{Selling Price of 1 kg} = \textbf{£2.00}$$

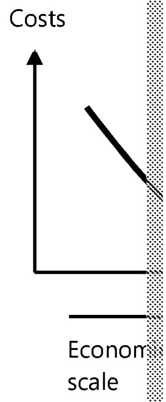
The difference between the selling price (£2.00) and the cost of raw materials (£0.5 Ltd receives for every 1 kg of breakfast tea it sells. If, however, 2000 Teas Ltd was t breakfast tea it purchases from its supplier (i.e. buying in greater bulk), the compa lower price [illegible] raw materials.

Let's calculate the difference again, but assuming 2000 Teas Ltd negotiates the co per 1 kg:

The difference between the selling price (£2.00) and the cost of raw materials (£0.4 continues to sell at the same rate, the company will make much higher profits due gain from buying in greater bulk.

Since 2000 Teas Ltd now pays less for its tea, it could bring down the selling price *generating more sales* and *increasing profitability* as a result.

External Economies of Scale
This refers to the decrease in the long-run average costs when the industry that a firm is in grows (rather than the firm itself). Examples may include better infrastructure in the vicinity (transport links, internet access, etc.), research and development institutes nearby that firms can benefit from or the relocation of suppliers in closer proximity to a firm.



Minimum Efficient Scale (MES) of Production
This refers to the size (or scale of production) at which the firm experiences the highest levels of economies of scale. This happens when a firm's long-run average costs are at their lowest.

Increased Market Power over Customers and Suppliers

Remember Porter's five forces model? Businesses are constantly at odds with one markets' suppliers and custom

Let's use another example:
Frosty Glazers Ltd is a manufacturer of windows that buys its raw materials from a suppliers. These same suppliers provide raw materials to most of the window man in the market and so they can exert a lot of power in the form of setting prices an Frosty Glazers Ltd understands that if the few suppliers decide to increase the pric materials, the company will have no choice but to pay it.

One manager at Frosty Glazers Ltd announces that she has found another supplier provides raw materials at the same quality and at a lower price. The company start from this supplier and so increases its power as a buyer over the other suppliers. Fr reduce its prices in order to become more competitive and gain market share over

Increased Market Share and Brand Recognition

Most supermarket chains, such as ASDA and Sainsbury's, work tirelessly to increas
become the one name people think of when they need to do their weekly shop). F
their customers (and potential customers) as well as pushing all manner of advert
These could be anything from posters on bus shelters or double-page spreads in
free offers, in-store demonstrations and loss leaders (such as selling televisions at
selling price).

Firms often increase their market share and brand recognition as a short- to medi
greater goal (strategy) of increased profitability.

Increased Profitability

Profit is the amount of revenue a business has left over after all *expenses and tax*

Profitability, meanwhile, shows how *profitable* a business is of turning revenue int
as a ratio). Businesses often achieve this objective of increasing profitability throu

- By purchasing raw materials in bulk, a business can decrease its total costs.
- By increasing its output, a business can decrease its average operating costs.
- Through aggressive marketing, a business can increase brand awareness on
- By decreasing selling prices, a business can make more sales overall.

Problems Arising from Growth

Growth is generally a good thing for business, but there are a few minefields to m

Diseconomies of Scale

Let's look at 2000 Teas Ltd again:

The company is able to sell 100 tonnes of breakfast tea every month (mostly to su
120 tonnes every month. This amount is enough to fulfil demand and have some
fluctuations in demand.

Encouraged by the number of sales generated, 2000 Teas Ltd decides to increase
month. However, the company soon realises that demand does not meet this sup
raw materials, which increases the total costs and, therefore, the average cost of 1

Internal Communication

Another diseconomy of scale can come from the expansion of a company's processes. As a firm grows in size, the internal network of communication can become more complicated and, therefore, less efficient. If a business grows to an unmanageable point, there is a chance that the bulk of the firm's employees lose sight of whatever vision or strategy they are working towards.

As a manager's *chain of command* grows, it may also become more difficult for subordinate employees to voice their opinions or receive support in pursuing
the company and even resulting in a demotivation of a workforce that feels undervalue

Overtrading and Skill Shortages

This is a common problem with new businesses.

Cool Beans Ltd is a supplier of coffee beans, which it sources from plantations in Chiapas, Mexico. The company imports the beans and then roasts them and packs them for sale in the UK. Cool Beans Ltd is a relatively new company and so has very little in terms of workforce or infrastructure. Nevertheless, the company has been inundated with demand from the get-go.

Motivated by the influx of custom (mostly from local cafés and shops), Cool Beans L
than it can reasonably fulfil. The company is overworking its staff and running its m
with demand. The workforce quickly becomes demotivated as a result and Cool Bea
of its customers, leading to loss of earnings for the company.

What seemed like a good idea at the beginning (making so many promises to cus
harm to the business than good.

The Role of Corporate Culture

The corporate culture of a business is derived from its values and, importantly, ho
the rest of the organisation. Business values can include anything from environme
manufacturer Patagonia) to innovation (e.g. firms such as Apple) to supporting un
Whole Foods Market).

Firms must share their values with their staff; this helps to create a sense of directi
regardless of department or function, works towards the same overarching goal. A
values with its staff may find that each department develops its own agenda as to
in turn, can create conflicts of interest and an inefficient, unproductive workplace.

Corporate values, when communicated effectively, can have great influence over
business. If a firm invests very little in the sharing of corporate values, for instance
accordingly. This can create a culture where workers aim to achieve only the bare
business to survive. Conversely, if a firm devotes time and resources to communic
aspect of the business, staff are likely to feel encouraged to strive for the highest
can lead to a noticeable increase in productivity and quality.

People, whether consumers or potential employees, are drawn to companies that
Google is a great example of a company whose core values include continual inno
this value with its staff and even allows employees time to work on their own pers
Google Maps) have gone on to become essential products in the Google portfolio

2.1.1. Questions

1. **a)** Explain how a business benefits when it successfully communicat
   all employees.
   b) **i)** Look up the mission of The Coca-Cola Company (*www.co*
   company's three core values.
   ii) Explain how communicating these values to the public can be
   company.

2. **a)** What is profitability?
   b) Identify and explain two ways in which a business can increase it

2.1.2 Methods of Growth

Businesses can grow either internally or externally. Internal growth occurs from in the business and its products. This can be done either through loans or saved (ret occurs from combining firms. This can be done through merging and integrating another (takeover).

Organic Growth

Organic growth occurs when a business grows internally. If a business is successfu profits which can be reinvested as expansion. Equally, a business could grow by in expansion projects. Borrowing money can be done either through a loan, or by iss As well as gross investment, funding things such as marketing can allow a firm to customer base. Research and development can also allow the firm to expand into

Advantages and Disadvantages of Organic Growth

- \+ Organic growth is less risky than attempting to integrate with another firm.
- \+ The growth can be financed using its own wealth (in the form of retained pro
- \+ The rate of growth is generally sustainable for the business; rapid expansion
- \+ Firms retain control over their business, whereas firms that merge have less c completely give over their control.
- – Business growth is dependent on the growth of the market. If the market col to collapse.
- – Organic growth tends to be a slower form of growth.

Inorganic Growth

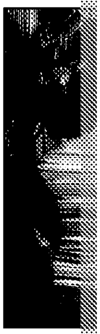
Horizontal integration describes when one business joins another at the same sta two farmers joining together) while *vertical integration* describes when one busine production process (e.g. a supermarket buying out a farmer).

Let's use an example:

Dress Nation Ltd is a British clothes retailer. The company has many competitors, online traders. The diagram below shows how Dress Nation Ltd's production proc

PRIMARY STAGE	Supplier of raw ma
SECONDARY STAGE	Designer of clot
TERTIARY STAGE	Manufacturer of cl
QUATERNARY STAGE	Retailer of cloth

Diagram: the production process of Dress Nation L



Dress Nation Ltd is situated in the quaternary (fourth) stage of the production process, as the company is the one selling products that have already been designed, manufactured and supplied. Dress Nation Ltd is now looking to grow and so it might decide to use vertical integration or horizontal integration.

Vertical: if Dress Nation Ltd purchases a clothing manufacturer, it will be integrating into a different business type (i.e. different industry sector) and, therefore, entering another stage of the production process (the tertiary stage).

Horizontal: if Dress Nation Ltd buys out another clothing retailer, the company is because Dress Nation Ltd and the other business are the same (i.e. within the sam clothing retailers.

Vertical Integration

Vertical integration can move forward (progressing along the production chain) o the production chain). For example, a doll industry may have one firm collecting t cotton into material; another company stitching the doll together and the last co distributes the dolls to the public. Forward integration is integration towards the the firm one production step closer to distribution. Backward integration is away f the supplier of raw materials.

Advantages and Disadvantages of Vertical Integration

- \+ Merging with other businesses can bring about economies of scale (see Topi money, for example through bulk buying when they grow larger. This will cu become more competitive.
- \+ Firms can find [illegible] to produce their goods if their suppliers don't for production. Backwards integration means a firm can control the supply of make it [illegible] efficient. Integrating with that company can also reduce the co obtain the materials at a reduced price.
- \+ The information gained from experience in one stage of production can be u example, a distributor could have knowledge of what products sell best and integration with a producer.
- – Firms are more embedded in one market, which can be problematic if the ma will have reduced their capacity to adapt, as moving into a different market w
- – The other stages of production can require a vastly different skill set and knowl

Here is a list of businesses owned by Procter & Gamble:
http://www.pg.com/en_UK/brands/all-brands.shtml

PepsiCo are another conglomerate competing with Coca-Cola. Have a company's website and compare the businesses it merged with as a r integration actions of the other. For example, when PepsiCo took on T made plans to merge with Innocent Smoothies.
http://www.pepsico.co.uk/brands
http://www.theguardian.com/business/2013/feb/22/coca-cola-full

Horizontal Integration

This involves two or more firms that do the same thing, though they often operat competitors before the integration.

Advantages and Disadvantages of Horizontal Integration

- \+ The integration of the two working in the same field means they can learn experiences. This will [illegible] efficiency and boost innovation as 'two heads
- \+ Because the integration stays within one production stage, this makes the fir they a[illegible] deeply rooted into one market.
- – Management may find they have less authority over the integrated workforce as not yet built a relationship with and may still have ties to their old company. productivity to fall.

Conglomerate Integration

A conglomerate is a company that has merged with a variety of businesses which another. The conglomerate can have businesses in unrelated industries and at diff & Gamble is a well-known conglomerate that didn't publicise the number of busi sponsorship of the 2012 Olympics.

Advantages and Disadvantages of Conglomerate Integration

\+ By expanding into other markets, a conglomerate can spread and reduce risk hits a downturn, the business could face the threat of closure. However, the b markets can support those in declining ones and keep the conglomerate goi is greater than the loss.

– Spreading across markets can cause a drain and reallocate resources away fr

– The owners of the conglomerate will be inexperienced and lack the knowledg market. This will be a disadvantage as they go up against firms that already h

Advantages and Disadvantages of Internal (Organic) and External (Inc

Corporate Culture Clashes (Structural Friction)

There are no culture clashes with organic growth as the body of the company rem taking on new managers or employees, but it is much easier to immerse one new an entire workforce. Inorganic growth, on the other hand, can be costly in the lon their methods of running their compa[illegible] be hard to alter the mindset of a with the process it follows, and failure to do so could potentially lead to a collapse

Rate of Growth and Risk

Although organic growth may be funded through borrowing, there is less risk, as manageable, making it more stable. Inorganic growth gains a chunk of a business workforce, greater capital and market share. This is a very quick way to grow; how production is risky. There can be structural friction and managing a new workforc production may not always go to plan.

Market Share and Control

Horizontal integration gains more market power over one industry than vertical in gives firms an advantage over those firms who haven't merged with another stage gain a greater market power within the economy, which means they can manipula benefit. Having economic market power can help in individual markets, too, becau the conglomerate's lead or at least their decision would be heavily influenced by t even if the non-conglomerate firm has a great market share in that industry. Orga market power, even cause them to be the biggest firm. However, it is a much slow not diminish the number of competitors in the market, whereas horizontal integra the volume of firms sharing the market.

2.1.2. Questions

3. Monty Video Ltd is an online video-streaming service. The company s videos per week to customers throughout the UK.

- **a)** The company is looking to buy out one of its competitors. Identif vertical or horizontal integration.
- **b)** Two directors at Monty Video Ltd wish for the business to grow o through integration. Explain one reason why the directors may fe

4. Copy out and complete the following sentences using the phrases *org* *horizontal* and *conglomerate*.

When a business grows internally, we call this ________________ g

experiencing ________________ growth can do so in three forms o

example of ________________ integration might be when one new

another newsagent, while ________________ integration describes

buys up many different businesses from various levels of the producti

example of ________________ integration would be if a greengroce

vegetable farm, as they are on different levels of the production proc

2.1.3 Research and Development (R&D) and Innova

Competitive Advantage through Innovation

Businesses improve their competitiveness in a variety of ways, such as by reducing their products, customer care and after-sales service, and by investing in staff trai

Competitiveness reflects the *energy and effectiveness* of all of the business's functi *value* to the product or service to make it *more desirable* to buyers. In order to ac to innovate by doing the following:

1. *Assessing* its organisational *strengths and weaknesses*, including the skills and *all* employees. This allows a business to analyse its present and future needs competitive ability.
2. *Developing* strategies for *external changes in* the local, national and global ec competition, the environment, technology and the political climate. A busine *control* over external changes.
3. *Ensuring* adequate *finance is available* to implement strategies and plan
4. *Using new and appropriate technologies* to reduce costs, increase business fle market growth, and gain a competitive advantage over business rivals.
5. *Devising and monitor an integrated human-resources policy* to ensure that en and knowledgeable, skilled and experienced enough to contribute to the bu
6. *Knowing who its customers are*, what they want and need and when they wan marketing mix, coupled with an integrated approach to marketing, will help objective is achieved.
7. *Outsourcing work to other businesses when and if appropriate*. This is an exter theory; for example, a manufacturing business specialises in the manufacturi *have the expertise* to undertake extensive market research and so may emplo *market-research agency* to undertake such research on its behalf.
8. *Ensuring that they provide a top-quality product or service*. Best practice in *qu* competitiveness of a business on local, national and global bases. This is bec *guarantees of continuous quality* for a product or service. For example, busine *9000 certification*, which is the *generic name* given to a family of *quality stan* framework around which a *quality-management system* can effectively be im

Incentive to Increase Market Power

Much of a firm's competitive advantage comes from its research and developmen that have a strong focus on R&D, such as tech giants Google, Apple and Faceboo their markets. By investing heavily in R&D, a firm can differentiate itself from any brand presence (so people see the company as different) and developing a certai consider the company's products as high quality).

There is an incentive for companies to invest in R&D since not only do their bran loyalty can increase as a result of this, leading to more regular sales, revenue and enough market power through R&D, it is able to be competitive without having t more market power also means the business can set its own prices (perhaps even having to worry about what its rivals are charging. In addition, with more market profit, part of which a company can reinvest into its R&D processes to continue t

Product and Process Innovation

While innovations in a company's product are generally quite small (such things a
slightly enhancing its efficiency – think of updates to cars or smartphones as exan
can be extremely large.

Supermarkets are a great example of process innovation: the distribution, purchas
chains use have improved hundredfold since the advent of computer technology.
supermarket and purchase a bag of crisps, those products are then communicate
room to let workers know that they need to put more crisps out on display. In the
suppliers are automatically notified how many crisps have been sold throughout t
provide the right number of products on the next delivery.

Role of State Funding

Investment in R&D, as we discussed previously, can help firms achieve high levels
grow their market power, influence and customer loyalty. This represents significa
company but for the local economy where it is located. State governments look to
businesses that operate within them, as these bring in funds that can be invested
Through re[illegible], governments can attract more people and firms to start bu
in turn, has the potential to bring up the average real income of the area and dec

It is common for governments to offer grants and loans to businesses in order to
local area. The incentive brings more industry to the area, which in turn helps to ir
(GDP). Naturally, some disadvantages can come with offering grants to businesses

Drawbacks of State Funding

Grants are expensive, for a start. If the business receiving the grant is foreign, it m
in the local economy but instead send the money back to its home nation. This is
to have to pay. In addition, encouraging new business does not necessarily mean
a drop in unemployment. Many firms, especially those that need specialised work
own workforce and so would not do much to increase the number of job opening

The Product Life Cycle

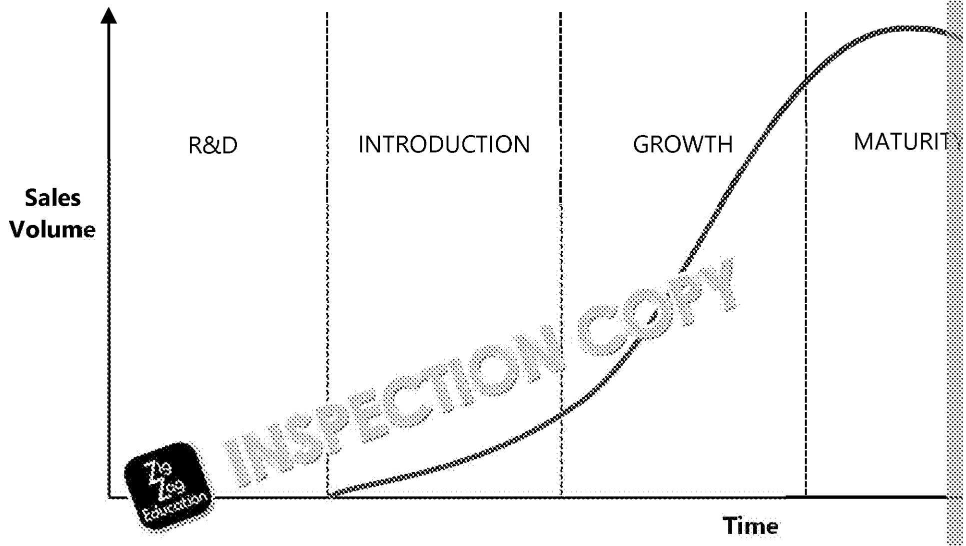


Diagram: The product life cycle

The product life cycle is the basic life story of a product/service. Much like the life
life cycle has a beginning, middle and eventual end. Some life cycles are incredibl
toilet paper) while others have much shorter expectancies (such as mobile phones

Stage	Description	Cash flow
Research and Development	The point before any sales can be made	Only costs at this poin
Introduction	The product/service is now launched	It is in the beginning stages and so makes fe sales, has low profitab and has little market share
Growth	The product/service is becoming established	Sales and profitability growing, as is the potential for greater market share/growth
Maturity	The product/service comes towards its peak and sales have begun to level out	The brand has strong market share and so th company still receives profit at this point
Decline	Sales are falling due to decrease in market share and growth	The company may be making a slight profit o even a loss at this poin

Problems with the Product Life Cycle

- It is difficult to understand which section of the life cycle a product/service is its life (product death). This is because markets can change and so a product moment may become the ultimate must-have item the next.
- The life cycle works most effectively when markets are stable, without any dy between trends.
- The classic bell curve ignores the idea that a product/service can continuousl been saved from the decline phase thanks to *life-extension strategies*, such as audience.
- Some products/services die directly after the introduction stage because the research into their market – the market might not even exist! Other products decline, because companies are forever advertising.
- The product life cycle cannot show any future sales (i.e. businesses cannot te are in the cycle) and so marketers cannot see whether there are more sales to about to start declining.
- If a marketer is looking at a life cycle with up-to-the-minute data, there migh sales. This could look like a genuine problem for the company, which then st if the same marketer looks at the life cycle next year, this spike/dip may no
- If decline is long and drawn-out, a business might not realise and confuse th product/service is on its last legs.

Many of today's marketers choose 'benchmarking' over using the product life cyc comparing a business's achievements with those of the industry standard. A yo-yo selling thousands of cases of yo-yos this year, but how does that compare with th life cycle shows a product/service's life from start to finish and so needs all the pa to tell the whole story.

Extension Strategies

When a product or service is nearing the end of its life, a company will sometimes breathe new life into it. These strategies can prolong the life of a product/service sometimes indefinitely. Not every strategy works, though.

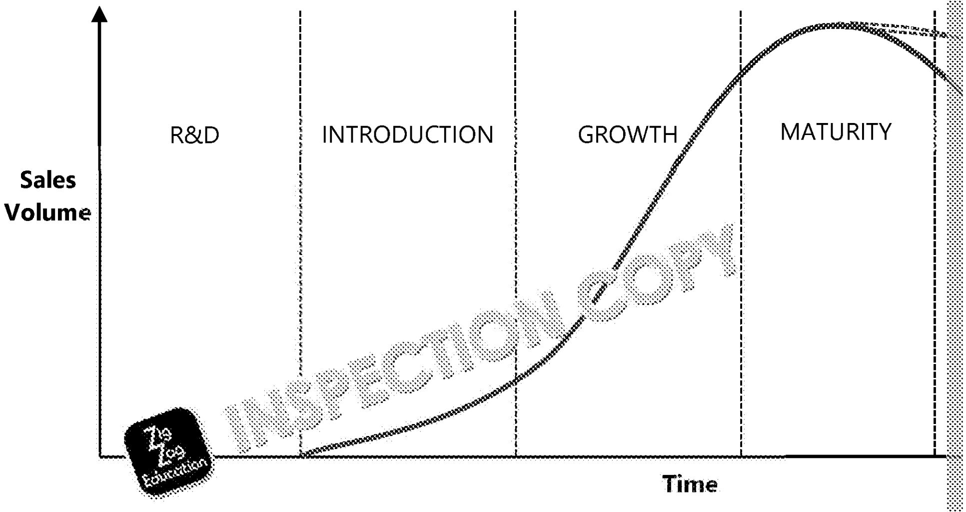


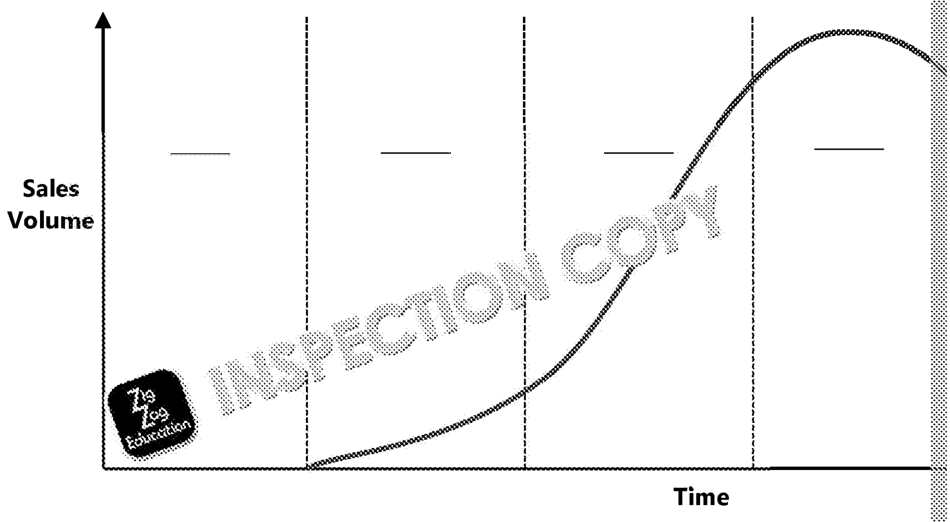
Diagram: The product life cycle with potential extension s

Product extension strategies involve techniques such as developing new features product/service. Apple, for instance, have managed to extend the lives of their m the app store, which gives consumers the chance to buy and download new appli experience.

Promotion extension strategies involve anything from finding new users for a pro of an item to redesigning its packaging. Some products experience a new lease of advertising campaign, while others just get worse. Some companies try increasing product/service and suddenly get hit with high demand – this happens because n high price with quality.

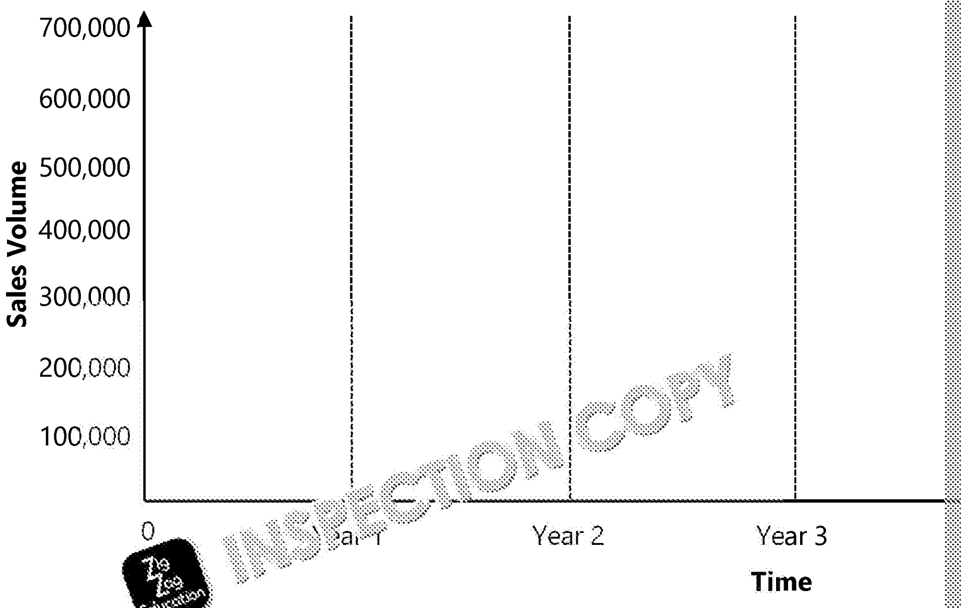
5. a) Copy out and complete the following product life cycle, putting ea right position.

Maturity *Introduction* *Research & Development* *Decl*



b) The soap manufacturer Squeaky Kleen is looking at the sales for Bubble Joy. The product took one and a half years of research ar then introduced to the market. At the Year 2 mark, sales were re the product was generating 600,000 sales but this had fallen by Bubble Joy continued to decrease and the product was finally put in Year 5.

Copy out the product life cycle below and complete it with a line Bubble Joy.



6. Explain one benefit and one drawback for governments offering fundi

2.1.4 How the Digital Economy Affects Markets anc

Market Information in the Digital Economy

The Internet plays a major role in most people's daily lives and has changed the w
another. It has also had a great effect on the customer-to-supplier relationship.

Price Comparison Sites

The amount of information that consumers have at their fingertips has exploded s
People no longer need to search around each shop on their local high street in or
if someone sees a product they like, they can instantly look it up on a price-comp
reviews online to find out whether the shop is offering a fair price. This strengther
buying power of the consumer.

Viral Marketing

Nowadays, people can share content with one another in seconds – we don't ever
any more to share a silly video. Companies understand this, and the power it has,
content to be published online. This can include video clips, images, infographics,
campaigns, [illegible] other content. The aim in creating this content is for so
social media [illegible], text, etc.) that it *goes viral*.

Social Media

Shareable content can be exchanged online via email and message boards, thoug
social media. These channels, such as Twitter, Facebook or Snapchat, can be used
businesses, too. Much like advertising at the top of search engine results, brands c
appear higher on consumers' social-media feeds. This sort of brand awareness is l
managed correctly, can result in high volumes of user-generated content, where c
talking to their friends about your brand.

Social-media channels also allow businesses to relate to their customers on a mor
responding to any questions or complaints, and to promote their brand's persona
entire social-media team to focus on this side of the business – and some teams w
events (such as the Academy Awards or BAFTAs) in case they can use their social-
something!

Just as a brand can instantly communicate a message, so too can its consumers. If
product or service and tells all their followers, this can easily spiral out of control.
manage this sort of negative publicity – and quickly!

The Supply Side

Micromarketing

Businesses that use mass marketing communicate their messages to as many pote
Niche marketing, on the other hand, looks to sell only to those who have a genuir
handmade jewellery or luxury vehicles. Micromarketing is a form of niche marketi
attract potential customers. Businesses utilise social media as a way to create nich
made offers or discounts to specific users. This technique benefits both the user, w
discount clothing, and the business, which creates organic buzz around its produc
sharing the competition or sending the discount offer to their contacts.

Online Retailing and Distribution

The availability of new technology has changed the way firms do business around
at a desk or on the sofa (or even lie in bed!) and do their shopping at the touch o
tablet/phone.

This change has seen a complete overhaul in retail. Businesses no longer need bri
their products/services. Online stores are open 24 hours a day – consumers can e
Businesses do not need to employ a team of sales assistants to help customers fir

required to take physical money. All of this has allowed businesses to cut costs, w
consumer as lower prices, helping businesses retain future sales.

The rise of online retail outlets, such as Amazon, has created a more 'cut-throat' b
consistently try to outdo one another on price. Due to this, trends do not last long
if a business does not stay ahead of the curve, it will miss out. This is something t
Lewis and HMV, have had to adapt to.

Can you think of any ways in which businesses such as HMV had to adapt due to or

Recruiting and Training Staff with Digital Skills

In today's technological economy, there is high demand for workers with digital s
that need to find the right candidates but also on the candidates themselves, man
before the advent of computer technology. Companies, therefore, can either look
desired digital skills or employ people with a view to delivering training to them o
house or externally).

Both of these methods can be expensive, however: by taking on workers without
company must spend money training them to the required level. Conversely, by h
businesses will likely need to pay higher wages and work hard to keep them inter
understand that they are in demand and so can move to the prospect that best su

The Demand Side: Long-Tail Theory and Wider Geographical Ma

Large digital companies are benefitting from what economists call the *long-tail th*
of selling a few choice items to many consumers, companies in the digital age sell
few consumers.

Take Amazon, for instance: for many shoppers, this is the main stop for online pur
Amazon for thousands of different products and, as a result, the company sells a f
are some products that skyrocket in popularity, such as the final instalment of the
Amazon sells thousands of different products in small quantities.

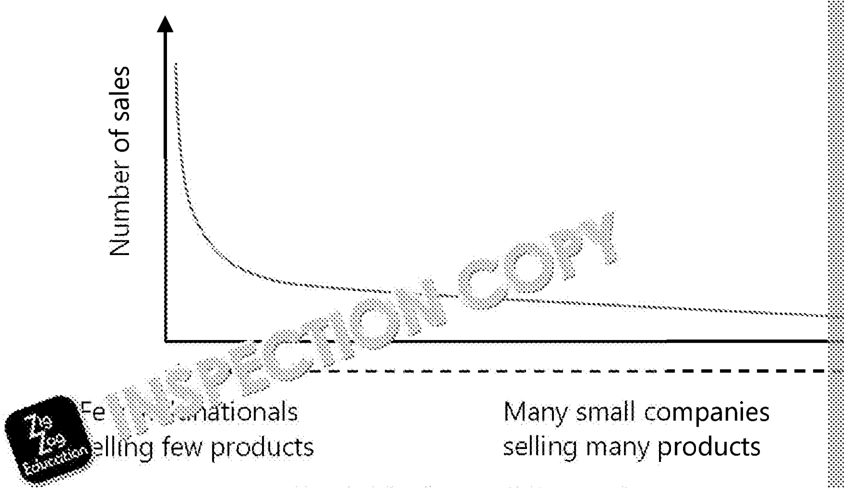
Using the long-tail theory, a graph of Amazon's sales would look something like t

Graph: The long-tail theory

The graph of Google Play store would look similar to Amazon's: while some a
Candy Crush, sell to thousands of consumers, most of the apps on Google Play m
company has an initial spike of just a few popular apps and then a long tail of tho
few consumers.

Thanks to the digital age that we live in, even the smallest company can now find
selling niche products (such as handwoven woolly hats) would have previously ha
outside their local areas, the advent of the Internet has enabled consumers to sea
need and order them directly from these businesses.

This change towards digital lowers geographical borders, making the world a muc entire market, which has developed a long tail much like that of the previous grap their audience, they are selling many different products to a small number of cons McDonald's, which continues to sell its few key products (e.g. Big Mac, French frie every day. The graph of this market would then look like this:



Graph: The long-tail theory: the digital market

Impacts on Markets and Firms

The long-tail structure of the digital market has changed the way that most firms simple bricks-and-mortar store would have been enough to peddle a company's require an online presence.

Getting online has led to an explosion of custom (and, therefore, revenue and pro independent bookshop may have had trouble selling products in the past, the Inte e-commerce sites, such as eBay, in order to sell to a worldwide audience – sudden jumps from around a couple of hundred to millions of people!

The opposite effect can also occur, however. The advent of digital created a new p the market and, therefore, it increased the competition. Woolworths, Comet and V street names eventually all made significant financial losses and failed due, in part to the lack of foresight from the companies' management. The traditional firms th business practices in alignment with market trends benefited from this choice and their goods and services in a multi-platform format:

- online checkouts
- e-commerce profiles (e.g. Amazon and eBay)
- mobile apps (Apple and Google Play stores) and
- traditional bricks-and-mortar high-street storefronts

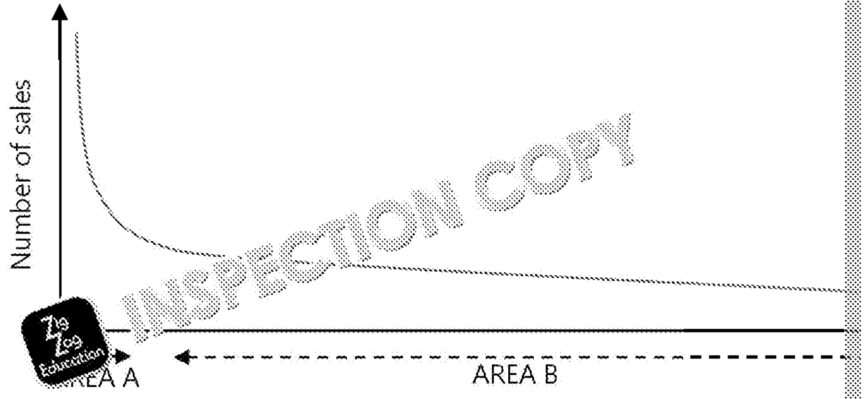
There is, of course, a plethora of online firms on the Internet that do business without even needing a physical presence. Consider eBay and Amazon: these highly successful businesses sell products and services without anyone having to set foot in their buildings. This allows digital firms to slash their costs and offer extremely attractive prices to the consumer.

Much of the successes and failures linked to the advent of digital relate to the cre place, i.e. the necessity for certain businesses to collapse so that other new firms c In the case of digital, rather than a gradual collapse and rebirth of the market, we (in business terms at least). In only a matter of years, the entire marketplace has c normal for people to choose, rather than walking into town to do their weekly sho laptop, tablet or smartphone.

2.1.4. Questions

7. Jam and Banana is a small business that specialises in the production fruit conserves (marmalade, jam, etc.). The company is owned and o friends, who started Jam and Banana after meeting at a music festiva Banana's products are handmade and so the company's consumer ba

a) Identify on the following graph (Area A or Area B) where you thi belongs.



b) Explain how Jam and Banana could potentially move itself into th

8. Which of the following digital elements has had the most effect on th your answer.

Price-comparison sites *Viral marketing* *Soci*

2.1.5 How Small Firms Compete

Small-firm Survival in Competitive Markets

As businesses grow, they benefit from economies of scale – from being able to af
negotiate lower prices to spreading the fixed costs of production across a larger q

Once they reach a peak in profitability, rather than expand, many businesses mak
reason for this decision is that firms can achieve a form of *competitive advantage*.
three main headings: *innovation*, *architecture*, and *reputation*.

Innovation

By remaining small, businesses can avoid dilution of their core competencies and
do best.

- **Product differentiation:** small businesses can maintain their differences fro
certain areas of the market and becoming the experts in their trade. This, rat
thinly across all segments of the market, allows small businesses to improve
selling points (USPs) that make them stand out from the larger competition.
- **E-commerce:** while many large retailers began as bricks-and-mortar shops a
trade, small startups have the advantage that they can begin trading online a
expensive) presence. Moreover, much like product differentiation, small busi
the online sector and become the benchmark for quality in this area, too.
- **Niche Markets:** small businesses can take advantage of the demand for spe
firms fail to satisfy. In many cases, customers are willing to pay high prices fo
companies can earn high profits for each sale.

Architecture

A small business is able to maintain tight controls over its network of internal (em
customers, etc.) relationships. It can also be much easier for small businesses to n
cooperation than large ones because employees feel more directly responsible fo

- **Positive management:** with a relatively short chain of command, business own
in company processes, which can help with motivation of staff and, ultimately, h
- **Shared strategy:** since owners have a closer relationship with their staff, it is
strategic and tactical decisions. This also means that any changes can be diss
efficient rate, allowing the business to react quickly to internal and external i
keep all stakeholders informed of aims and objectives, ensuring that everyon
ultimate goals.

Reputation

Quality is vital for a business when it comes to asserting competitive advantage. R
operation has its benefits here, too:

- **Flexibility:** with a short chain of command (compared to that of a larger firm
relatively quickly to any changes in customer requirements. This sort of flexib
reputation with customers and also works as a promotional tactic to entice m
- **Customer service:** the flexibility of a business is increased by the fact that it
rather than reams of bureaucracy. As such, small businesses are also able to
it comes to customer assistance. Once again, this improves the business's rep
base and acts as an attractive element to any potential new customers.

2.1.5. Questions

9. Identify how firms benefit from staying small with regards to innovati
architecture. Choose one firm for each focus.
  - **a)** Innovation
  - **b)** Reputation
  - **c)** Architecture

10. Haverford West Caravans is a small business owned and operated by
Nikolai. The pair rent caravans to tourists for anywhere from one nigh
have experienced considerable growth in recent times and demand fo
increased significantly.

John would like to expand the business by hiring more employees, wh
business should stay small.

Decide who you think is correct in this situation and explain why this

2.1 Key

Profitability:	how profitable a business is, comparing gross, opera sales revenue
Horizontal integration:	when two or more businesses merge at the same st
Vertical integration:	when two businesses merge from different stages o
Conglomerate integration:	merging of multiple businesses that are all at differe process
Unique selling point (USP):	a feature that makes a product/service appear diff
Objective:	a business's objectives are those goals/targets requ
Competitive advantage:	firms that positively distinguish themselves from the c the competitive advantage, or *the edge*, over thei
Differentiation:	the ways in which a company gains competitive ad product branding, price, marketing and customer s

2.2 Firms, Consumers and Elasticities of

2.2.1 Price Elasticity of Demand (PED)

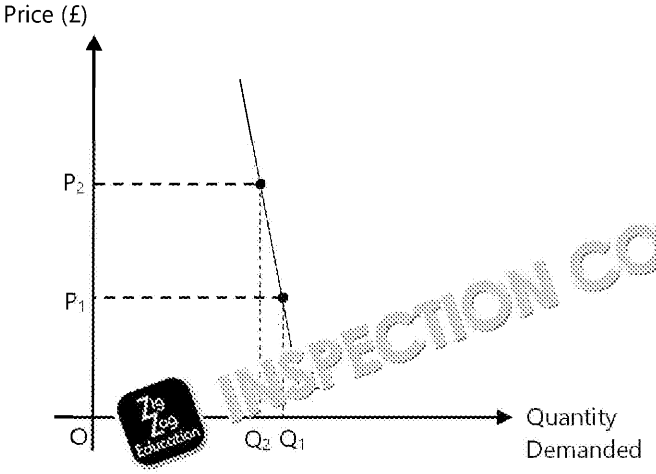
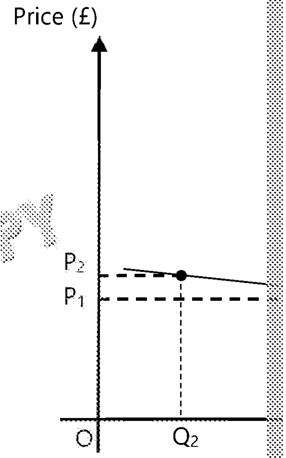


Diagram: Inelastic demand



Di

Elasticity of demand measures the amount that quantity demand will change as a surroundings. Elasticity of demand can be thought of as the sensitivity of demand demand. There are different types of elasticity that measure the responsiveness of factors. You will only need to know about price elasticity of demand for your exan understand to begin with but this topic will make more sense as you read on.

The type of market in which a product exists has significant effect on its PED. Mass markets, for instance, such as value-brand crisps and toilet paper, are subject to extreme price competition and so consumers can be heavily influenced by the perception of good value. The demand for niche market items on the other hand, such as high-quality journals and glassware, is much less affected by price. Instead, consumers often look for the one product that best fits their needs and that is of a high calibre.

Is the market or niche?

Price Elasticity of Demand

Price elasticity of demand measures how much a change in price will change the a demand. If prices rise you are likely to buy less of the good but what elasticity of you will reduce your spending by.

Think of your favourite flavour of crisps. How many packets of crisps would you be would you buy if the price increased to £1, and how many would you buy if they r you think is too expensive and instead swop to another flavour, or another produc

If something is price inelastic it means you are unlikely to change the quantity you as a response to the change in price. As you can see on the diagram of inelastic d This is because, although there is a large change in price (P_1 to P_2), there is a relati demanded (Q_1 to Q_2).

If something is elastic it means you are likely to change your quantity demanded b response to a change in price. As you can see on the diagram of elastic demand, t because, although there is a small change in price (P_1 to P_2), there is a relatively la (Q_1 to Q_2).

The formula for elasticity is derived by calculating the gradient of the line:

$$gradient = \frac{\Delta Y}{\Delta X}$$

However, because the demand curve is negative, for ease we use the 'negative re produce a positive number. For those who don't do maths, this means we 'flip' the is concerned with percentage change, we get…

$$\text{PED} = \frac{\Delta \text{ Quantity Demanded \%}}{\Delta \text{ Price \%}}$$ percentage change is calculated like this =

- If PED is **greater** than 1, then it is **elastic**
- If the PED is **less** than 1, then it is **inelastic**
- If the PED = exactly 1, then this has unitary elasticity, which means a change change in quantity.

It is the magnitude (size) of the elasticity that is important, not the sign. The nega negative relationship between price and quantity demand (which is the law of der focus on the size. The exa [illegible] the elasticity to **1 decimal place!**

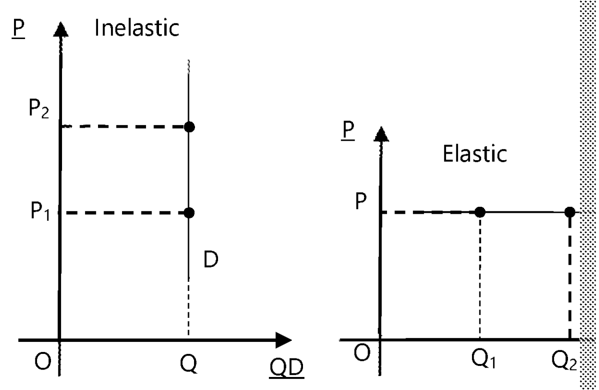
For example*, if the price for a magazine rose from £3 to £3.50 in a corner shop, and th bought the magazine fell from 20 to 15, what would the elasticity be?*

Q: old = 20, new = 15 *(percentage change in quantity)* $\Delta Q\% = \left[\frac{(15 -}{20}\right.$

P: old = £3, new = $3.50 *(percentage change in Price)* $\Delta P\% = \left[\frac{(3.}{}\right.$

$$PED = \frac{-0.25}{0.17} = -1.5$$

We ignore the '–', so the PED is 1.5. Because 1.5 > 1 the demand for the magazine i



The graphs above only show 'relative elasticity' and 'relative inelasticity'. Perfectly demands are shown in the diagrams below. Perfectly inelastic has a PED of (exactl demanded will not change with a change in price. Perfectly elastic has a PED of in change with no change in price.

The elasticity of a good has a relationship with the revenue a firm recieves.

Factors that Influence Elasticities

Substitutes (Uniqueness of the Product)

If there are lots of available alternatives then customers can easily 'substitute' one therefore are likely to change their consumption as a response to a small change substitutes usually have elastic demands. On the other hand, if the good is unique then it is likely to have an inelastic demand. This is because customers cannot eas instead have to limit the amount they use; reducing their consumption is easier th another good.

Necessity of Luxury
If the good or service is essential the consumers are unlikely to change the amoun fundamental to consumers will have inelastic demands. A luxury good, such as tic more elastic demand because it is not vital and consumers can forgo the good an sensitive.

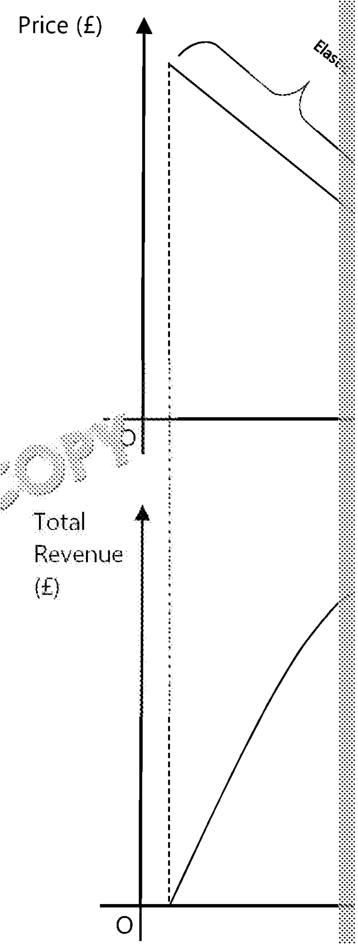
Proportion of Spending
Something that is relatively cheap takes up a smaller proportion of total spending expensive. Goods and services that make up a smaller proportion of expenditure w which make up a larger proportion. For example, consumers are more likely to cha electricity if the price were to rise than they would be to change their consumption is because the price of the good that makes up a larger proportion of expenditure

Time Period
People are more likely to change their consumption in the long term than in the i variety of reasons. First, people may not change their consumption of a good bec over time. Equally, people may take time to collect information and make decision before switching. Last, people may be unable to change immediately because the phone contract, if the tariffs increase, people may not be able to swap for a few m stay with a company. Demand tends to be inelastic in the short term but elastic in

Habitual Consumption
If people are used to buying a good, then they are unlikely to change their consu is difficult for people to recognise and adapt habits and therefore people are likel goods they are used to buying. Goods that are habitually consumed will have inel

Price Elasticity of Demand and Total Revenue

First, let's look at price elasticity over the demand curve. The price elasticity of demand varies as you move across the demand curve. This is because the ratio of quantity to price changes and the significance of a changed price varies. At the top end of the demand curve, prices are high, so a change in price is likely to have little significance, e.g. if a good was £1.50 and rose to £1.70 you're unlikely to change the amount you buy. However, at the bottom of the demand curve, prices are low and a change in price is more noticeable, i.e. if a good was 20p but increased to 40p you are more likely to change your consumption. Additionally, at the top end of the demand curve, prices are high and quantity is low so $\frac{P}{Q}$ is high. As this is the equation for elasticity, at the top end of the demand curve elasticity is high. At the bottom end of the demand curve prices are low and quantity is high so $\frac{P}{Q}$ is low and elasticity is low. In the middle, quantity and prices are the same. This is where unit elasticity is found, where the change in price will equal the change in quantity.



Total revenue is the total amount of money a firm has received for all its goods ar good multiplied by the total number sold. Elasticity affects the total number of go effect on total revenue.

$$TR = \mathrm{P}\ \times \mathrm{Q}$$

At the top end of the curve where the price elasticity is elastic, a change in price w quantity. Although price has decreased (which would decrease elasticity), the qua overall total revenue would increase. This can be seen on the diagram.

In the middle, a decrease in price will cause an equal decrease in quantity, the rati decreasing quantity is the same and the overall effect is that total revenue will not

On the bottom half of the demand curve, where it is price inelastic, a decrease in p in quantity. At this point, the increase in quantity is not enough to offset the decre begins to fall.

2.2.1. Questions

1. **a)** What is meant when a good has a relatively price-inelastic demar
b) Draw a perfectly price-inelastic demand curve.

2. **a)** What is meant when a good has a relatively price-elastic demand
b) Draw a perfectly price-elastic demand curve.

3. The price of a fizzy drink has increased from £2 to £2.50, while the de 1,000 customers to 700 customers.
a) What is the price elasticity of demand?
b) Does this value indicate the good is price elastic or price inelastic
c) What is the total revenue of the fizzy-drink company before and a
d) Does this indicate the fizzy-drink company was at the top end or curve and why?

2.2.2 Competing on Price

Pricing Strategies

Price Skimming

Microsoft pr
consoles

This involves charging a higher price on release of a product or when it is in the growth stage of the product life cycle. Companies use this technique as a way to make back a significant portion of the funds that lead up to a product's launch, such as research and development and production costs. This strategy is often used by games console manufacturers. There is a risk, though: if one games company releases its new console at a high price at the same time that another new console enters the market at a similar price or lower, this could result in a significant loss of potential sales.

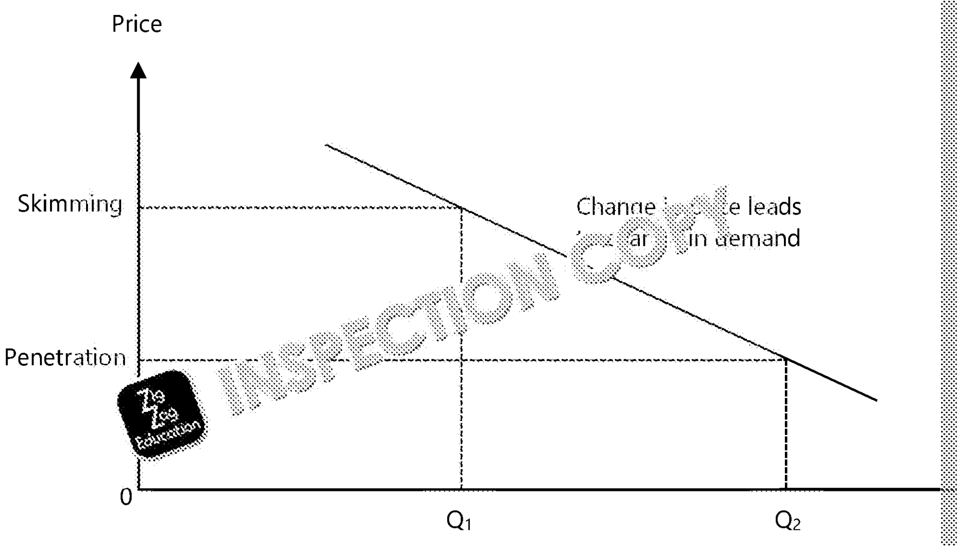
Price Penetration

At the other end of the spectrum is price penetration: this is when a company cha
their product or service. It is sometimes used on the launch of a new product a
and quickly gain market share. A publisher, for instance, may use this technique t
new magazine. The drawback to this technique comes if other businesses decide t
price war on your hands, which is not good for anyone (except perhaps the consu

Price Skimming	Price Penetration
When the price of a product is inelastic	When price is very elas
Quickly recoup costs of R&D	Recoup costs of R&D
Product life cycle is relatively short	Product life cycle is lor
Barriers to entry are high	Barriers to entry are lo
If PED is unknown, it is better to be safe with a high price on introduction	If a business is able to volumes, it can save m

Table: Why businesses choose price skimming or price pe

The graph below shows the relationship between demand and price when a busin
penetration or price-skimming strategy. When a business enters the market with a
than the rest of the market (price skimming), demand will probably be low. On the
in at a ludicrously low price, undercutting all competition, demand should go up.



Graph: Price penetration vs price skimming – adapted from Baine

Competitive Pricing

Price leadership is common in oligopolistic markets, such as the airline industry. C
set the price for a product or service and then all other businesses will follow. The
established company that controls the largest market share due to selling high-qu
setting the going rate, price leaders demonstrate their dominance and premium s
retain brand loyalty, as customers perceive them as the high standard. It also mea
has lower price elasticity of demand (PED) since customers will be more willing to
believe the product is of the highest quality.

A market that has clear price leadership will have a number of *price takers*. These a
market price set by its price leader/leaders. Price takers cannot compete on price
is high – if a price taker decided to increase the price of its product, consumers wo
competitor that offers it at the market price.

Price discrimination, or *yield management*, involves a business charging different p
same market. An example of this is the theatre, where businesses will manage the
of day or target audience, e.g. matinee performances tend to be cheaper.

Perception [illegible]
Price leadership can turn into *collusion* if the market price of a product/service inc
needing to rise.

Nowadays, it is illegal for businesses to get together and decide on the price of a
that collude together to fix the price of a product/service is called a *cartel*.

Cost-Plus Pricing

One common method that businesses use to determine how much to charge for t
Plus pricing. This method involves calculating the average cost of producing an in
a *mark-up*, which considers how much consumers would actually be willing to pay

$$\frac{\text{Total budgeted cost} + \text{Mark-up}}{\text{Budgeted sales in units}}$$

The following data shows figures for Larry Wellington's shoe shop. Larry plans to
to charge a mark-up of 25% on each pair of shoes. Larry has budgeted for £10,00
cost of each sale will be £2.00.

Total budgeted fixed costs	£10,00
Budgeted variable cost per unit	£2.00
Mark-up percentage	25%
Budgeted sales in units	5,000

Total cost:
= Total fixed cost + Total variable cost
= £10,000 + (£2.00 × 5,000)
= £20,000

Mark-up:
= £20,000 × 0.25
= £5,000

Total cost + Mark-up:
= £20,000 + £5,000
= £25,000

Budgeted selling price per unit
= £25,000 ÷ 5,000
= £5.00

The final price per unit is £5.00. This includes the cost of the item plus mark-up to

Price Tactics

These are the short-term price manipulations that companies use on a day-to-day over their rivals.

Discounts: Companies offer discounts for a short time as a way to stimulate dema include two-for-one offers and buy-now-pay-less schemes.

Special promotions: A company may choose this tactic if sales decline for one of it sometimes uses this tactic, for example, by offering eight cans in a pack instead o

Loss leaders: This tactic involves selling one product at an artificially low price in o see what else is on offer. Supermarkets often stock loss leaders, a DVD player for the attention of customers and bring them through the door.

Psychological pricing: A company might want to target £10 for its product, but decid emotional tactic that plays on the fact that £10 is not as much of a bargain as £9.9

Predatory pricing: When a business sets a price so low that it threatens to destroy market's barriers to entry. This sort of pricing should only be done in the short ter afford to make such losses. Businesses must be careful, though, not to go against Fair Trading.

Factors that Influence Pricing Strategy

Businesses make pricing decisions based on a mix of factors. Some of these factor while others are external.

Competitors: Are there other similar products or services available on the market? product differently depending on its price. Product differentiation comes into play points (USPs) of a good can have significant sway over how much consumers valu to decide on appropriate pricing. Firms should take care, though: make their prod the crowd and they might just lose their audience.

Costs: Can the product be manufactured at a cheaper rate? Businesses need to un to introduce a product to the market and the profit they wish to make.

Demand: Businesses must understand the price elasticity of demand for their mar *price elastic*, any increases to its price could *significantly reduce* market demand (e can live without these goods and may choose to buy something else if they beco demand for a good is quite *price inelastic*, any changes to its price may *not make* petrol or bread: these goods are essential to our society and so people will proba even when prices go up).

Pricing objective: What is the business objective? Is it looking to expand? Increase have a bearing on which strategy a business chooses.

Target audience: Does the business want to sell to the general public or to a speci the audience for a product or service have a particular age range? A business will setting a price.

Product life cycle: Does the product have a long or short life cycle? If the life cycle long, the business can afford to charge less because it will make sales over a long period.

The marketing mix: How different is the product/service from its competitors? Do the brand have a strong presence within the market? A business must also consid whether it is a price leader or taker. If the business is a leader with a strong brand, product will be less price elastic.

Changes in Pricing to Reflect Social Trends

The rise of the Internet has given way to more innovations in communication tha
predicted – and the world continues to change, as does business.

Online sales: Pioneered by Amazon, online selling is a firm fixture in today's marke
you find something you like, there's no point putting any money down until you'v
sold online can be much cheaper since producers do not need a physical location

Price-comparison sites: No one likes buying car insurance, and before price compa
Now, you can go online, choose your price range and instantly find a list of packa

Both online sales and price-comparison sites have created a climate of competitiv
work in a price-transparent environment – if customers don't like your price, they
the same product. Due to this, marketers need to reconsider their pricing strategi
parts of the production process (such as packaging) in order to reduce cost and p
consumer. Another method is to use *loss leaders* as a way to encourage consume
businesses, such as supermarkets, that offer a variety of products and services.

2.2.2. Questions

4. a) Bill Oddity plans to open a birdseed shop. He has projected that h
bags of seed in his first year and would like to charge a mark-up
below to calculate the price per unit (bag of seed) that Bill shoul

Total budgeted fixed costs	£1,500
Budgeted variable cost per unit	£0.25
Mark-up percentage	20%
Budgeted sales in units	25,000

b) What would happen to the price per unit if Bill increased the mar
Do you believe consumers would pay this price? Explain your ans

5. Identify and explain two factors that can influence a business's pricin

2.2.3 Types of Non-price Competition

There are many forms of non-price competition (from advertising and promotion distribution). Each form of competition can affect the *position* of the *demand curv* consumer demand grows ever greater.

Let's look at some of the ways in which companies can increase their competitive

Differentiation in the Design Mix

Markets are always changing and so is consumer expectation. What was acceptab considered out of date today. Businesses often react to consumer trends by creati innovating on an existing product to make it more appealing (e.g. changing desig Dyson understood that the vacuum cleaner was a source of frustration for many p he invented the 'bagless' vacuum.

Another method is to introduce an existing product to a new market (e.g. repacka audience or marketing to different countries). Once only found in colder climates, a thriving market in many African countries.

Whichever method it chooses, a company will ensure it has a complete design mi

The *design mix* splits into three main areas: function, aesthetics and cost. Some fir costs first and address the other elements later. Other companies may concentrat time. Airlines, for instance, were once seen as a luxury and so aesthetics were very luxurious comfort). Nowadays, economy airlines have changed the way we think a something more people can afford and so the design mix has had to change, too.

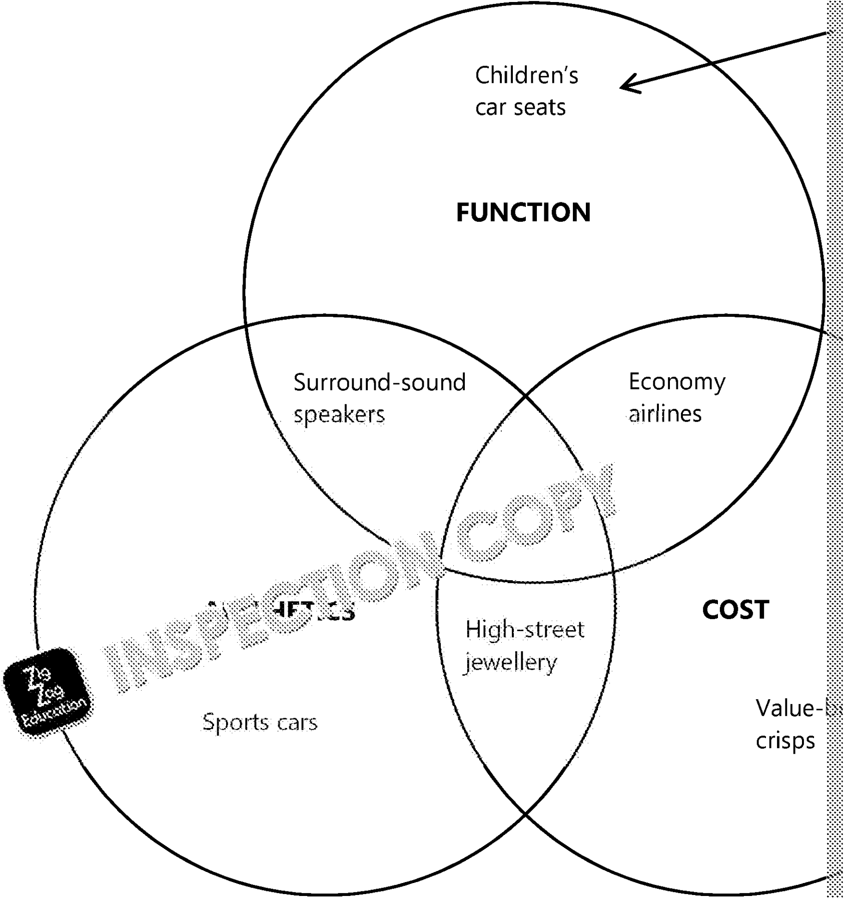


Figure: Example products and services in the design

Some Things Never Change
Businesses have to understand their markets and be aware of what competitors a
coming to the end of its life cycle, for instance, a business should be ready to intr
on the current product.

Some things, however, never seem to go out of fashion. Coca-Cola and Cadbury's
impressively long life cycles. Even when consumer tastes change, these products a
through an effective design mix.

How the Design Mix Can Change

Firms decide how to manage their design mix using a variety of factors, including competition, customer expectation, environmental issues and the market. They also need to take into account their own business objectives. If a business is looking to maximise profits, it has to consider whether the best way to achieve this is by cutting costs, making the most attractive product or offering a unique selling point that no other brand has.

Changes to Reflect Social Trends

The design mix of a firm can change depending on a variety of internal and extern
may change in a few years. A business must be able to react to this and fulfil cust
someone else will!

Sustainability: This has become an integral aspect of business – not just because
because this is what consumers expect. As such, many firms have led the way in te
recycling by starting or joining schemes that give back to the planet (e.g. reducing
required to ship a product or planting trees for every three products sold).

Ethics: General business practices have had to change, too. In today's digital worl
consumer to research an organisation and learn whether their processes are ethic
promote the fact that they use suppliers that pay fair wages to factory workers, w
fashion industries have worked to stamp out animal cruelty from their business p

Health: The modern consumer is no longer willing to just buy something without
Fast-food chains, such as McDonald's, have had to change their product ranges i
for healthier options. This rise in demand has also brought organic food into the
certain independent shops, consumers can now buy organic produce in most ma

Technology: Technological advancement has the power to influence how firms do
have as consumers. Online shopping is now the norm – and home delivery, too. Y
electronics shop, find a TV you like and look up prices on your phone while you're
change their models to match this – and you can now order anything you like onl
like, too, with films and TV series available directly to your television, laptop, mo
and surely there are more to come!

Government: Legislation, such as that in reaction to climate change, has created a
to behave more responsibly. This can be seen in equal employment policies, but a
are now being introduced. Have you noticed an increase in wind turbines or solar

Business objective: Whether a business is looking to survive, enter a new market,
a market leader, it will need to formulate a working design mix. For survival, the b
increase sales. However, if it wants to become market leader, it may need to focus
develop a unique selling point.

A unique selling point (USP) is any feature that makes a product appear different
created through intense research and development while others come out of ext

Advertising, Promotion and Branding

The promotional mix, also known as the *marketing communications mix* or *marco* communications that a company uses to promote its products or services. From p sponsorship and advertising, promotion is an essential part of any business.

Public Relations

Companies use this technique as a way to *increase selling potential* of their produ image for the external market to see. They achieve this in many ways, such as spo positive media coverage (in the news), encouraging employees to have a respectf anyone in contact with the business and understanding how to handle negative p

Advantages of Public Relations:

- Businesses promote themselves through storytelling, which can incite great interest.
- Through this promotion, businesses create a name for themselves, which consumers remember.

Disadvantages of Public Relations:

- It is difficult to measure success with this method.
- Once a business story is released to the press, it can become skewed through word of mouth.

Direct Marketing

This involves contacting carefully selected target audiences on an individual basis, through 'personalised' letters. Direct selling initiatives aim to get an immediate re create long-lasting relationships and build on their customer database.

Advantages of Direct Marketing:

- Businesses can track the success of their work.
- Companies can test the usefulness of a method before opening it to a full-sc

Disadvantages of Direct Marketing:

- Many consumers do not want to be contacted, especially in an unsolicited m
- This form of promotion can lead to poor-quality leads.

Personal Selling

Businesses will often send a sales representative to meet with potential customers to promote the human side of the business, injecting personality into the marketi

Advantages of Personal Selling:

- Person-to-person means the method can be adjusted to whomever the busi
- This is a good way to build strong personal relationships.

Disadvantages of Personal Selling:

- Personal selling has a high cost per action (CPA), i.e. the price of finding a co
- Employees require training in order to practise personal selling.

Advertising

This consists of any paid form of communication that is not personal. Companies consumers and persuade them to buy their product or service without having any advertising include newspapers, television, radio, buses and bus shelters, hoarding cinema.

Advantages of Advertising:

- The potential for consumer reach is great.
- Some types of advertising can be easily tracked.

Disadvantages of Advertising:

- If an advertising campaign becomes too ubiquitous (i.e. you see/hear it every backlash from consumers who now hate the company – is all publicity good
- Potential for reach is great, but targeting can be impersonal and so consume

Sales Promotion

This is a short-term *incentive technique* designed to encourage and persuade the service. Examples of this include in-store samples and demonstrations, competitio time/inventory offers and buy-now bonuses.

Advantages of Sales Promotion:

- Promotions can help encourage repeat purchases.
- They can also entice customers who previously may have been reluctant to m

Disadvantages of Sales Promotion:

- The sales from promotions can often be one-time purchases and then never
- They are also expensive to manage (i.e. if the promotion does not work, the f

Sponsorship

Companies use sponsorship to promote their products or services to consumers t Examples of this technique include sponsoring live events, organising product pla and celebrity endorsement.

Advantages of Sponsorship:

- If people like the sponsored event, the business's brand can receive a positiv
- Since people are already watching the event, the firm can easily disseminate

Disadvantages of Sponsorship:

- If people dislike the event, the brand receives a negative knock-on effect.
- Some events, such as the Olympic Games, are so big that numerous brands s clutter and so limited genuine brand exposure.

Digital Communications

Information technologies allow businesses to reach out to more potential custom scope for online advertising, product-focused apps, mobile adverts, user-generate social-media sponsorship.

Advantages of Digital Communications:

- Businesses can target the consumers they want through paid search results a
- Digital is much cheaper than physical communications, such as newspapers a

Disadvantages of Digital Communications:

- Since most brands are looking to advertise, there is great potential for ad clu
- As consumers become more Internet-savvy, they are learning to ignore digita

What Influences a Business's Choice of Promotional Mix?

Choosing the right promotional mix depends on the business and its objectives. S

- *Budget:* How much money has been allocated to the company's promotional
- *Competition:* Who is the competition, what is their potential threat and what to combat them?
- *Promotion objectives:* Are the promotion objectives to create product awaren or generate sales or enquiries?
- *Product:* What mix would best suit the product?
- *Product life cycle:* What stage is the product at in the life cycle?
- *Target market:* Who are they? What do they need or want? When do they ne and why?

What is Branding?

While promotional activities can be used to generate an immediate reaction, so th consumers buy a product or service (e.g. a clothes shop advertising a limited end- season sale), companies use branding as a way to increase *consumer recognition* o their product, service or name.

Businesses invest in branding as a way to promote the way they wish to be seen. strong brand means less reliance on direct selling, sales promotions or price cuts, the customers will hopefully come to you! Branding also helps create a personalit a product, service or business.

Types of branding include:

- manufacturer/corporate
- product
- own-brand product

Manufacturer/corporate: This branding focuses on the business itself by getting th along with [illegible] who they are and why their products or services stand out a example, are considered high quality by consumers due, in part, to the products t brand that the company has managed to create.

Product: Companies that invest in this type of branding want to ensure their prod thinks of when they have a specific need. Many companies promote a select few *f* which are the most successful things they sell. Microsoft Corporation's flagship pr Windows and Office.

Own-brand product: This branding started as a way for some supermarkets to offe consumers (Tesco Value, for example). Nowadays, most supermarkets offer their o their own 'Essential' product range. How do you think Waitrose's own-brand prod products?

Rebranding is a marketing strategy in which a company changes a brand to give i Companies rebrand by creating a new name, term, symbol or design (or a combin consumers, stakeholders or suppliers will see the brand differently. Some rebrand while others fail miserably.

Generic vs Branded Products

Strong branding can significantly *add value* to a product, compared with generic, unbranded products. This allows the producer to command large areas of a market. If consumers see a brand as particularly high quality, they might be willing to pay a premium for it and even seek it out directly. This can lead to a reduction in *price elasticity of demand (PED)* for the product, meaning the producer can charge a higher rate without affecting the number of sales.

Once the
brand

Having a strong brand can also help create *barriers to entry*, which keep potential competitors from joining the market.

Creating a brand is still a risk, though: just because a brand is well known doesn't mean it will be successful. If a brand has a history of providing low-quality products, for instance, the producer can have major difficulty when they finally try to turn the business around. Consumer opinion is difficult to shift!

Another pitfall in branding is to make your product so famous that every similar, by the same name. These products are called *brandnomers* or *generic trademarks.* Velcro, Sellotape, Pritt Stick and Tannoy.

How to Build a Brand

Differentiation and Unique Selling Points

Differentiation is how different a product appears compared to its competitors'. Many companies choose to invest in differentiation rather than cutting prices for several reasons:

- Price cutting can create a negative image for a product or service, because many consumers still associate quality with price.
- If a product appears different enough from its competitors (in a positive way), consumers are more likely to remain loyal.
- A brand image of high quality allows the producer to charge a premium without losing sales.

Dy
techn
Th
D
desi
comp
Chir
neve
only

One way that a business can achieve differentiation is through *unique selling points (USPs)*. Examples of types of USP include:

- design
- after-sales service
- unique features
- distribution
- quality
- durability

A business looking to differentiate itself from competitors must first understand w
markets, for instance, quality is the most important factor, while in other markets,
convenient form of distribution (e.g. online, home delivery).

Whenever a business considers a promotion or branding strategy, it must also tak
competitors – what are other companies doing and where is there a gap? The bus
strategy as part of its marketing mix, alongside the other three Ps: *Price*, *Place* and

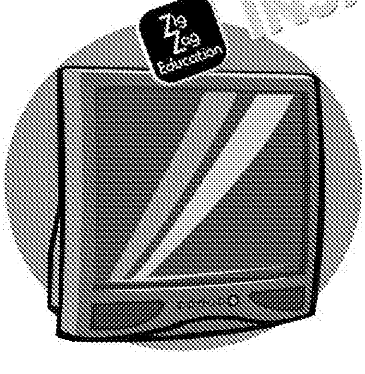
Advertising

Businesses advertise their products and services in many ways, including print (ne
hoardings (or billboards), television and radio (commercial breaks), public spaces
metro/tube tunnels) and online via web-page banners, search-engine results, and
advertisements.

Advertising generally comes at a high price. This strategy works well for businesse
can afford to reduce their profit margins, but smaller businesses will struggle to c
the volume of advertising, such as cereals, this can also prevent new firms from er

In the 1990s, Budweiser beer were looking for ways to reinvigorate their brand for
(between ages 21 and 30). The company decided on a TV advertising campaign in
brand name as 'Bud...weis...er'. The advert played during the Super Bowl and was
Budweiser to the 21–30 market. The campaign won numerous advertising awards
most brilliant of its time.

Changes in Traditional Advertising



In the past, if you advertised on a TV channel suc
UK would have seen your product. Nowadays, ho
channels, and different ways to watch them, that
most cost-effective option. Commercial breaks ar
attention any more. Advertisers now use mass me
product placement and live-event sponsorship.

Sponsorship

The use of product placement in television shows c
practice for brands. Why do you think this is happe

Some brands choose sponsorship over advertising. This involves giving support (u
something in exchange for an increase in brand awareness.

Examples of sponsorship include:

- sponsored events
- product placement (film and television)
- social-media sponsorship
- celebrity endorsement

English footballer David Beckham is arguably as famous for his fashion tastes as fo
years, Beckham has taken part in many sponsorship campaigns with big-name bra
Armani, Samsung and Burger King.

A controversial form of sponsorship is the *advertorial*. This is a printed brand adve
formatted to seem like a genuine article. Newspapers and magazines receive paym
but they must clearly show that they are advertisements. However, it is not always
between article and advertorial.

Emotional branding
This form of branding plays on the emotional states of consumers; their needs, wa
use advertising to promote its product to consumers and associate it with an emo
Company, for instance, advertise the theme park Disneyland Paris with a focus on
Travel agents often run advertisements showing consumers their 'perfect getaway
friends and family coming together.

Distribution Methods

Any business that wants to succeed must make sure its product or service is availa
time and in enough abundance to satisfy demand. In order to achieve this, a busin
develop the appropriate distribution network for its product or service.

If a business has not considered these factors, it may fail to draw attention or satis
the newest technology in the right place, for instance, if there aren't enough prod

A distribution network shows the journey that a product/service takes to get from
the right distribution method is essential. Distribution networks should:

- encourage repeat purchases from consumers
- enable safe delivery of a product/service
- maximise the number of potential customers for a product/service
- ensure quick delivery of a product/service
- provide market information to producers and retailers
- create a positive relationship between producer and consumer

Distribution Channels

A distribution channel is the flow of organisations that connect a product from pr
member of the channel plays its part. If a small-scale producer was to handle distr
business expenses would be high, making the product cost more for the consume
some form of distribution channel.

There are three main flows in distribution and these can be separated into two gro
channel.

Short-channel distribution, or direct marketing, involves just two organisations in t
consumer.

Two-stage distribution

This method is commonly used by businesses that sell large machinery or equipm company, for instance, will manufacture a new product and then use direct selling consumers.

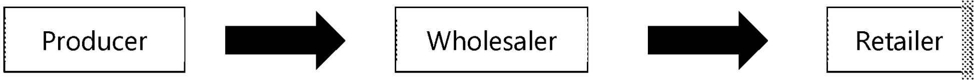
Long-channel distribution, or indirect marketing, involves the producer, consumer the way. These intermediaries can be anyone from wholesalers and distributors to resellers.

Three-stage distribution

This is the distribution method of choice for electrical goods manufacturers. When a creates a new product, it will then sell directly to retailers who then set a price for th

Four-stage distribution

Wholesalers act as *middlemen* between the retailer and producer by buying up lar four-stage distribution, the producer could be a cheese farmer, who provides the bulk. The wholesaler then breaks the cheese into smaller quantities and sells it to country, such as supermarkets, newsagents and corner shops. Retailers then sell th



Choosing the Right Distribution Network

The aim of a distribution network is to deliver a product/service on time and in go must make sure to choose the right one. In order to choose the most relevant net the following:

The Product

If the product is *new to the market*, it may need to be introduced to the customer *explanations*. Consequently, it would be inappropriate to sell it through general re types of machinery, equipment and tools may best be sold at trade shows, or thro The sale of such products should be backed by an extensive advertising and mark

The Market

Products that are extremely *specialist or particularly expensive*, e.g. ships, earth-mo relatively small *customer base* and, therefore, tend to be made available to buyers *specialist retailers*. This is different for *general household groceries*, which have a ve therefore, can be bought from a *large number of outlets*.

Legal Restrictions

The law of the country may determine *where* certain goods can be sold. For examp purchased from a chemist's shop.

Customer Expectation

Customers *expect to buy certain goods in traditional establishments*. For example, b supermarkets and glasses from opticians.

Internet Distribution

Those four are not the only factors that drive a company's choice of distribution n
is a global one, with communication instant, and so businesses need to stay inform
them. This includes methods of distribution.

Consumers expect businesses (especially large ones) to offer their products and se
allow customers to buy their products/services in all sorts of ways, from website c
(e.g. PayPal) to mobile phone apps and online stores (e.g. Amazon and eBay).

These outlets, while all digital, are still costs for a business. Amazon, for instance, p
right 'place' in order for the consumer to see it and make a purchase. Google, mea
sponsor their links so that consumers find certain products before others. These ou
shops and trade shows, but they are still places in the distribution network and, the

Devising Appropriate Marketing Approaches

The marketing mix of a company can involve anything from distribution and prom
and product differentiation. Some companies will focus more on the price that the
firms will pay attention to the way they promote their products/services.

The choice of a business's marketing mix depends on three key factors:

- the nature of the product/service
- the company's potential consumers
- the market

A smartphone on the luxury end of the scale, for example, can sell for a high price
market do not need feel the need (at least, not much) to compete on price. In this
likely to compete with one another on design or distribution than price or promot
expect. A low-cost stationery manufacturer, on the other hand, may compete on p
anything else in the marketing mix – customers come for the rock-bottom prices a
company to invest much in product differentiation or distribution.

Ryanair is a great example of a company that soared above the competition by co
of the marketing mix. Most of the competition came from high-end airlines and s
– the people who wanted to fly but could not afford it. The company took away al
focused its efforts on offering the lowest possible price. This price initiative differe
rivals, growing shares of a market segment (low-cost air travel) that had previousl
thus the budget airline was born.

2.2.3. Questions

6. A beverage company wants to introduce a new fizzy drink to the mark traditional advertising (newspapers, TV, radio, etc.). How else could t their new product? Specify any examples.

7. Why are so many companies using social media as a way to advertise think there are any problems involved?

8. There is a four-stage distribution flow diagram.

Producer → Wholesaler → Retailer

Name an example for each stage of the flow diagram, e.g. producer =

2.2.4 Income Elasticity of Demand

Price elasticity measures how much a change in people's incomes will change the will demand. If incomes rise you are likely to buy more of a good. But what incom much you will change your spending.

Think about how often you might go to the cinema with friends if you were paid times you would go to the cinema if you were paid £50 or £100 a week.

The formula for income elasticity of demand is $YED = \frac{\Delta \text{ Quantity Demanded } \%}{\Delta \text{ Income } \%}$.

Percentage change is calculated like this = $\left[\frac{(\text{New value} - \text{Old value})}{\text{Old value}}\right] \times 100$.

Income elasticity can distinguish between a normal good, a luxury or necessity go

An example of a normal good would be a car. A normal good increases in deman would be expected. So in this example, as incomes rose, the demand for cars wou positive YED. A normal good can be split into two groups, a necessity or a luxu

A luxury good is one where the change in demand is proportionally more than the a necessity good. A necessity, such as a car, would have a YED of less than one. A would have a YED of more than one.

An example of an inferior good would be public transport. With an inferior good, the good falls. So in this example, as incomes rose, the demand for public transpo negative YED.

For example:

a) *Quantity demand for good X decreased from 200 to 150 when incomes rose by*

$$\Delta Q\% = \left[\frac{(150 - 200)}{200}\right] \times 100 = -0.25$$

$YED = \frac{-0.25}{0.2}$ *= −1.25, YED is a negative and therefore Good X is an inferior goo*

b) *Good Y's quantity demand increased from 180 to 240 when incomes rose by 2*

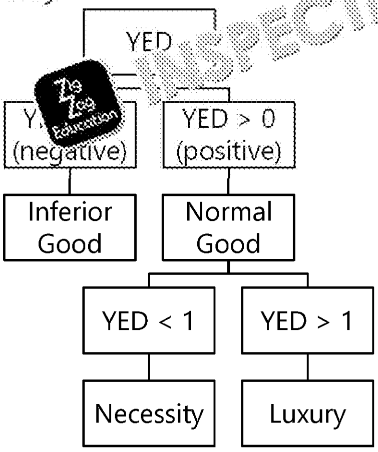
$$\Delta Q\% = \left[\frac{(240 - 180)}{180}\right] \times 100 = 0.33$$

$YED = \frac{0.33}{0.2}$ *= 1.7, YED is a positive and therefore Good Y is a normal good, 1.7*

c) *Good Z's quantity demand rose from 200 to 210 when incomes rose by 20%*

$$\Delta Q\% = \left[\frac{(210 - 200)}{200}\right] \times 100 = 0.05$$

$YED = \frac{0.05}{0.2}$ *=-0.25, YED is a positive and therefore Good Z is a normal good, 0. necessity.*



Significance of Elasticity of Demand

For firms it is important to know the elasticity of their goods when making decisic good is price inelastic then they decrease the price without fear of losing sales. Hc elastic they should carefully consider any price changes. As we have discussed, pri firm's total revenues. Similarly, knowing their income elasticity will allow them to p they can predict a rise or fall in incomes, such as knowing the economy is going ir

It is also important for governments to know elasticities when it comes to decisior the relationship between total revenue and elasticities for firms, tax revenue has a demand is price elastic then the producer will pay more of the tax. This is because increase the price it charges to customers without affecting the quantity demand. consumer will pay more of the tax. This is because the producer can easily pass or higher profits without changing the number of goods they sell.

Equally, the more elastic the demand, the less revenue is made for the governmer to the price will cause the quantity to fall and fewer sales means less tax is paid. H imposed a tax because they were trying to limit consumption, such as on cigarett demand the greater impact the tax will have.

Influences on Income Elasticity of Demand

There are many factors at play that can influence YED, the main ones being:

- whether goods are luxury, necessity or inferior
- expectations of income, such as promotion, job loss and recession
- the norm of the consumer market, i.e. the presumptions of consumers regarc

Simply put, consumers buy more inferior goods when times are tough and more l the rise.

2.2.4. Questions

9. An economy's average income rose from £25,000 to £32,500 a year w demanded for...

  a) Good A rose from 190 to 250 units. What is the income elasticity

  b) Good B rose from 180 to 190 units. What is the income elasticity

  c) Good C fell from 230 to 200 units. What is the income elasticity o

  d) Which good(s) is a...

    i) Normal good

    ii) Luxury

    iii) Inferior good

    iv) Necessity

2.2 Keywords

Branding:	This is the image that businesses create for a produc the[illegible]
Promotion:	This is how businesses build awareness of a product, such as direct selling and online advertising.
Sponsorship:	When a business supports another person/business i promotion, such as the sponsorship of sporting ever
Loyalty:	Brand loyalty (for a product, service or company) o to stay with a business and make repeat purchases
Competitive advantage:	Firms that positively distinguish themselves from the the competitive advantage, or *the edge*, over thei
Differentiation:	This covers the ways in which a company gains cor strong product branding, price, marketing and cust
Added value:	When a business turns the sum of raw materials into worth more. Value added is calculated as: selling p cost to create product/service.

2.3 Productive Efficiency

2.3.1 Productivity

Productivity

Production and *productivity* differ in a similar way to distance and speed, e.g. dista was able to go while speed shows how quickly they were able to do it. Production output a firm produces in a specific volume of time, while productivity gives the ra given time period (e.g. the hourly rate of output per individual input).

Outputs can include the productivity per person, per factory or per machine. Most their employees on how many sales they make. This productivity is measured thro

Let's use an example:
A textile worker might be able to produce seven pairs of gloves in one hour, and s their productivity would be seven gloves per hour. A machine producing the same gloves may be able to do so more quickly, increasing the productivity to, say, 35 pairs of gloves per hour.

This example shows that machinery is able to achieve higher levels of productivity human workforce. However, it is good to note that not all machinery can perform the same high quality levels as human workers. Many consumers also value handr goods over their machine-made counterparts and will pay more for the quality.

Factors that Influence Productivity

Businesses use all sorts of methods in order to increase their productivity, includin
- increasing the number of hours that employees work
- making changes to key business processes
- motivating the workforce
- purchasing new equipment, technology and premises
- increasing the amount of training that employees receive

There are downsides to these methods, however, which can lead to pushback fron
- employees very rarely choose to work longer hours
- while a firm may offer new training or change business procedures, their wor
- if a labour force is expected to increase its productivity, it may want to be rev
- whenever a firm announce changes that affect productivity, some members o threat to their jobs

Productivity and Competitiveness

Both of these terms are closely linked with the success of a business. Firms looking within a market (e.g. gain more market share) will explore productivity as a means

The operations department is normally the business area responsible for increasin processes that operations lead must be in line with the aims and objectives of the become more competitive in the marketplace, operations will need to support this by in

Firms concentrate on productivity as a method of becoming more competitive for
- Firms that cannot produce enough to fulfil market demand will lose out to m must, therefore, increase productivity in order to meet demand and stay rele
- Markets that have particularly price-elastic demand are very competitive and reduce their costs enough (e.g. by increasing productivity) so that they can c
- If a firm's main objective is to decrease their costs by 15 per cent, they can ac productivity. The more goods the firm can produce, the lower their overall co
- Service-focused firms will concentrate on productivity as a way to provide a b more goods/materials a business has available at any time, the more quickly demand and, hopefully, encourage further sales in future.

Productivity and Wages

With great productivity comes great output. Most businesses look to produce the they can – this way, they have more products/services to sell to their customers, p their rivals. The higher the output of a company, the more profit it can produce o

One way in which firms can motivate their employees to achieve high levels of pr attractive wages. As firms earn more profit through greater productivity, they can workforce. The more profit that a company makes, the more it can afford to pay it human capital occurs in other ways, too, such as providing training (which increas allowing staff more responsibility for overall operations and/or business managem

Productivity and Economic Growth

As wages increase with productivity, so does the average disposable income. If all were to raise the wages of their workers, the general consumer would have more *paribus*, would feed back into the businesses offering their goods for sale. This inc economy in the form of tax that consumers pay on all their goods and services.

In much the same way that high productivity helps increase the volume of output the economy grows. Growth in production levels for a business, and for an area of national output (GDP).

Once one area of the economy has reached a peak in productivity, the general wo another economic area which requires more labour capital. Economic improveme significant effect on the country as a whole – an economy that becomes well-kno instance, could increase the business it does with foreign nations that require this

Labour-intensive or Capital-intensive Production?

Businesses make the decision on whether to focus on labour- or capital-intensive skills and efficiencies available with each factor of production. Is the business's lab machinery? Could they produce more at a lower cost if they invested in more equ their size and position within the marketplace and the kind of service consumers r

Remember Me

Labour-intensive production (e.g. bakeries and hotels) involves mostly labour, whi (e.g. car manufacturers and transport) involves mostly capital.

When a firm understands which route is best for them, they can explore the differ become more efficient. These include:

- **Productivity of labour:** Encouraging the workforce to increase their product through assigning targets, motivation and/or better matching people's skills
- **Nature of processes:** Businesses must use the correct method of productior might use flow production since it needs to produce many goods all to the e
- **Capital utilisation:** The fixed costs of a business stay the same regardless of so a business must utilise these (e.g. equipment, machinery) to their maximun goods/services will become more expensive to produce.
- **Scale:** Businesses all look for profit and so they also look to grow. This can le purchases which help a business lower costs overall. However, if a business diseconomies of scale, such as poor communication through long chains of c
- **Innovation:** Firms are always looking for cost savers, ways either to produce efficiently or to deliver them more cheaply. Retailers that move online, for ins longer needing a shop window.
- **Lean production:** Businesses invest in methods to reduce waste, not only to a way to save money. Less waste (as well as fewer repeat processes) helps bu improve efficiency.

2.3.1. Questions

1. Explain which of the following factors can have a positive influence or productivity. There is more than one correct answer:
   - increasing the responsibility of employees
   - purchasing equipment that is more suited to the production task
   - reducing employee wages
   - improving the training process of new employees

2. Identify and explain two ways in which productivity helps a business b

2.3.2 Capacity Utilisation

Efficiency

This refers to the maximum output a business can achieve through a minimum nu
Efficiency involves everything from a business' workforce to their procedures, scal
(i.e. equipment and machinery).

Efficiency can be improved either by a firm increasing the number of outputs they
producing their outputs using fewer inputs.

Let's show that visually:

Efficiency method 1:

Efficiency method 2:

Capacity Utilisation

Firms calculate capacity utilisation to show their actual output and how it compar
output they could produce.

The equation for this is:

$$\text{Capacity Utilisation} = \frac{\text{Current Output}}{\text{Maximum Possible Output}} \times$$

Let's use an example:
Plastic People Ltd is a company that manufactures mannequins for fashion retaile
own three factories where they are able to produce a maximum of 50,000 manne
however, they have only managed to produce 37,000 mannequins each month.

$$\text{Capacity Utilisation for Plastic People Ltd} = \frac{\text{Current Outp}}{\text{Maximum Possible}}$$

$$\text{Capacity Utilisation for Plastic People Ltd} = \frac{37{,}000}{50{,}000} \times$$

$$\text{Capacity Utilisation for Plastic People Ltd} = 0.74 \times$$

$$\textbf{Capacity Utilisation for Plastic People Ltd} = 74$$

This calculation shows that Plastic People Ltd are performing at only *74 per cent o*

Full or Spare?
When a business is working at full capacity, it is using all resources that are availa
other hand, tells us that the business has some capacity left over and so it is missi
could potentially be making.

Implications of Under- and Overutilisation of Capacity

In the previous example for Plastic People Ltd, we showed that the business was u was not making the most of the machinery/workforce/equipment available. The o overutilisation, where a business runs at more than 100 per cent of its available ca

There are problems that come with underutilisation of capacity, including:

- The fewer resources that are used by a firm, the higher the fixed costs are to fixed costs are spread across more products, they will work out cheaper per u
- Firms that underutilise their capacity run the risk of not meeting demand whe case, a firm would have *excess demand* that it is unable to fulfil. This could lea negative image for themselves, of a firm that is not strong enough to compe
- The workforce of a firm that underutilises its capacity could be lacking in mot overachieve.

Overutilisation of capacity comes with many issues, too, including:

- The workload can get too intense for a firm's workforce, which then becomes
- Whenever machines or people do things quickly, they run the risk of reducing able to produce more goods in the given time, but each product may be uns
- If a business is already producing at over-capacity, they will have problems if higher, as the firm will have no way of fulfilling this surge in custom.
- Maintenance of equipment and machinery becomes near impossible since bu all times.

Silver Linings

It is worth noting that there are positives that come from both over- and underuti under-capacity, for instance, will have time available to do necessary maintenance demand. Overutilisation, on the other hand, will create maximum sales (if quality i profit, which can be reinvested into the business in order to purchase more capac meet demand.

Improving Capacity Utilisation

As we now understand, fixed costs do not change and so businesses should alway of the capacity they have available. This will help keep production costs low while fulfil potential demand.

A firm can make improvements to its utilisation (whether increasing or decreasing including:

- **Estimating the long-term levels of sales:** This will help the business prepar demand so that it is always working as close to the necessary capacity as pos
- **Creating more demand:** This can be done through promotion and brand str If a business has capacity to produce 100,000 units, for example, but does no work to create that demand.
- **Understanding the consumer:** This is normally done through primary and s more a business learns about its customers (and potential customers), the be make sure it meets demand.
- **Selling assets:** If a business is continually unable to use its entire capacity to consider selling some of their machinery/equipment. This money could the as promotion in order to create more interest in their goods.
- **Employing more/fewer staff:** Capacity can take the form of equipment, ma business has more employees than their consumer demand requires, they ma Likewise, if demand is high, the business could need more staff in order to ru goods.

2.3.2. Questions

3. Put the following statements into the correct categories.

Quality might be ignored and so can decrease to the point of products becomi

The fewer goods a firm produces, the higher the fixed costs per unit.

Maintenance of equipment becomes impossible as there is simply not enough

Workforces lack motivation as there is little drive to overachieve.

Motivation of employees decreases because the amount of work is too intense.

Firms are unable to meet sudden spikes in demand

Drawbacks of underutilisation	Drawbacks o

4. Explain the difference between full capacity and spare capacity.

2.3.3 Efficiency and Competitiveness Using Lean P

Quality Control, Quality Assurance, Kaizen and Total Quality Ma

Quality Control vs Quality Assurance

These two terms are frequently used in business and are often confused. Let's set
quality assurance and what is *quality control*.

	Quality Control (QC)	Quality Assura
Description	Analysis of quality in a finished good/service	Analysis of q business process used to pr goods/ser
Why used?	QC is a corrective method. It helps identify and fix defects in goods before they are released.	QA is a manager It helps improve of a business's p process
When used?	This is a reactive measure. Businesses make improvements to any defects at the end of the production process.	This is a proactiv Businesses fore processes need t place in order t defects from c

Quality Circles: One way for businesses to empower their workforces is to use *qu*
of their employees into groups (quality circles) and give them direct responsibility
helping to improve – business processes. The circles identify potential for enhanc
efficiency.

Kaizen

Kaizen businesses work to improve their processes with the idea that this should
outcomes. Unlike quality circles, which give responsibility to some employees, kai
of the workforce by continually asking for ideas on how employees believe their b

The kaizen method (also known as *continuous improvement*) can bring about man
benefits, including increase in employee motivation and productivity, reduction in
processes, higher quality and overall improvements to a business's final products/
Firms that use kaizen consider it an integral part of their business practices. A goo
example of a kaizen-focused business is the Japanese car manufacturer Toyota.

The philosophy behind kaizen is based on *gradual change* and *employee suggestio*
small, considered steps (rather than focusing on large individual innovations) with
volume of changes will eventually result in huge improvement.

Businesses cultivate a *culture of continuous improvement* by encouraging their wo
These suggestions can be as big or small as necessary – sometimes improving the
creates the most notable results! Suggestions can be given anonymously, using
person. Kaizen businesses focus on the talents of their employees, and their ability
than invest in expensive machinery in order to get to the same outcome.

Kaizen may seem like a long-winded (and therefore pricey) way of working, but by
people most involved in a business's quality procedures day in and day out), these
foundation for innovation that gives them the competitive advantage over any riv
improves quality, but increases motivation, too, as employees feel more valued an
go the extra mile for their employers.

Total Quality Management (TQM)

TQM is another method that aims to empower employees: unlike kaizen, which w involves the entire business; it is the culture of the organisation. Employees act lik analysing the work they receive from other departments in order to, as a unit, criti best-quality product/service possible.

Competitive Advantage of Quality Management

Keeping goods/services to a high standard of *quality* (i.e. how well the product do gives a business competitive advantage over its rivals – the higher quality your go appears to consumers. This high-quality image can also give the perception that t are of a similar value, leading to repeat purchases and word-of-mouth sales. In m value high-quality products/services are more willing to pay high prices and so, if quality, high-end consumers may be more likely to purchase from you.

Just-in-time Management of Stock

The just-in-time (JIT) method of managing stock has become more adopted over method keep a low inventory of stock and produce only to specific orders. This m forecasting demand, wherein businesses predict how much demand there will be a to cover this demand, businesses produce to requirements. This method requires a must be able to inform their suppliers in time when consumer demand rises.

Advantages of JIT Management of Stock

- **Time saver:** Businesses receive an order, request the stock from their supplie good or put it directly on the shelves. There is no need to keep stock in stora
- **Money saver:** The business should spend less money on stock until they abs
- **Compact production:** With less stock in storage, a company's production lin more efficient as a result.
- **Add value:** A business can instantly add value to their stock because it is eith shop shelves or manufactured/converted into a good. There is very little time would be money wrapped up in stock.
- **Less obsolescence:** This is still a risk, but businesses run much less risk of ob and sell goods when there is demand.
- **Less risk to goods:** If fewer goods are in storage then they are less likely to

Disadvantages of JIT Management of Stock

- **Suppliers:** Businesses need suppliers they can trust to do a good job at shor produce stock in time, the business will suffer greatly.
- **Expensive:** This can be expensive to do on a grand scale, as businesses need computer systems in order to monitor incoming orders and available stock.
- **Mass orders:** If a business using JIT stock management suddenly receives a g cope with the volume of requests. Moreover, the business' suppliers may not
- **Unforeseen circumstances:** War, famine and natural disasters can put halts business' supplier.

The JIT method of stock control is particularly suited to businesses such as car ma print on demand. In both of these cases, stock is only required once an order has closely linked with waste *management* and *lean production* since it helps a busines and improve efficiency from start to finish.

Waste Minimisation

Businesses reduce the amount of waste they create for many reasons; from addre reacting to consumer demand. By correctly managing their waste, businesses can simultaneously bringing down their costs of production.

Technology has been a major player in the movement toward waste minimisation
these new technologies in order to:

- reduce defective products
- curb overproduction of goods
- decrease wait time for consumers and down time of machinery
- monitor and moderate unnecessary stock
- streamline production

Waste minimisation also relates to actual waste, i.e. overuse of product packaging
bring down their packaging costs by using reusable boxes. Transport costs, mean
their goods in bulk rather than per order.

Competitive Advantage from Lean Production

Lean production is a form of production that focuses on waste-saving measures, i
manufacturers. This form of production involves a range of techniques, including:

- JIT
- total quality management (TQM)
- kaizen
- cell production
- reduction of excess stockholding
- improvement of communications between production and marketing depart

The Benefits of Lean Production

Businesses can reap many rewards from employing lean production, including:

- **Productivity:** This increases as employees decide the most efficient way to p
- **Motivation:** Businesses can motivate their workforces by giving more respon
- **Shared decisions:** Empowered workforces take part in decision-making, whic management and opens up the potential pool of ideas.
- **Waste management:** Businesses that operate lean production benefit from holding (from JIT methods), which increases available funds and, therefore, ca
- **Quality:** Employees and management work together to streamline and impro help increase quality.

2.3.3. Questions

5. Identify two differences between quality control and quality assurance

6. Explain one reason why a greengrocer might choose to implement the of stock control.

2.3.4 Impact on Costs and Sales Revenue

Impact on Average Cost

We showed in Chapter 2.3.1 how the productive efficiency of a company has signi
the wages of its employees and the overall economy. Productive efficiency can als
average costs. When a firm achieves high levels of output, for instance, it is opene
costs are spread across a great number of products/services and so the company
individual unit.

Let's use an example:

Flour Pour Ltd is a bakery based in North Wales. The company's total costs reach
fixed costs. Flour Pour Ltd used to bake 1,500 loaves of bread per day and so its fi

$$\text{Fixed costs per unit} = \frac{\text{Fixed Costs}}{\text{Number of Units in Total}}$$

$$\text{Fixed costs per unit} = \frac{£150}{1500}$$

$$\textbf{Fixed costs per unit} = \textbf{£0.10}$$

The management of Flour Pour Ltd eventually decided that £0.10 of fixed costs pe
increased the production output to 2,000 loaves per day. This changes the costs p

$$\text{Fixed costs per unit} = \frac{\text{Fixed Costs}}{\text{Number of Units in Total}}$$

$$\text{Fixed costs per unit} = \frac{£150}{2000}$$

$$\textbf{Fixed costs per unit} = \textbf{£0.08 (rounded up from 0.07}$$

By increasing the output of production, the company is able to reduce its average
This saving can then be passed on to the consumer in the form of lower selling pr
potential buyers and, as a result, increase the revenue and market share of the bu

Flour Pour Ltd may decide to keep its selling price the same. This would still increa
because it would be making more off each item it sells (this, of course, is assumin
In either instance, Flour Pour Ltd would be making more profit overall than when
per day.

Minimising Waste of Resources

In Chapter 2.3.3, we showed how managing a company's waste offers a variety of
efficiency to bringing down average costs. There are other advantages still for bus
minimisation, including:

Profits: As the costs of production fall, the profits of the company can increase. T
anything from employee training or new equipment to infrastructure, communica
production processes.

Brand reputation: By investing in the production process, a company can also im
products/services. This has a knock-on effect of creating a positive reputation, i.e.
as of a higher quality than its competitors'.

Brand Loyalty: Once a company's reputation is secured, it can be used to convert
consumers that buy a company's products, the more *brand ambassadors* it create
company's products/services over any others when talking to friends or family.

Market Share: As a result of the increase in brand loyalty, the company can then product portfolio, securing an even larger market share. With such a strong reput find it difficult to muscle in on the firm's market share.

Competitive Advantage of Short Product-development Lead Ti

A *lead time* is the amount of time between an organisation making a business de Short lead times are often important when businesses need to react to a change i particularly true in highly dynamic markets, such as electronics – as one company smartphone technology, for example, its competitors need to be quick to catch u fashion. While some fashion retailers focus on high-quality, handmade products, brands work quickly and cheaply in order to push out new lines that match the ev society.

The Competitive Advantage of Low Quality

Quality is an integral element to the success of many businesses. It allows firms to charge high prices and therefore earn high profits. Consumers often see high prices and associate them with high quality and so the companies continue to benefit from product sales. The element of selling price is not essential to all businesses, however.

The fashion retailer ZARA is a good example of a business that sells items at low prices while still achieving significant global success. The firm concentrates on imitating designer fashions, and does so both quickly and cheaply. ZARA's customers do not demand the highest quality possible. Rather, th fashionable items, which ZARA sells in the thousands. The firm produces its good from designing a line to having it sent to stores within four to five weeks) and so t sudden trends. In this sense, ZARA's business model is low selling price, but extre

2.3.4. Questions

7. Explain why businesses aim to decrease their average costs.

8. Smart Talkies Ltd is a manufacturer of smartphones and tablets. One rivals recently released an update to its mobile phone range, which n offers. As a result, Smart Talkies Ltd has decided that it must react a manufacture a more advanced version of the competitor's phone.

The current lead time (the time between making a business decision Smart Talkies Ltd is nine months. Identify whether this lead time sho Please explain your answer.

2.3 Keywords

Overutilisation of capacity:	when a business produces more goods/services than it – this can cause stress on over-worked st for downtime and maintenance of equipment
Underutilisation of capacity:	when a business produces fewer goods/services can lead to staff being underworked, which ma company money on employees they do not ne
Productivity:	a company's hourly rate of output per each inp
Efficiency:	how much a business can achieve through a mi average costs
Kaizen:	employees are organised into groups (quality ci responsibility for continuously analysing, and imp business
TQM:	a constant, company-wide culture of quality m

2.4 Life in a Global Economy

2.4.1 Globalisation

Globalisation has no set definition and can be described differently across various
tend to say it is the ability to move production to anywhere in the world and the r
can be sourced from any country. It is a process of integrating separate countries,
single global entity. Borders and barriers between people and markets are remove
interdependent. As the world becomes more globalised, there is greater factor mo
factors of production can be sourced from anywhere across the globe.

In business, there are three main aspects of globalisation. First, there has been an
between countries, particularly in recent years between developed and developing
the goods that are made, a bigger proportion of these goods are traded internati
used domestically. Last, globalisation is recognised as the increased movement of
countries.

Factors That Have Contributed To Globalisation over the Last 50

Transport Infrastructure and Operations

The improvement in transportation and infrastructure around the global has allow
resources. As a result this has increased the trade of goods and services across co
production from various countries as it is easier and less costly to do so. Because
resources that are cheapest, the reduction in transportation costs mean they are l
across the globe and so become more globalised.

Communication Technology and IT

The improvements in the ability to communicate across the world means informat
imperfect information as a barrier to trade is reduced. The increased use of the Int
to allow the world to share cultural and social experiences.

Trade Liberalisation (WTO)

Agreements reached by the World Trade Organisation (WTO) have prevented cou
barriers to trade are removed, economic agents are more freely allowed to trade t
resources across nations, thereby becoming more globalised.

Increasing Transnational Companies (TNCs)

Transnational companies are those that are spread across countries; they sell the
produce their goods in various nations. The increasing number and the increasing
activity in the global market and thereby increased globalisation.

The Cold War and Political Change

At the end of the Cold War, economies that were formerly closed off to the world
market. This then lead to an increase in the global supply of labour.

Capital Market Liberalisation

As financial markets [illegible] across countries, mainly due to the increase in IT and co
traders were able to operate in various countries, causing the flow of money to m
becoming more globalised.

2.4.1. Questions

1. Explain how the following have contributed to globalisation in the last
  a) Information communication technology (ICT)
  b) Transportation

2. Copy out and complete the sentences below, using the following thre

migration *international trade* *investme*

Globalisation is made up of three main characteristics:

1. Rising _________________ as gross domestic product increases

2. Increased _______________ which involves the buying and sel

3. ___________ which describes the movement of people an

2.4.2 Developed, Emerging and Developing Econor

Indicators of Growth

Economics Background...

Economic Growth is the monetary value of a country in terms of the size of its ec
Economic Development is the quality of a country in terms of how established a
welfare is.

How do they differ and compare...?

Development and growth differ in terms of what they are concerned with and so t
Production is better at showing the size and value of an economy whereas somet
showing the quality of a workforce. There is often a relationship between the two,
debated and does not always hold true; it is believed that increasing economic gr
economic development. This is because an economy that is growing has more inc
income can be used to improve other areas of society, such as funding job crea
services which can be taxed, meaning there is more money going into the govern
redirected towards improving schools and hospitals, for example.

GDP per Ca

GDP is the sum market value of all the goods and services produced in one economy in one year. Because it shows the size of an economy, the rate at which it changes shows the growth (or decline) of an economy. Economic growth is the value of the percentage change in GDP. So why look at GDP per capita? America is a large country, compared to somewhere like the UK. The UK has less labour and fewer resources than the USA and will therefore be able to produce far fewer goods and services. Comparing GDP across countries is difficult because a large country may have much higher GDP levels than a smaller country, but this does not necessarily mean they are growing more. Instead, economists may look at GDP per capita, which accounts for the size of the country. It takes the GDP of the country (total GDP) and divides it by the population of the country in order to get GDP per capita.

Sm
can l
if n
The
t
con
will
this
the t
t

QUANTITATIVE SKILLS

GDP Per Capita

The GDP of the UK was $2.678 *trillion* in 2013 while the GDP of Belgium was $524.8 *b*
economy is much bigger. But then the UK had a population of 64.1 million in 2013 while
More people mean a higher level of output of goods and services.

Therefore, economists sometimes look at GDP per capita (per person) to remove the effe
sizes. This is done by dividing the level of GDP by the population.

Let's do this with the figures from our example:

$$\text{UK GDP per capita} = \frac{2.678 \text{ trillion}}{64.1 \text{ million}} = \$41{,}800$$

$$\text{Belgium GDP per capita} = \frac{524.8 \text{ billion}}{11.2 \text{ million}} = \$46{,}900$$

So although the UK's overall level of GDP is higher, Belgium has the higher GDP *per cap*

Literacy

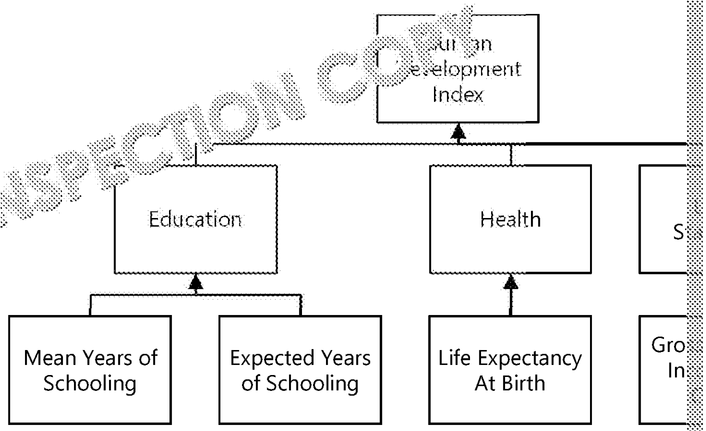
Literacy rates can be used to show an economy's development levels because lite
the education system in an economy. Equally, it can show the volume of the popu
more highly skilled a workforce is, the more productive it is (the more goods each

Health

Health statistics show the health systems in an economy; the healthier the workfo This is also good for showing development statistics because the healthier a perso will be. More developed economies will have more developed healthcare systems especially those who may not be able to afford healthcare.

Human Development Index (HDI)

HDI looks at three measures: education (mean years of schooling for an adult age schooling for new entrants), health (life expectancy at birth) and real GNI per capi GDP). The measures come together to create an index value between 0 and 1. Co according to how developed they are, 0 being less developed and 1 being more d



GDP as a Measure of Living Standards

Is GDP a perfect measure?

Think about the following:

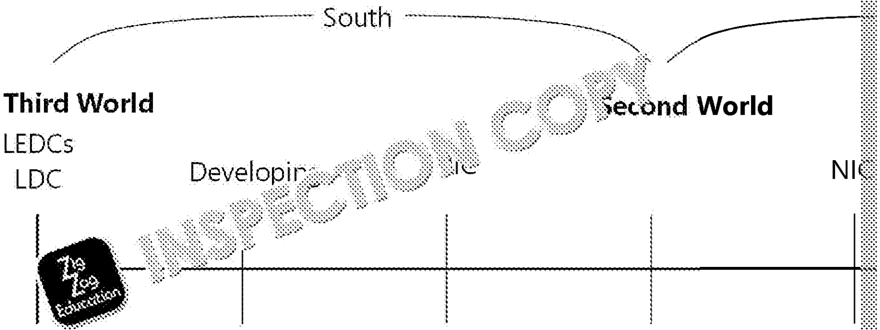
- If you mow your lawn then GDP is unchanged. Employ a gardener to do it, th lawnmower breaks and you buy a new one then GDP rises further.
- The production of tobacco products which cause illness and reduce life expe
- A country may be dependent on extracting coal and oil for its growth. GDP ri generations will not have access to the resources once they are used up. Is th

GDP is an economic measure and is good at showing economic growth. However, development correlation, it does not account for any social measures and ignores standards. It is, therefore, inadequate at measuring these dimensions. Yet, it is still levels across countries, and this is because the volume of goods that is produced qualitative variables such as happiness and well-being.

Further Your Economic Knowledge...

Talking About Development: Categorisation

Countries are often grouped into categories to refer to their develop industrialised status and a wide variety of categories is used. This bo meanings of these categories. You may have heard of some of these explain why and how some of them may be outdated or misused. Yo between these in your exam, this is merely for additional backgroun are interested in expanding your cultural horizons.



The most common categories are those that spilt countries into one developing, less economically developed countries (LEDCs, or LDCs) developed countries (MEDCs or MDCs). These refer to countries base development measures, such as GDP or HDI. What is good about the compared to developing/developed is that it identifies the distinctio economy and living standards, whereas developing may imply the c a backward and deficient culture.

There are other categories such as the North/South divide. This cate North are generally more developed than those in the South. A line i although this does not correspond to the equator, this grouping sug static and unchangeable.

West and East is another locational classification; however, this refers Western culture is generally 'American' culture, and Eastern culture l criticised because it groups all Asian cultures into one, such as Japan reality these cultures are vastly different and some may find this quit

Another one you may have heard of is first-world, second-world and previous categories, which specify countries either 'are' or 'are not', t countries can fit into. Originally, this looked at grouping countries ba stance; first world being capitalist, second world being communist ar 'non-aligned countries'. This concept is now outdated, although now third world in terms of income and wealth. However, this was not the

The terms Recently Industrialising Countries (RIC) and Newly Industri the two ends and instead look at the currently changing countries i status. NICs are countries such as China, which are fully industrialise countries such as the UK, which started industrialisation in the late ni countries such as Brazil and Mexico, which are starting to become m

What may be identified here is that it is hard to categorise countries the make-up of society, economic and political stances all vary by so hard to identify set similarities and differences. Mexico, for example, the more developed, wealthier or industrialised categories, does hav sustainable transport system than countries in other groups. Some a talking about a spectrum of development, as this highlights that cou certain categories. It is important to think critically about these categ to differentiate countries, what do they imply, are they accurate or o point on the spectrum, can countries be grouped or are there too m

Characteristics of…

Generally, this is the idea that development, environmental care, political and eco
positive trend with economic growth. It has been said that first a country develop
shifts to democracy and human rights. Once a country has economic stability, it t
schools, hospitals, improving the environment and reducing inequality.

However, in reality this has not always been shown to be correct. For example, Bhut
rates. However, because their policies are designed round the happiness index rath
lowly on GDP measures but highly on living standards and economic development,
relationship with their surroundings and environment. Countries such as China have
growth, but as a result they have a pollution and smog problem and still have a ver

Kuznets came up with a slightly different relationship that states that as a country i
will get worse, such as inequality and the environment but they improve again onc
industrialising. To learn more about the Kuznets curve and the environmental Kuzn
https://www.youtube.com/watch?v=[illegible] and
https://www.youtube.com/[illegible]XEGunQZU4

Developed (Mature) Economies

Economic:
- Low levels of economic growth
- High levels of GDP
- Generally focus on 'sophisticated', high-tech products, or quaternary-sector services, such as financial sector goods.
- High import levels of raw and primary goods
- Trade patterns are generally already established
- Economic stability
- Tend to use capital-intensive techniques

Political:
- Tend to be democratic
- Low levels of corruption
- Transparent governmental working
- Public has greater influence
- Politically stable

Environmental, social and demographic:
- Low child mortality rate
- Low birth rate
- Higher levels of gender equality
- Nationwide and often free public services, such as schools and hospitals
- Lower levels of environmental damage

Developing Economies

Economic:
- Low but rising levels of economic growth
- Low levels of GDP
- Primary product producers and often only focus in one area
- Subsistence farming
- Low levels of international trade
- Capital deficiency uses labour-intensive techniques

Political:
- High levels of c
- Political instab

Environmental, So
- High child mor
- High birth rate
- Low levels of g
- Very few publi
  often only avai
- High levels of e

Emerging Econo

Economic:
- Medium but ra
- High levels of e
- Often export-o
  sophisticated g
  products
- Great opportu
  countries bran
  and are able to
- Increasing use
  intensive
  Susceptible to

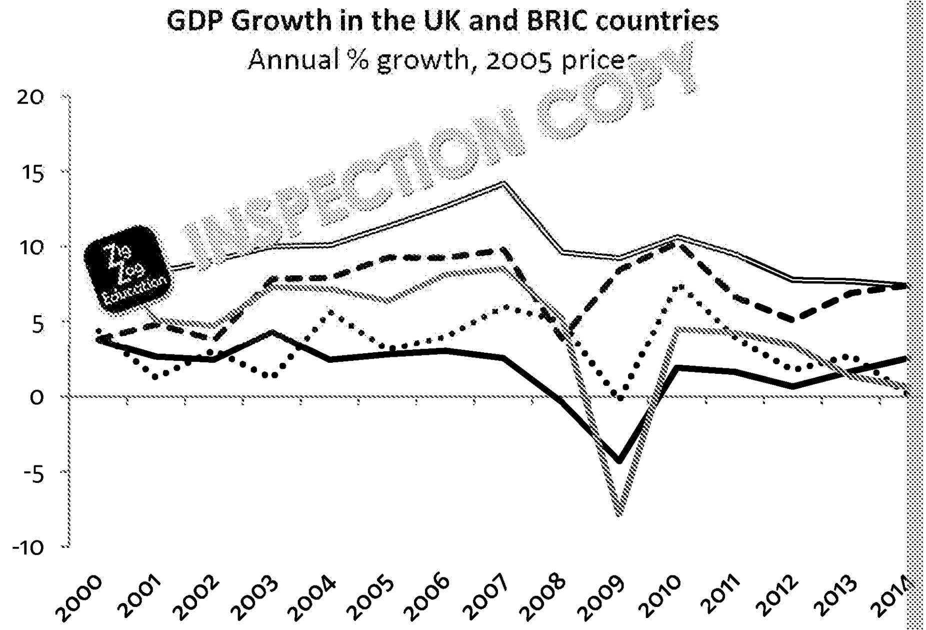
Political:
- Variable, some
  democracy, so
- Medium levels
- Desire stable, u
  so they can wo

Environmental, so
- Medium levels
- Medium birth
- Improving but
- Very high leve
  economy and
  industrialisatio

Have a look at some of the indicators and measures the World Bank has collected developing and emerging economies. Compare and contrast them! *http://data.wo*
To learn more about social and demographic statistics and their changes between emerging economies, watch this video on demographic transition models:
https://www.youtube.com/watch?v=HQIpdtUXeiU

Growth Rates of the UK and BRIC (Brazil, Russia, India, China)

The graph and table below show the GDP growth of the UK and BRIC countries be patterns that are similar and those that differ between each country.



	Brazil	China	United Kingdom
		GDP growth %	
2000	4.4	8.4	3.8
2001	1.3	8.3	2.7
2002	3.1	9.1	2.5
2003	1.2	10.0	4.3
2004	5.7	10.1	2.5
2005	3.1	11.4	2.8
2006	4.0	12.7	3.0
2007	6.0	14.2	2.6
2008	5.0	9.6	-0.3
2009	-0.2	9.2	-4.3
2010	7.6	[illegible]	1.9
2011	3.9	9.5	1.6
2012	[illegible]	7.8	0.7
2013	2.7	7.7	1.7
2014	0.1	7.4	2.6
		HDI	
2012	0.73	0.70	0.88

The previous graph and table show us that developing countries (e.g. those in the growth in GDP from 2000 leading up to the 2008 financial crash. China and India growth after the financial crash. The UK, on the other hand, which is a developed growth in GDP compared to the BRIC countries.

GDP is Not Everything

The table below shows the top 10 countries in the world ranked by the human de gross domestic product (GDP) per capita. Note how the lists are quite different. N world as determined by GDP per capita feature in the top ten countries as ranked

Top 10 Countries in 2014	
Ranked by HDI	**Ranked by GDP per capita**
1. Norway	1. Monaco
2. Australia	2. Liechtenstein
3. United States	3. Luxembourg
4. Netherlands	4. Norway
5. Germany	5. Qatar
6. New Zealand	6. Switzerland
7. Ireland	7. Australia
8. Sweden	8. San Marino
9. Switzerland	9. Denmark
10. Japan	10. Sweden

Mean and Median Incomes

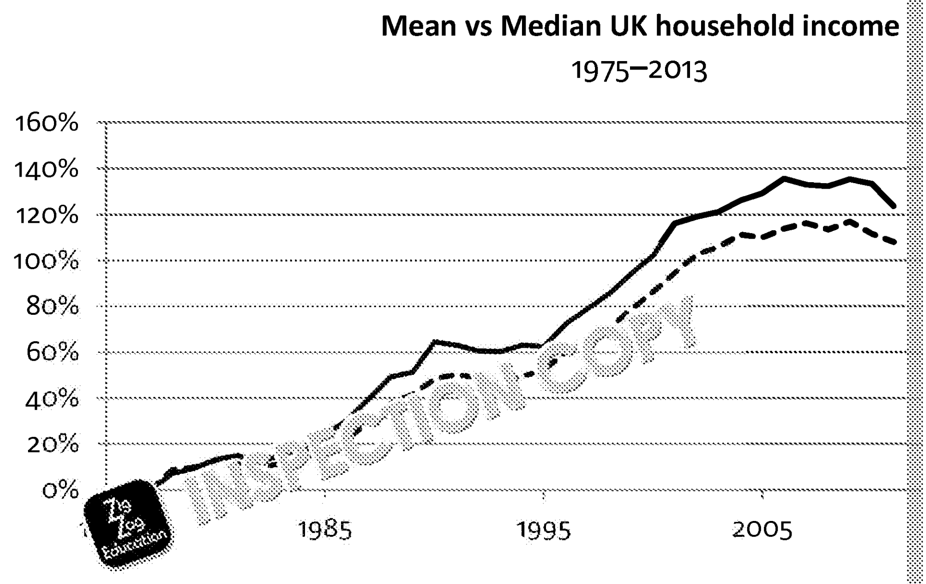
Median income is the 'middle income'; this differs from the mean and gives a mor average income earned, especially when dealing with data sets that have outliers for an example...

In a neighbourhood of seven people, the lowest earner earns £10,000 and the hig table below lists the wages of the seven workers in the neighbourhood in order o

Person:	1	2	3	4	5
Income:	£10,000	£20,000	£25,000	£40,000	£50,00

The median income is £40,000, but the mean income is £68,500 (to the nearest £5 and to some degree Person 6, earn income that is far above the rest. Using the m the income status of the population and it would appear that people were better Relative poverty would be an income below 60% of the median income, which is £ would be in relative poverty.

The graph below displays this in terms of the UK's household income. Here, it sho
incomes were very similar in the 1970s but that they had spread apart by the 200



Your Turn: When mean income is larger than median income, does this show tha

Let's use another example:

QUANTITATIVE SKILLS

Converting from money to real terms
Macroeconomists like to compare values over time to get a sense of the direction in whic
growth changed? Have wages increased?

The trouble is that the value of money changes too as a result of inflation. A pound in 1C
much as it is today.

Measurements of prices *from the time they were recorded* are known as **nominal** or **mon**
values over time will be exaggerated because it will capture both changes in the underl
level due to inflation.

To truly compare values over time, therefore, we must convert to **real terms.** This is a wa
in the price level. To do this, we use a price index (such as CPI) to 'deflate' later values.

For example, suppose that the median wage increases from £25,000 to £26,000 over t
increase in nominal terms of 4%. However, the price index shows that there is also positi
1%.

We therefore construct a 'deflator' which is 100 divided by the index: $\frac{100}{101}$

This is then multiplied by the new value to give it in real terms:

$$\text{New real wage} = \frac{100}{101} \times 26{,}000 = £25{,}743$$

So the new [illegible] median wage is £25,743. This is *less* than £26,000 because the effect c

2.4.2. Questions

3. a) What is GDP?
b) How can GDP be adjusted to account for population size?

4. How does GDP differ from HDI?

2.4.3 International Trade

Specialisation and International Trade

Adam Smith was an eighteenth-century economist who came up with idea of spe
This is the idea that a worker can increase their efficiency by concentrating on onl

Smith illustrated this with the famous 'pin factory' example – a pin has many intric
process, so one worker alone could only produce a few pins in a day. However, if
for one part of the production process (and become experts in this), the number
increase dramatically (although there is a limit to the gains from specialisation – a
repeating the same tasks).

In the context of an economy, Smith suggested that countries should only produc
producing, i.e. the good they have an absolute advantage in, and trade with other

***For example**, France should specialise in producing wine and Belgium should speci
order to obtain both goods, France and Belgium should trade their excess wine and*

The Heckscher-Ohlin model explains how a country's original comparative advant
endowment – by this the theory means the original make-up of resources that are
Countries which are abundant in labour but where capital is scarce will find they h
producing goods that heavily use labour rather than capital.

This is why comparative advantage advocates trade; countries take advantage of t
producing goods that use their abundant resources, and trade them for those goo
are too scarce.

Trading Blocs

A trading bloc a set of countries which have an agreement on the level of trade re
themselves.

Examples of trading blocs:

- NAFTA = North American Free Trade Agreement
- EU = European Union
- LAPA = Latin America's Pacific Alliance
- SADC = Southern Africa Development Community

Free Trade Areas

Free trade areas are groups of countries which have an agreement to allow free tr
meant that there are low to no trade restrictions or barriers between the countries
increased trade among these countries

This agreement only determines the way in which the countries trade with the oth
agreement. The countries involved (member countries) are allowed to set their ow
countries outside of the agreement (non-member countries). From this, non-mem
potential high trade barriers of other member countries by entering through the m
lowest/cheapest trade barriers. Once they have accessed the free trade area throu
they are able to trade with the other member countries without the high-barriered

Custom Unions

Just like a free trade area, a custom union has an agreement with its member cou
restrictions in order to promote trade among member countries. However, to pre
countries avoiding barriers, a custom union will have a set of common protectioni
that all the member countries will set the same barriers and restrictions to non-me
European Union used to be a customs union in the 1960s and it set a 'common ex
countries (each member country would set the same tariff to non-member countr

Common Markets

A common market, like a free trade area, has an agreement with its member countries to have low to no trade restrictions and a set of common protectionist measures, like a customs union. But, additionally to a customs union, a common market allows free movement of factors of production among its member countries. The EU allows any person who lives within the EU member countries to move freely without restriction, i.e. as an EU citizen, you are able to travel between EU countries without a visa or a passport (although, travelling via aeroplane still requires a passport so this rule is somewhat redundant to UK nationals due to the issue of living on an island).

Monetary Unions

A monetary union is the last step towards full integration and before the EU, had only ever been a theoretical idea. A monetary union, like a free trade area, has low to no trade barriers to free trade, like a customs union, has a set of common external protectionist measures and, like a common market has perfect mobility of factors of resources. However, the additional condition is that the member countries adopt a single currency (the euro!). There is another step, economic union, where member countries attempt to align their economic policies (monetary and fiscal). The EU is heading towards this step, although this is only a theoretical possibility; the outcome is uncertain and it may not even be feasible. You do not need to know this for your exam.

Extra Activity!

To understand the European Union, the European Central Bank and the Eurosystem, watch...

https://www.youtube.com/watch?v=TAlcFwGIQBg

Go to zzed.uk/5868

Trade and Growth

Countries that partake in international trade will find their growth rates will increase. This is because, opening up to the international market will mean an increase in product audience and so there is room for firms to expand and grow. Equally, countries can import raw materials and 'low-value added' goods for production, such as a table company importing pine wood. Firms can outsource production to other countries to expand not just their markets but also their production and have lower costs in order to obtain a competitive advantage. Following the 2008 financial crisis, the world saw a decrease in the amount of international trade with many countries opting for protectionist measures, i.e. taking care of themselves and their own people.

Extra Reading!

Give this article a read:

http://blogs.telegraph.co.uk/news/danielhannan/100186074
not-a-free-trade-area-but-a-customs-union-until-we-unders
difference-the-debate-about-our-membership-is-meaningles

Go to zze

Imports and Exports

Visible goods are physical objectives, touchable goods that are produced.
Invisible goods are unattainable facilities, untouchable services that are provided

The balance of payments is made up of four parts: the capital account, the current

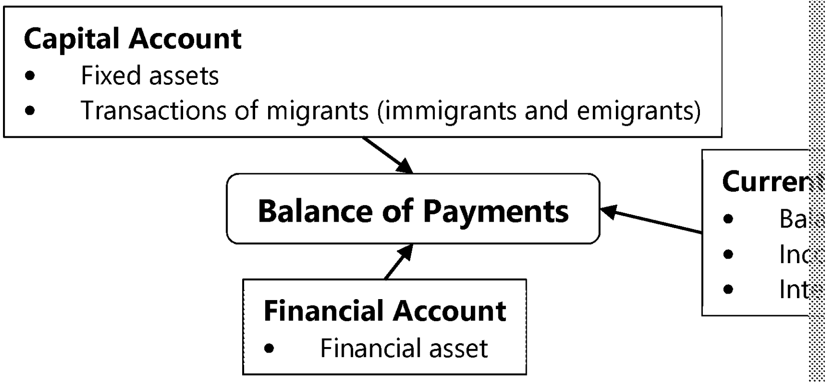
The current account has a component called the 'balance of trade' which looks at the value of goods that been exported compared to the value of goods imported and the overall balance of these. There are two parts to the balance of trade: the trade in goods balance, and the trade in services balance.

An import appears as a negative on the account because money leaves the economy in return for the imported good, and an export appears as a positive on the account because money enters the economy in return for the exported good. Therefore…

Balance of Trade Deficits can occur when the value of imports exceeds the value negative, meaning more income is flowing out of the economy.

Balance of Trade Surplus can occur when the value of exports exceeds the value is positive, meaning more income is flowing into the economy.

The balance of payments must always equal zero. If we buy more imports than th we will need to fund these purchases from another component of the account, su which would be recorded on the financial account. So deficits in one component surplus in another account



Imports and living standards

The availability of imports is important for high living standards which depend on goods. Generally, countries can't produce all the goods and services they need fo the UK we can grow bananas – but only with a system of greenhouses, UV lamps efficient for tropical countries to grow bananas and for the UK to import them.

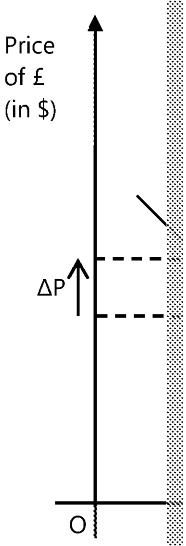
The availability of imports therefore is important because it gives consumers cho standards. If countries become embroiled in trade wars and impose import taxes then ultimately their own citizens will suffer through a lack of choice and higher p

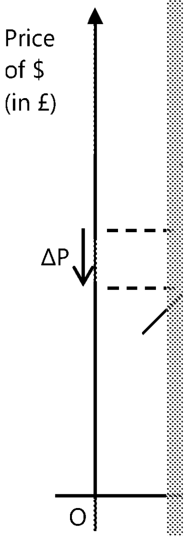
2.4.3. Questions

5. Why is international trade important for countries with an export-led

6. a) Explain when a country has an absolute advantage and when it h advantage.
   b) 'Division of labour should always be used because it only has ben extent is this statement true?

2.4.4 Exchange Rates





When a good is bought, an amount of money is given over 'in exchange' for the good. The value of the good is shown by the amount of money swapped for it. Currency is seen in the same way as a good. The exchange rate shows how much of one currency can be swapped (exchanged) for another currency, or the value of one currency (e.g. £) in terms of another currency (e.g. $).

If an American consumer decides to buy a British good then they will need to change their American currency ($s) into British currency (£s) because the good is valued in £s.

Let's look at the exchange rate of £s and $s and how this transaction would change the market equilibrium in the foreign exchange market. The top graph shows the demand and supply of £, the quantity of £s in the global economy is shown on the x-axis, 'quantity of £'. The price of £s is shown on the y-axis and the price/value of £s is shown in $s as we want to know how many £s we can get for $s. The bottom graph shows the demand and supply of $, the quantity of $s in the global economy is shown on the x-axis, 'quantity of $'. The price of $s is shown on the y-axis and the price/value of $s is shown in £s as we want to know how many $s we can get for £s

As the American wishes to buy £s, the demand for £s increases from D£$_1$ to D£$_2$. This causes the price of £s in $s to increase by ΔP. The value of the £ has appreciated; this means the purchasing power of the £ (the ability of the £ to buy) has increased; the £ can buy more $s than before. As they sell their $s for £s, the supply of $s increases from S$$_1$ to S$$_2$ and the price of $s decreases by ΔP. The $ has depreciated in value; this means the value of the $ has decreased so its purchasing power has fallen and it can buy fewer £.

Appreciation is when a country's currency increases in value, i.e. the pound has a
was £1 = $1.50 (each pound costs $1.50) but is now £1 = $2 (each pound costs $2

Depreciation is when a country's currency falls in value, i.e. the pound will have d
was £1 = €2 (each pound cost €2 to buy) but is now £1 = €1 (each pound costs €

Extra Activity!
Black Wednesday was a significant event in UK economic history. To learn about it, watch this video…
http://www.youtube.com/watch?v=K_oET45GzMI&list=
7_Yzout-xAqMCwLPKiPLZgOIPmVLH_&index=1

Go to zzed.uk/

Impacts of the Exchange Rate On Firms

An appreciated currency would mean foreign goods would appear cheaper. Expor
international competitiveness and may be forced out of business. However, this sh
efficiency and cut costs.

There will also be a downward pressure on inflation as consumers have access to c
Companies that import raw materials for production will find their costs fall and a

A depreciated currency would mean there was more money coming into the econ
competitively priced for foreign consumers. The export industry would grow as m
firms within the market would expand and job creation increase.

A depreciated currency also has an upward pressure on prices as companies who
costs rising and also foreign goods become more expensive.

Interpreting Exchange Rate Data – Example

Currency	Exchange rate, December (£1 equivalent)	Exchange rate, December In £s	Exchange Janua (£1 equiv
US $	1.5	0.67	1.45
Euro €	1.4	0.71	1.6
Indian rupee	100	0.01	80

The table above contains (fictional) data on exchange rates. Column 1 shows how
bought for £1 in December (so £1 is worth $1.50). Column 2 shows how many pou
of the foreign currency – so 1 Indian rupee is worth £0.01. The figures in Column 2
Column 1 (for example, 1 / 1.5 = 0.67).

Columns 3 and 4 show the exchange rates in the next month (although exchange
daily basis). Using this, we can see whether the pound has weakened (depreciated
over time.

With respect to the US$, the pound has depreciated – since one pound buys fewe
economy performed particularly strongly over this period (or the UK performed w
strengthened with respect to the Euro, as £1 now buys €1.6 instead of €1.4 (so €1
71p). Perhaps the Euro economies performed poorly in this period (this would als
depreciated with respect to the US$).

When interpreting exchange-rate data such as this, you need to be clear which wa
Is it pounds to dollars (Column 1 or 3), or dollars to pounds (Column 2 or 4), for e
look at graphical exchange-rate data, rather than tabular.

Effective Exchange Rates (EER)

The exchange rates discussed so far only compare the currencies of two countries
exchange rate (EER) tracks a currency's exchange rate compared with a combinati
over time. The EER is weighted in favour of a country's main trading partner: for th
countries and the United States. The UK's exchange rate with respect to the euro a
form a large part of the EER.

The EER is usually measured as an index. Suppose we take the base year as 2000 (
the pound appreciated over the next few years compared to most other currencie
an increase, perhaps to 110. A large depreciation over the next few years would b
to 90. The World Bank [illegible] the data on EER (see *http://data.worldbank.org/indica*

If you look at the UK data, you will see evidence of a strong appreciation of the pound since 2010.

2.4.4. Questions

7. a) Explain the meaning of 'exchange rate'.
b) Explain the meaning of 'depreciation'.

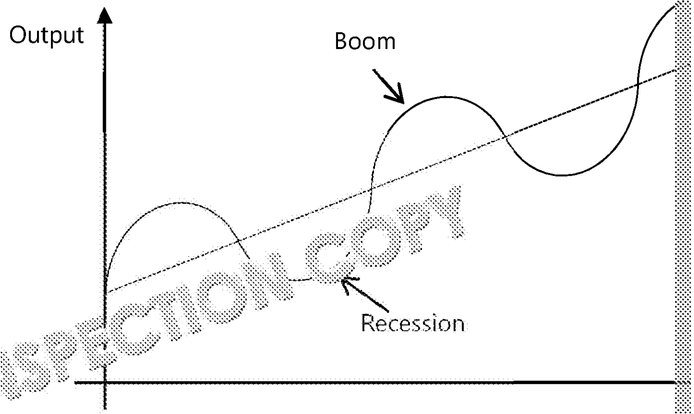
8. A Chinese consumer decides to buy a British good. Explain why this tr
would help the British pound to appreciate and the Chinese yuan to d

2.4 Keywords

Globalisation:	A broad notion referring to the idea that the wo interconnected
Human Development Index:	An index that ranks countries based on a measu and education
Economic development:	A term used to describe actions by government to improve living standards and economic healt
Trading bloc:	A group of countries that have agreed to reduc
Fixed exchange rate:	When a country's governing body or central ba currency, in terms of another, at the same level
Floating exchange rate:	A system which allows the value of a currency to free market forces of demand and supply
Managed exchange rate:	A system in which the government intervenes to the exchange rate, possibly targeting a specific
Real GDP:	Measurement of gross domestic product that ha
Nominal GDP:	Measurement of gross domestic product that ha inflation
GDP per capita:	A measure of national income divided by the po

2.5 The Economic Cycle

2.5.1 The Economic Cycle



The trend-growth line shows the generally upward growth rate of an economy. In growth rate, an economy needs to have economic stability. By this it is meant that performance, such as price, unemployment, growth and balance of payments, rem no fluctuations. However, in reality it is difficult to keep these variables unwaverin swing above and below this trend rate. The causes for the fluctuations are still mo of these regular, periodic fluctuations 'cyclical changes' in the economy.

Boom

A boom is when the real national output of the economy is producing above the economy is using all of its resources (machines, workers, raw materials) it can pro goods possible. During a boom, the economy is using more resources than it curr in the short run by, for example, employing workers to do overtime.

Characteristics of a Boom:

- Aggregate Demand: high and increasing levels
- Economic Growth: high
- Employment: rising
- Unemployment: low
- Wages: rising
- Government Tax Revenue: high
- Profits: high
- Share Prices: high
- Prices: rising, high levels of inflation

As an economy grows rapidly above its trend rate, firms will expand their business order to do this they will need to employ more resources, for example labour, and economy moves towards full capacity, the prices of the resources will increase. Th (workers) will be employed and it will be harder for firms to gain more and so they order to get them. This means wages will increase, but so too will costs of produc these costs of production, creating rising rates of inflation (cost-push inflation). Ec employment, those who originally didn't have an income will now have a wage to employed will see an increase in their wages. This increase in income will mean to will increase, which will push up aggregate demand and, as the theory goes, the g prices (demand-pull inflation). The government will see high levels of tax revenue have a job and will pay income tax, but also a greater level of consumption mean on the goods they purchase. National debt levels may fall during a boom as the g surplus and are able to pay off their debt.

Recession

A recession is when the real national output of an economy is producing below th
lead to negative growth rates. The economy is not at full employment, meaning it
and there is 'spare capacity' in the economy. This means it is easy for firms to exp
resources to use, but often the firms don't have the funds available for investment

Characteristics of a Recession

- Aggregate Demand: low and decreasing levels
- Economic Growth: low, potentially negative
- Employment: falling
- Unemployment: high
- Wages: falling
- Government Tax Revenue: low
- Profits: low
- Share Prices: low
- Prices: falling, low levels of inflation, possibly deflation

As an econ[illegible]ls, firms will find their profit margins fall and will have to shrink
laying off wo[illegible] and other resources. Employment will fall and people will find t
consumption will drop because people won't be able to afford to spend. Firms wil
falling due to the decrease in demand. Resources will become cheaper in price, as
be more willing to accept lower wages. The government may find they need to bo
spending increases on unemployment benefits but their tax revenues fall as consu

Implication of the Economic Cycle on Firms

The implication the economic cycle has on firms largely depends on the type of fi
Generally speaking, though, firms work more efficiently when there is economic st
ahead. Fluctuations are unnerving and affect customer consumption behaviour. U
recessions can have greater effects on firms, especially when they cannot plan for

This is when the topic of elasticity comes into play. Firms that have income-elastic
their goods will vary greatly with cyclical changes. During a recession, firms with in
be extra careful because there is the strong possibility they will go out of business
high revenues as people's incomes rise. Firms that sell inferior goods will see the o
that sees an increase in demand with falling incomes; for example, for supermarke
increases as incomes fall as people swap to consume these goods to save money.
inelastic goods may not notice too much of a change in their demand with chang

2.5.1. Questions

1. Draw an economic cycle diagram.
  a) Label the positive output gap(s).
  b) Illustrate this gap / these gaps using an AS/AD diagram.
  c) Using the concept of capacity, explain what is happening within t
  d) What is happening to [illegible] unemployment, confidence and th
  throughout th[illegible] gap?

2. What [illegible] effects of economic growth on consumers, firms, the go
standards?

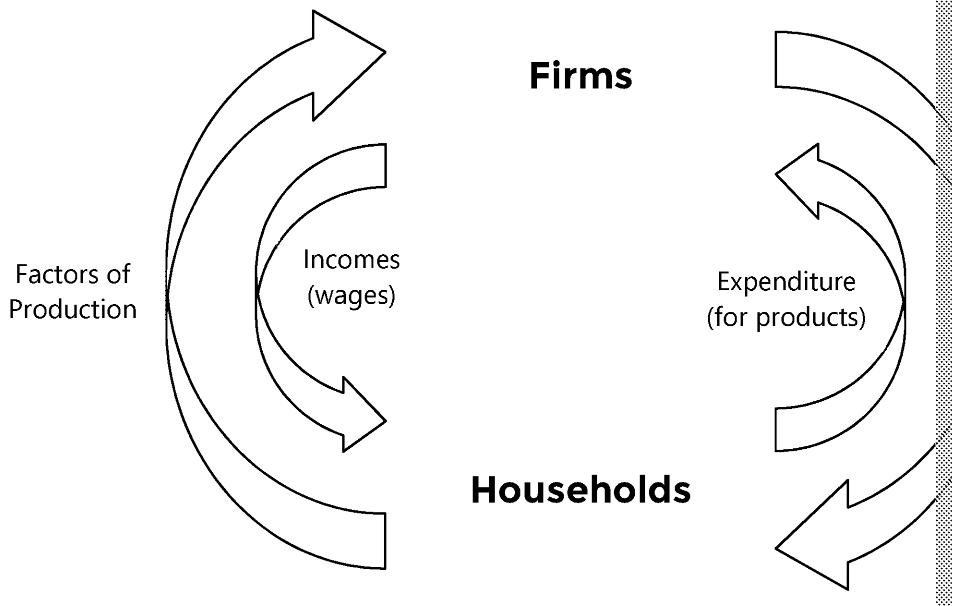
2.5.2.a Circular Flow of Income, Expenditure and O

Income is the money that a person receives in exchange for something, i.e. wage letting a property. It moves from one agent to another, it is seen as a flow of mon

Wealth is the money that a person holds. It may have built up from wages or inve anywhere. It is seen as a stock as it is money that is kept stored. Wealth can be sa houses (assets).

Wealth can create income; the money and items stored can generate a flow of mo of is a house. The house is wealth, it is a stock/store of wealth, but if you let it out an income back from it in the form of rent.

With this in mind, let's look at the diagram that shows the circular flow of income simple economy. There is no government or interaction with other economies, the By households we mean a unit of people of any amount, one individual or a famil from where they work (at the firms), and spend their incomes buying the goods ar Firms receive factors of production, such as labour, from households and produce bought by consumers. Income flows round and round the economy from firms to



Injections and Withdrawals

This is a very unrealistic model of the economy. In reality, firms do much more tha produce goods; similarly, consumers do more than spend their wages on goods. I that may intervene and we do interact with other economies.

Think of the circular-flow-of-income diagram as a circular flow of water. Water flo income, but you can 'inject' more water into the system and the system will grow water from the system then the system will shrink. If the injections are bigger than economy will grow. If the withdrawals are bigger than the injections, then overall macroeconomic equilibrium is reached when the system (economy) remains cons withdrawals then economy will neither grow nor shrink.

Withdrawals are things that economic agents (within the system) do with their in out of the circular flow. By taking money out of the circular flow it is no longer go

Injections are things that outside economic agents do with their incomes that res the circular flow. There is now more money going around the system. Each injectio

Savings and Investments

Savings are a withdrawal because instead of spending incomes and keeping it flow may instead put it into a savings account. This takes it out of the system. Investme because they put money into the economy in order to improve or increase produc investments can be influenced indirectly by changing the rate of interest. If interest likely to save because they will receive more money from their savings account. If i likely to fall because people will be deterred by the larger sums of money they'll ha

Taxes and Government Spending

This injection and withdrawal can be directly influenced by the government. Taxes a letting incomes flow around the economy, a proportion of income is given to the g is the money that the government spends in the economy in order to provide thing

Imports and Exports

In reality, our economy does interact with other economies. When we buy foreign goods we send money from our economy to the other economy and receive a good from their economy into ours. The good is an imported good, but the money is a withdrawal. We may make a good that is bought by an economy in another country. In this instance our economy receives money as an injection and our good is exported to theirs.

Impacts of Injections and Withdrawals and the Multiplier

The market is in equilibrium when the injections are equal to the withdrawals. Wh more income is entering the economy than is leaving and so the economy will gr are greater, then more income is leaving the economy than is entering and so the the economy shrinks and grows by is not always equal to the injections or withdra multiplier. An example will be used to explain the multiplier...

> *The government decides to build more colleges and sixth forms to encourage s education. They have £20 million that they give to various building contractors million into the economy. The economy grows by £20 million. The building co builders in return for their labour; the income flows from firms to households. T incomes on bills to buy electricity for their houses. The income then flows from*

As the money goes round and round, it generates more and more income. The economy absorbs the original injection and grows. The income then flows around the economy again and the economy grows again.

The money may be saved instead of spent, or it may be spent on imports instead of domestic goods. As firms and households receive the income, it will be taxed. This means the economy will keep growing and multiplying until all the additional income has been withdrawn.

The size of the multiplier depends on two things: the amount of income that is inj withdrawn each time. If injections are large, then the economy will grow by a larg large then the economy won't grow by much each time. This creates the multiplie between leakages and withdrawals and the proportions of each.

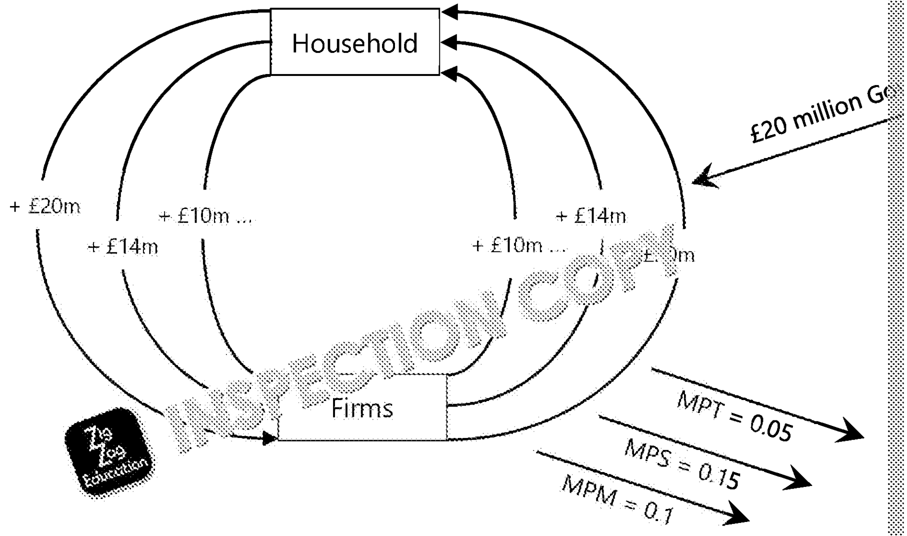
So how would this work using the example that was given at the beginning? See t economy would increase by the £20 million injection. £20 million would go round every £1, 5p would be spent on tax (5% of the injection), 15p would be saved (15 be spent on imports (10% of the injection). So 30% of the £20 million would be le million to be circulated round the next time. Then 30% of the £14 million would b about only £10 million to circulate round the next time. This goes on and on until and in total the economy would have grown by £60 million.

The multiplier can also be shown using an aggregate supply and demand diagra to learn what aggregate demand and aggregate supply is...

2.5.2.a Questions

3. **a)** What is an injection and what is a withdrawal?
b) List the six injections and withdrawals.

4.



a) Draw a circular flow diagram with all the injections and withdraw
b) Explain how income flows around the economy.
c) What would happen if injections were bigger than withdrawals?
d) What would happen if the government increased the tax rate?

2.5.2.b Aggregate Demand and Aggregate Supply

Aggregate Demand

In the last theme we look at demand; in this topic we look at aggregate demand, w economy. Every individual person's demand curve and each demand curve for eve together to create the aggregate demand curve. It is the total spending in the eco households) on domestic products in a given time period.

$$AD = C + I + G + (X - M)$$

60% 15% 25% 1%

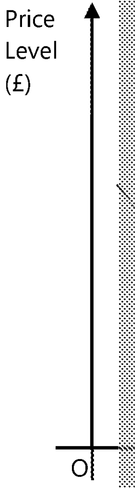
Aggregate demand is made up of four components: consumption, investment, go exports.

Consumption is the total amount of spending from households, individuals and c people go out and consume more goods this means consumption has increased, demand. On the other hand if consumption falls, aggregate demand falls.

Investment is consumption for firms. Firms invest money either to increase th they produce or to replace their old machines. If investment increases then this is and so aggregate demand increases.

Government spending is mostly autonomous. Whereas consumption and investm tax or interest rate changes, for example, government expenditure is determined b other factors of the economy.

Net trade is the sum total of income flowing out of the economy from imports an economy from exports. If exports increase and/or imports fall, net trade increases If there is more money coming into the economy than leaving (if exports are grea trade surplus. If imports are greater than exports then there is a trade deficit. The imports bought not only depends on their price, but also the price of foreign goo goods are cheaper relative to foreign goods then we would say 'UK goods are mo demand for UK exports would increase (as foreign consumers would switch to bu for imports would fall (as domestic consumers would swhich from foreign goods t increase, imports would decrease, net trade would increase, there would a trade s demand would increase.



Each component has a relative importance to aggregate demand. Consumption makes up around 60% of aggregate demand whereas investment only makes up 15%. An equal change in each of these components would effect a disproportionate change in aggregate demand, for example a 10% change in government spending would have a far bigger effect on aggregate demand than a 10% change in net exports.

The diagram to the left shows the aggregate demand curve. When aggregate demand increases, the curve shifts out, and when aggregate demand decreases, the curve shifts in. In theme one with demand and supply diagrams, the x-axis was the quantity of goods produced. In macroeconomics we look at the whole economy and so we look at the total goods and service that were produced in an economy. Because Real Gross Domestic Product (Real GDP) is the total volume of goods and services produced in one economy in one year, it is what is used for the x-axis. Microeconomics talks about prices for individual goods in the context of individua with macroeconomics the focus is on the 'price level' in the economy. That is, the all goods in the economy. Movements up and down the y-axis indicate rises and f the economy. A rise in the price level is known as inflation, a fall in the price level is known as deflation. Disinflation, however, is when the price level has risen, but not by as much as before, i.e. the rate/volume that prices have risen by has fallen.

Inflation = a sustained rise in the general price level
Deflation = a sustained fall in general price level
Disinflation = a fall in inflation, i.e. a fall in the increase of general price level

Aggregate Supply

In the last theme we look at supply; in this topic we're looking at aggregate suppl
economy. Aggregate supply is the sum total of all the supply curves for every firm
microeconomics supply firms would switch to producing the goods with the great
macroeconomics looks at aggregate supply, firms switching from one industry to
the overall supply from the economy.

There are various schools of thought within economics and some have conflicting
exam you need to be able to differentiate between the Keynesian AS curve and th
two schools [illegible] different shaped AS curves. First in this topic you need to under
short-run and long-run aggregate supply.

Short run and Long run

Short run: <u>at least one</u> factor of production is fixed; they are not all variable.

Long run: all factors of production can be changed.

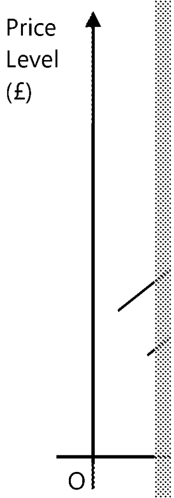
> ***For example:*** *A fishermen has a fishing rod (capital), a river running through his garden (land), bait for the fish (raw materials) and, of course, himself (labour). The people in his village have recently heard that fish is good for you. The price of fish has increased.*
>
> *The fisherman decides to increase his supply of fish. He buys more bait; one*
> *Capital, land and labour are still constant. This is the short run.*
>
> *He buys a better fishing rod that allows him to catch bigger fish; another fa*
> *Labour and land are still constant. This is the short run.*
>
> *He buys more fishing rods and asks his children to help him catch more fish*
> *changed (labour has changed and capital has changed again). Land is still c*
>
> *The river also runs through his neighbour's garden. He decides to buy some*
> *to increase the amount of river that he can fish for. Now, all the factors of*
> *now the long run.*

Short-run aggregate supply is the total volume of goods and services supplied
Firms are able to change some of their factors of production to react to price c
supply is the total volume of goods and services supplied in the economy in th
change all factors of production to react to price change. If all factors of produ
economy is able to increase aggregate supply to meet its maximum productive
run aggregate supply (LRAS) curve means the economy is producing at its max
at full capacity.

Short-run Aggregate Supply (SRAS)

Supply shocks are factors that cause a change in SRAS. They will affect firms in the change some of their factors of production. Short-run aggregate supply can easily react to changes in the firm's cost of production. The things that affect SRAS are:

- **Raw Materials (Wage Rates and Energy)**
  If the price of the raw materials used in the production of a good/service rises, then the cost of production will increase. Firms will reduce supply at each and every price level. The short-run supply curve would shift inwards if the costs of the raw materials increased.

  Energy is an influential cost within the economy because all firms need energy to produce goods and services. Factories and offices need electricity to light and heat rooms and for capital, such as manufacturing machines or computers. If energy prices increase firms may cut back on supply. The economy as a whole would see the aggregate supply curve shift inwards. Wage rates are another influential cost of production. Wages are the cost of labour and so if the wage rate increases, it will be more costly for firms to produce.

- **Exchange Rates (Exports and Imports)**
  The exchange rate will affect the prices of exported goods and goods that ar table-making company may import the timber. If the exchange rate changes expensive, then aggregate supply will fall, as firms will not be able to produc each and every price level.

- **Tax Rates**
  The government may change the tax rate on certain goods or add taxes/take increase the cost of production and reduce aggregate supply.

Long-run Aggregate Supply (LRAS)

In the long run all factors of production will be changed. Therefore, only factors th potential of the economy affect long-run aggregate supply. The things that affect

- **Technological Advances**
  Technological advances tend to mean there is an improvement in technolog More productive capital means output per unit is greater and therefore the n an economy is greater and long-run aggregate supply will increase.

- **Relative Productivity**
  Productivity refers to the amount of output a single unit of a resource could produce five units of a good in one working day, but through either training the worker could produce eight units of a good in one working day, the work increases. If the resources in an economy become more productive, i.e. they the economy's long-run aggregate supply will increase.

- **Education and Skill**
  The ability of the workforce is a constant variable and can only really be impr wider economy, such as to school leaving age. If the workforce is better educ it will be more productive. A more productive workforce will be able to prod so the long-run aggregate supply curve will increase.

- **Government Regulation**
  The government can add or remove regulations that will affect the efficiency increases the level of health and safety in order to protect workers, then this processes, making them less efficient, or stop potentially quick but unsafe pr volume of goods produced.

- **Demographic and Migration**
  The labour supply available to an economy is often fixed. If all workers are employed, there are only so many goods an economy can produce. Migration allows the supply of labour to increase or decrease, which would increase or decrease long-run aggregate supply respectively. The age of the population is also important. Working age is 18 to 65 by UK standards and so if migration or simply time means the economy is populated with people above working age, then this will cause little increase to the maximum productive potential. An influx of young people, either from a previous baby boom or immigration, is likely to increase long-term aggregate supply because this has increased the supply of workers.

- **Competition Policy**
  If there is greater competition within markets then firms will have to attract m goods that are cheaper and/or better than their rivals. This will drive firms to means of producing in order to cut costs, in order to obtain lower prices. Pol therefore, will encourage productivity gains and thereby increase long-run ag

Differing LRAS Curves

To learn the difference between the new classical view of the LRAS and the Keyne try to understand how classicalist and Keynesian economists differ.

How do Classicalists and Keynesians differ?

Classicalists believe that the long-run markets will always find equilibrium. In t for labour would lead to a fall in the wage rate and employment; the market a demand and supply for the labour market with wage rates (price of labour) on (quantity of labour used) on the x-axis. If the demand for labour falls, the DL c employment falls as fewer firms are willing to pay this wage rate for workers. T workers and unemployed workers will adjust their 'wage expectations' to accep rate falls and employment rises again, as more firms are willing to pay these ne Employment is not at the same level, but there is no unemployment, as those who aren't employed are not willing to supply their labour at these lower wages.

Keynesians instead believe that when the demand for labour falls to DL2, workers will not adjust their wage expectations and the wage rate will not change either: 'sticky wages'. The excess of supply of labour remains (unemployment) and will only disappear when demand rises again.

These two schools of thought and their differing assumptions create two different long-run aggregate supply curves (LRAS).

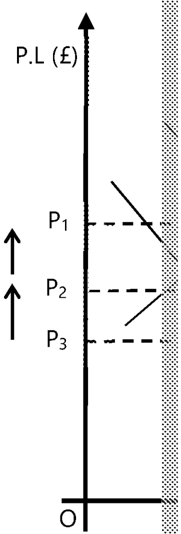
Th
wil
low
wo
Oth
uni
als

New-Classical (Free-Market View)
Classical economists believe that aggregate supply is perfectly inelastic. If all resources are being used efficiently, then it is not possible to produce any more goods. At this point aggregate supply is price inelastic. The economy cannot produce any more goods/services and so aggregate supply will not change with change in price. If aggregate demand goes up but aggregate supply cannot increase to meet this, then the rationing function of the market comes into play. If demand increases then more people will buy goods, supply can't increase so there will be a shortage of goods. Some consumers would be willing to pay higher prices to ensure they get the goods. Firms, assuming perfect knowledge, will increase prices but their supply won't change.

The diagram shows that any increase in AD will only result in price level changes and not output changes. The equilibrium point is always at full employment (where all resources are being used efficiently) and the market will always revert back to a point on the LRAS.

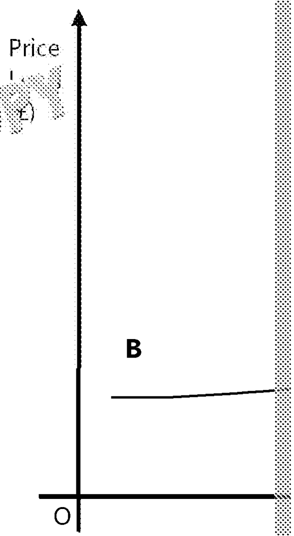
Classical economists believe the market will gravitate towards equilibrium at full e classicalists believe this will happen straight away. Some new-classicalists believe eventually the market will find equilibrium.

The new-classical model is adapted to include a short-run aggregate supply (SRAS) curve to explain the market when it is temporarily out of equilibrium and not on the LRAS curve. This can explain the market, not only when it is under full employment, but also when it is producing above full employment. If aggregate demand increases and shifts the AD curve out, then the economy will move along the SRAS curve so that more goods are produced to meet this increase of demand (Y_e to Y_1). Production is above full employment. This can be done temporarily by, for example, paying overtime to workers to work more hours. However, overtime pay for 'out of hours work' is more expensive and it is unlikely firms will stay at this point. Workers will increase their wage expectations and the wage rate will increase. This means the costs of production will increase and the SRAS curve will shift back in until it meets the equilibrium point C on the LRAS curve.



Keynesian (Interventionist)
John Maynard Keynes built a new long-run aggregate supply curve, which could explain a market that had reached equilibrium but was below full employment. The Keynesian AS curve assumes wages are sticky.

Section A of the curve shows perfectly inelastic aggregate supply. At any point on this curve, the economy is at full employment (the economy is at full capacity) and any increase in AD will only result in increasing price and no increase in output. This is because, in order to increase output, firms must offer higher wages than existing wages to encourage workers to leave their jobs and work for them instead. Overall, output will not rise because a resource has simply moved from producing one good to producing another, but prices have gone up.



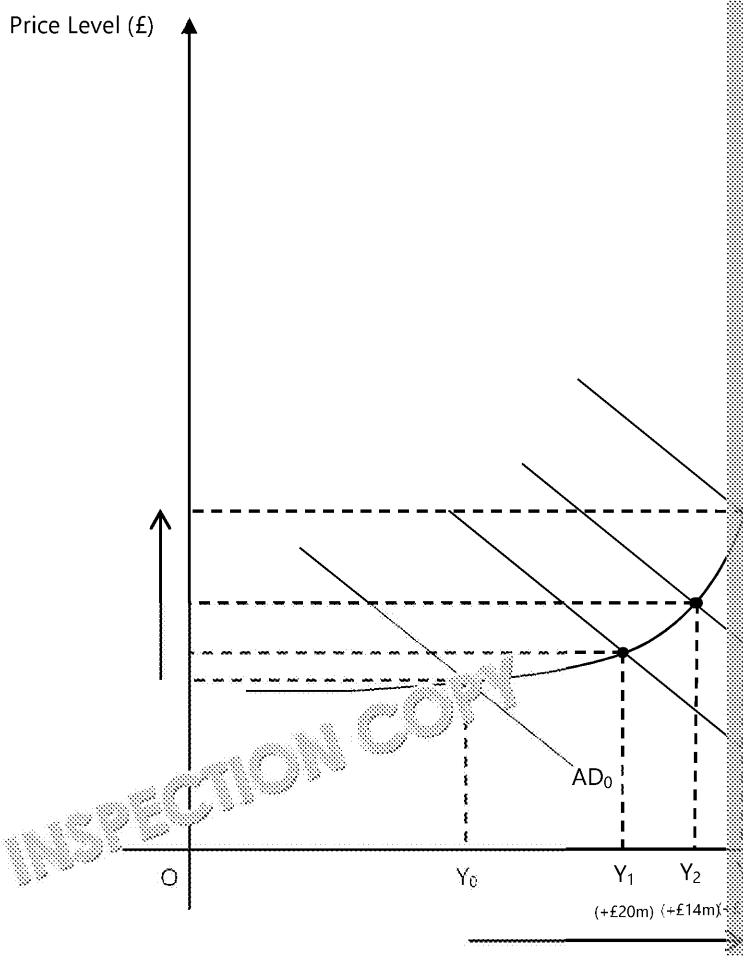
Section B shows an elastic aggregate supply. Here the economy is likely to be de resources are unemployed. At this point there is spare capacity to grow. Output c prices. This is because there is no competition for resources and a firm can offer a Overall output of the economy will increase but price level will not.

Section C, the middle section, is the part that brings the two extremes together. H increased GDP and higher price level. This is a well-known relationship where infla economic growth. This will be discussed later in Topic 2.6.4.

Classical economists believe equilibrium would always gravitate towards full empl everything will adapt to the changes, such as workers accepting lower wages. How frictions within the market that would prevent it from adjusting, such as sticky wa could be in equilibrium (where AD meets AS), but this could be stuck at a point be Unemployed workers won't accept lower-paid jobs and so remain unemployed. Th consumption and AD is unlikely to move and stay low, costs of production wou increasing demand to meet, so firms are unlikely to change their supply and incre resources.

Multiplier

The multiplier can also be shown using the aggregate demand and aggregate su example from Topic 2.5.2a (page 67) and the Keynesian AS/AD diagram, this will b



Every time the income flows around the economy, the aggregate demand curve i each time, as money is withdrawn.

The initial £20 million injection pushes the AD curve outwards to AD1. The econo £20 million worth of goods. £6 million was withdrawn and the other £14 million g AD curve is pushed out again to AD2, where the economy is producing another £1 goes on until all the income has been withdrawn from the economy; production h

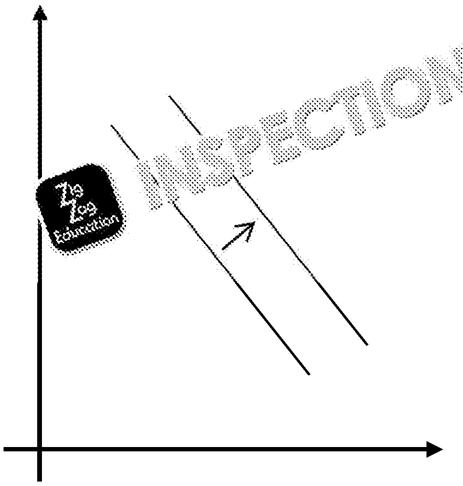
2.5.2.b Questions

5. **a)** For a firm, how are the short run and the long run defined?
   b) What factors could affect long-run aggregate supply?
   c) What factors could affect short-run aggregate supply?

6. Fill in the blanks:

$$AD = C + I + \square + (\square$$

7. **a)** Complete this diagram showing aggregate demand by labelling th
the y-axis.



   b) What has happened to this curve?
   c) **i)** What four main factors can shift the AD curve?
      ii) For each factor, explain two to three reasons the curve has m

8. Use a diagram to show how an outward shift in the AD curve will caus
and how this is only sustainable if the LRAS shifts too (use a classical

2.5.3 Inflation

Microeconomics talks about prices for individual goods in the context of individual businesses or markets. However, with macroeconomics the focus is on the 'price level' in the economy. That is, the average level of all the prices for all goods in the economy. Economists are not concerned directly with the level of the prices in the economy, however, but rather with the rate of change of price level, i.e. how much the prices have risen or fallen by.

Inflation is a sustained rise in the average price level.

Deflation is a sustained fall in average price level.

Disinflation is a fall in inflation, i.e. a fall in the increase in average price level.

Country A's inflation rate was 3% in June but in July its inflation rate was 2%. This rate has fallen but there is still a rise in general price.

Country B's inflation over a four-year period is shown below...

Year	Inflation
Year 1	2.0%
Year 2	1.4%
Year 3	0.3%
Year 4	–0.6%

For the first three years, country B experienced disinflation. It wasn't until Year 4, w that the country experienced deflating prices.

How Inflation May Change Measurements (Real versus Nominal

The problem inflation causes in measurements will be explained using GDP...

If GDP is the total number of products, then the number of goods and services sh 'volume' of goods and services, but what is the value? A function of money is to g compare the changes in the GDP, goods and services need to be given a compara Therefore, to calculate GDP, the total price for all the goods and services produce monetary value of the economy.

Prices, however, change over time. The price of a good is determined by the mark Changes in supply and demand will change the market equilibrium, such as for be due to the 'horse meat scandal' which caused a fall in demand, and a consequent generally been increasing over time mostly because the supply of oil is falling. Pri if this keeps changing then the unit of measurement keeps changing.

The nominal price is the current price of the good at the time of recording. Prices r nominal prices rise over time. If GDP is only measured in nominal terms, a country look as if it is performing strongly, when in fact the effect is mainly from price

For example*, an economy producing 50 pairs of socks at £1 each will seem to have prices increase to £1.50 but the economy is still only producing 50 pairs of socks, the level of £75. The economy appears to have grown; however, really it has not grown*

Instead, economists would rather look at the 'real' change when comparing GDP c change in 'real' value of the goods without the effect of rising prices (inflation). To calculate the volume of goods and services produced in a country in one year and would have had in a certain comparison year. The year that is picked is called the all subsequent measurements are based on. Read the following section to learn h over time using indices.

Price Indices and Measure of Inflation

Consumer Price Index (CPI) is measure of inflation and is the measure used by the name, is an index of prices, and measures the percentage change in prices. A perc the inflation rate.

There are far too many goods and services in the UK produced by a variety of suppliers and sold at a variety of outlets to measure all of them. Instead, CPI measures the prices of a representative proportion of aggregate consumption, i.e. CPI measures the price change for 650 goods and services that are typically bought by an average household. These 650 goods/services are referred to as a 'basket of goods' and are found from the Living Costs and Food Survey. This is where households taking the survey record their expenditure for a month and this is used to determine an aver pattern. The relative and changing price of this basket is used to give the rate of a (inflation). Preferences change, meaning the basket of goods changes and so the to keep the basket of goods revised and up to date.

T
o
av

The Living Costs and Food Survey has another use as well. Inflation on expensive on the economy than cheaper goods do. Equally, prices of essential and widely us food, will have a more significant impact on the economy than goods and service For this reason, some goods need to have greater importance attached to them d 'Weights' are given to items to account for their various impacts. These weights a Costs and Food Survey.

Indexation and Measuring CPI

Let's use an example to show how an index is calculated to show inflation.

Year	**Goods**		
	Good Name	**Price**	**Items bought as a percentage of total items bought (weight)**
2013 (base year)	Good A	£25	10% (0.1)
	Good B	£1.50	65% (0.65)
	Good C	£5.00	15% (0.15)
	Good D	£7.50	10% (0.1)
2014	Good A	£25.50	10% (0.1)
	Good B	£1.60	65% (0.65)
	Good C	£5.50	20% (0.15)
	Good D	£7.50	5% (0.05)
2015	Good A	£26	10% (0.1)
	Good B	[illegible]	60% (0.6)
	Good C	£5.50	20% (0.2)
	Good D	£7.50	5% (0.05)
	Good E	£7.00	5% (0.05)
2016	Good A	£27	10% (0.1)
	Good B	£1.60	60% (0.6)
	Good C	£5.60	15% (0.15)
	Good E	£7.50	15% (0.15)

1) First you need to select a base year. There may be particular reasons for picki
otherwise it can be any. In this example 2013 will be the base year because it

2) From the survey, the goods bought by most households and their weights fo
the survey. The goods and their weights may change slightly according to pr

3) The price level for each year is then found from the representative sample da
good by its weight and adding these totals together.
$\text{Price Level}_{\text{Year}} = (\text{Price}_A \times \text{Weight}_A) + (\text{Price}_B \times \text{Weight}_B) + (\text{Price}_C \times \text{Weigh}$
$\text{Price Level}_{2013} = (£25 \times 0.1) + (£1.5 \times 0.65) + (£5 \times 0.15) + (£7.5 \times 0.1) =$
This is done for all the years and is shown in the table.

4) Then the index value is found by $\text{Index for that year} = \left(\frac{\text{Price Value of Year}}{\text{Price Value of Base Year}}\right) \times$
So the year 2014 would be $101 = \left(\frac{£5.02}{£4.98}\right) \times 100$

5) The base year is always $100 \left[100 = \left(\frac{£4.98}{£4.98}\right) \times 100\right]$. Any index above 100 show
level and therefore inflation, e.g. from 2013 to 2014 (index 101) there was 1
(index 108) there was 8% inflation. If the index was 98 then there would be 2

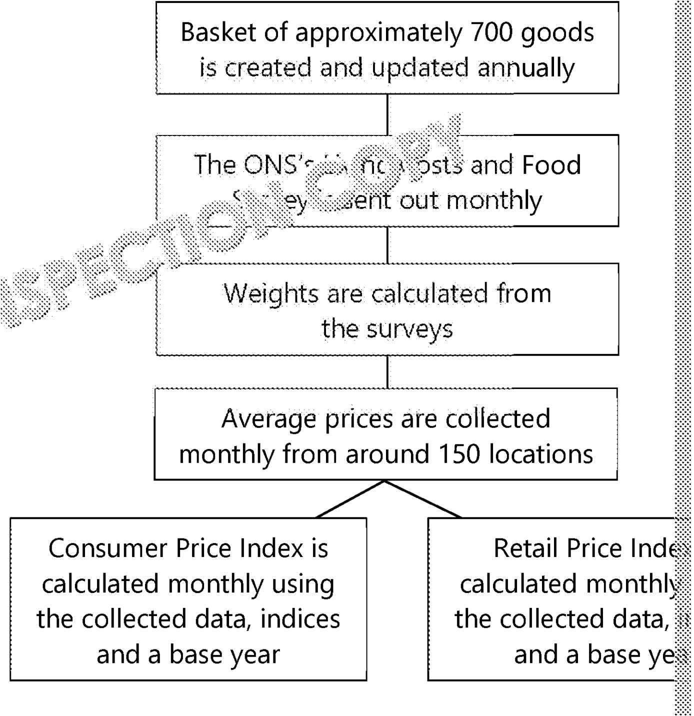
6) To find the inflation between years, you first find the difference between the tw
number. $\text{Inflation} = \left[\frac{(\text{Index}_B - \text{Index}_A)}{\text{Index}_{\text{Base}}}\right] \times 100$. So the inflation from 2014 to 2015
Because the base year is always 100, finding inflation from the base year can
$\text{Inflation} = \text{Difference between two years}$

Retail Price Index (RPI)

The RPI is another measure of inflation. CPI is used by the government but RPI is
and there have been talks of swapping from measuring inflation from CPI to RPI

Both measures use a representative proportion of aggregate household consump
they both record their prices for a variety of goods/services, suppliers and retail o
independent and large chains). They both use weighted prices and calculate index
change from a base year.

The difference between the two measures is very complicated and does not need
uses a geometric average, whereas RPI uses an arithmetic average. But the main d
costs and CPI includes energy costs which will show a bigger impact from oil-pric



Causes of Inflation

Now that you have learnt about the AS and AD curve, it is possible to explain the diagram (see end of section). Factors that cause inflation can be separated into tw affect aggregate demand and those that affect aggregate supply.

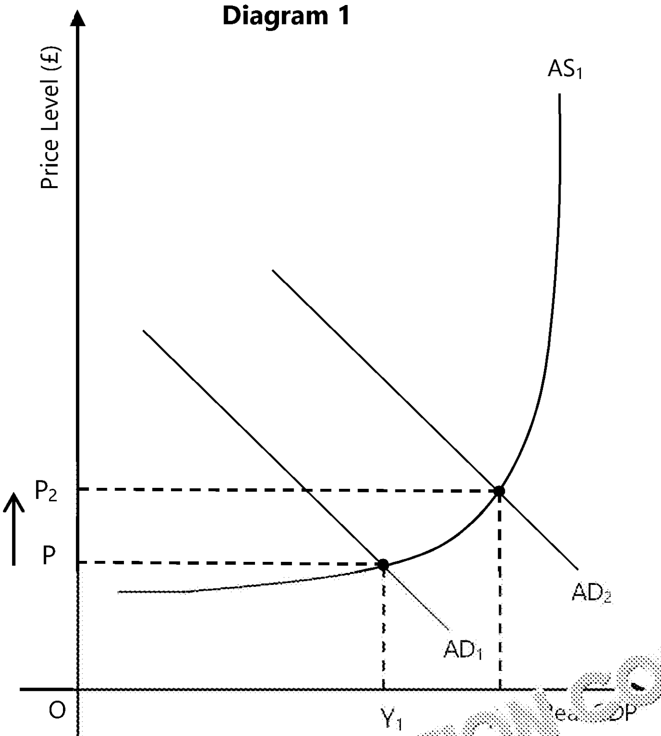
Demand-pull Inflation

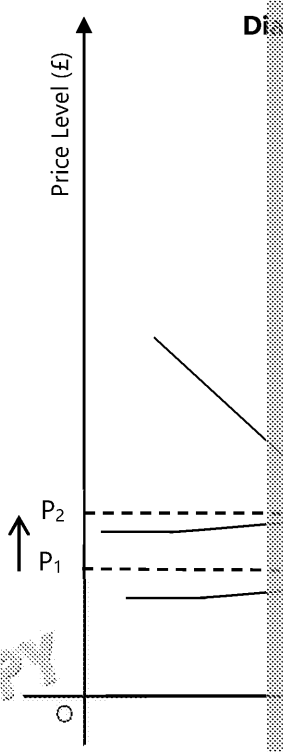
Demand-pull inflation occurs when aggregate demand increases and pulls up pric Diagram 1, where AD$_1$ shifts out to AD$_2$ and prices rise from P$_1$ to P$_2$. This happens supply, producers will find they are running into shortages. In order to ration their pulled upwards with demand. It is more prominent when the economy is near full people have an income and can therefore go out and spend it.

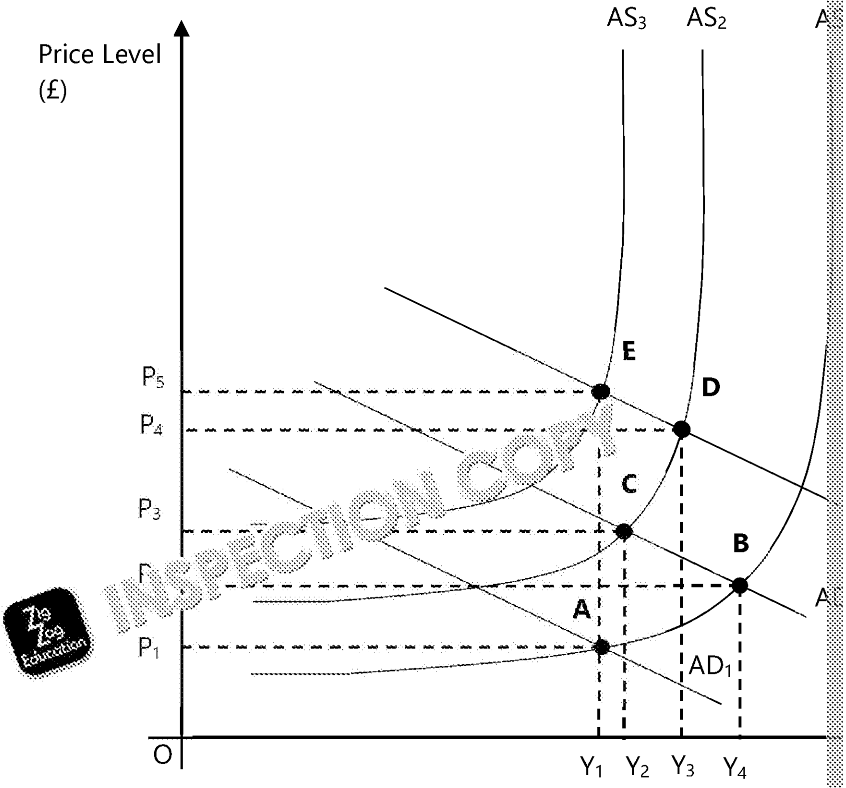
Demand-pull inflation occurs when any of the factors of aggregate demand increa rise, maybe because income tax has fallen, then consumption will increase and the outwards. If confidence and expectations are high then firms and consumers are l investment which will push the AD curve outwards and pull up price level.

Cost-push Inflation

Cost-push inflation occurs when aggregate supply decreases and the price level is on Diagram 2, where AS$_1$ shifts in to AS$_2$ and prices rise from P$_1$ to P$_2$. This happens increase. In order to cover these new costs, firms will push the costs on to the cons

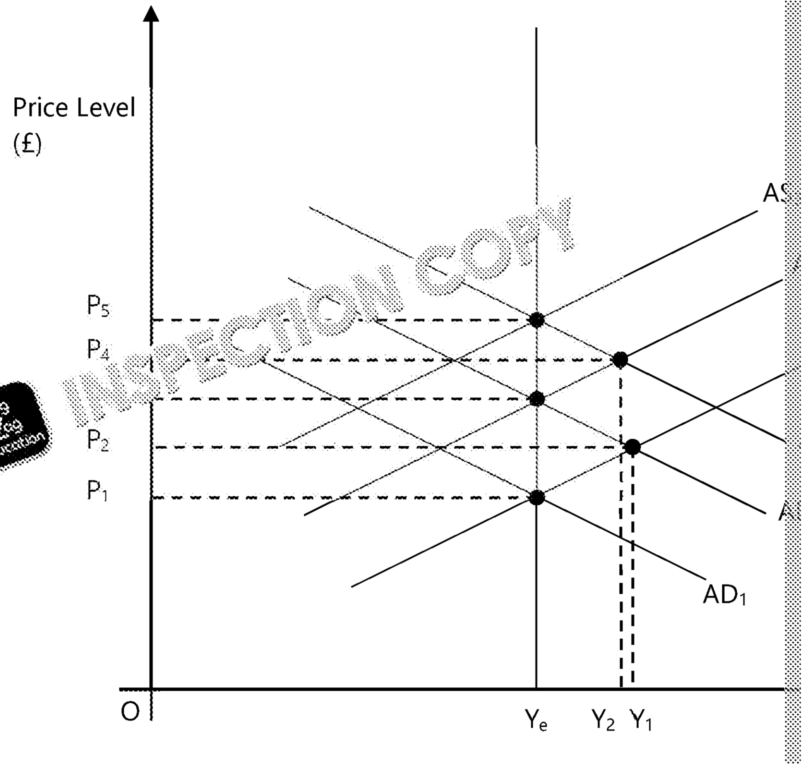






Wage-price Spiral

The wage-price spiral is a process that occurs when demand-pull and cost-push in diagrams above and below). Let's start at **Point A**. Here, prices are at P_1. Demand whatever reason and so the aggregate demand curve shifts to AD_2. Now the econ risen to P_2. The cost of living has gone up and so workers demand higher wages f aggregate supply curve now shifts in to AS_2. Now the economy is at **Point C** and t prices have risen to P_3. Because the workers have more money from their increase consumption and the aggregate demand curve pushes out again to AD_3. Now the and there has been demand-pull inflation, prices have risen again to P_4. To cover t demand higher wages, causing the aggregate supply curve to shift in to AS_3. Now **Point E** and there has been cost-push inflation pushing the price level up again to again. This is shown graphically using a Keynesian AS/AD curve (above) and a clas



Impact of Inflation...

There are a variety of problems that arise from price changes. Inflation can be ass because, often, inflation follows growth. Deflation, therefore, is associated with ne deflation can also cause negative growth rates. If prices are falling then firms and they can get a better deal because things will be cheaper. If people stop buying g then the economy will stop expanding (think about the circular-flow-of-income d that inflation should be positive; however, high levels of inflation can still have un

On Firms

Uncertainty, International competitiveness

- **Menu Costs:** Changing prices mean firms have to change their labels, print r machines (tills, vending machines, etc.) also have to be updated.'
- **International Competitiveness:** As UK prices rise, UK goods will appear mo in comparison to foreign goods, *ceteris paribus*. Therefore, inflation can dimi makes goods and services appear relatively expensive.
- **Anticipated Inflation (Uncertainty):** If inflation is anticipated, firms and go planning, thereby protecting themselves from inflation and mitigating its aff throw plans and mess up budgets which will lead to problems. If inflation steps to prepare for price rises but unanticipated inflation can create uncerta investment decisions.

On Individuals

Loss of real income, savers and borrowers

- **Diminishes the Value of Savings:** Because inflation decreases purchasing p value. The values of savings are usually diminished by inflation. High enough received from the bank for storing money with them) can help mitigate the v inflation. Pension schemes are susceptible to inflation for the same reason.
- **Shoe-leather Costs:** As a consumer, if you know roughly the relative prices o easily judge whether a price is acceptable. Firms need knowledge of relative of their good before determining a price. Inflation means prices are changin which makes it difficult to compare the prices of a good. This idea of a 'shoe leather' cost comes from the notion that shoe leather would be worn down from walking between various shops to gather knowledge of the prices of th goods.
- **Disposable Income (Loss of Real Income):** Disposable income is the incom what they want with; in other words, it is the money left over once tax has be have been added. If prices rise then the purchasing power of people's incom money doesn't go as far. Imagine you have £5, it costs £1 for the bus to scho of the day you still have £2.50 to do with as you please. Maybe you buy a ma of crisps. Now, you still have £5 but inflation is at 20%. The bus to school no you only have £2 left to do with as you please. But the magazine is £2.20 an unable to purchase the same things as before. This is a particular concern to Public-sector workers can find their wages are 'frozen' when the government freeze' means wages are kept fixed at the same nominal value. In real terms, rise and purchasing power falls.
- **Costs of living:** If prices increase then people's costs of living increase. This socio-economic groups living on or close to the poverty line. Workers with l comes to wage-rate determination may find themselves in a squeeze from ri do not increase at least with inflation.

2.5.3. Questions

9. What is the difference between inflation, deflation and disinflation?

10. How do real and nominal GDP differ?

2.5.4 Employment and Unemployment

Extra Activit
The ONS def
as those who
they wish to w
2008 Global F
underemploy

People w
wheth

I

People w
but ar
work, e.g
due to
chosen
or th

Employment: a worker who has a job and is earning a wage is said to be in employment.

Unemployment: a worker who is economically active but without a job is said to be unemployed.

Underemployment: a worker who is in employed in part-time work but is willing and able to be employed full-time is said to be underemployed.

Underemployment occurs when a job requires less of a worker than the worker is able or willing to do, e.g. part-time or reduced hours when the worker wishes to do more hours, or the requirements of a job are less than the skill set or education level a worker possesses. Underemployment in an economy can mean the economy is producing within its PPF because, even if all resources are used, they are not used efficiently. Recent university graduates are often underemployed, as financial struggles can cause them to take jobs that are below their skill set.
Employment does not fall just because unemployment has risen; they are separate values and fluctuate independently of each other. For example, if there is an increase in the number of people who are economically jobs, then then level of employment has risen but unemployment has remained th

Measures of Unemployment

There are two main measures of unemployment: ILO unemployment rate and clai count tend to differ by a greater amount when the economy is successful and thri is declining.

ILO Unemployment Rate

The International Labour Organization defines unemployment as 'those who are w work but have not yet found it'. To identify the level of unemployment, the Labou sample of households. The survey asks whether people are in or out of work, wan they are seeking or not seeking work. From the sample, an estimated percentage calculated for the economy.

Claimant Count

This measures unemployment by counting the number of people who have regist and are claiming jobseeker's allowance. To be eligible to claim iobseeker's allowar out of work but also economically active (i.e. able to work and actively seeking wo

The claimant count is quite a broad measure of unemployment, as it counts all the rather than just a sample of people. The claimant count generally underestimates this is because it only counts those who are claiming, there are many who are une jobseeker's allowance.

Causes of Unemployment

- **Structural Unemployment**

  When the demand for labour is low and doesn't meet the supply of labour th unemployed. This can happen in in a variety of ways and is caused by the im As economists, we assume the resources in an economy can shift between m We assume there are no barriers to factor mobility. However, when industrie adapt to rising industries because of a mismatch in skills.

  Structural unemployment can also exist because the supply and demand of la the country and mismatched. When a worker does not have the required skills as occupational unemployment – this is linked to structural unemployment. Ge when workers cannot move locations to take up a new job (perhaps due to ho

  Another variation on structural unemployment is technological unemployme may displace workers, as their jobs can be performed more cheaply by mach the automobile industry.

- **Frictional Unemployment**

  While people change from one job to another there is a period of unemploy unemployment. It is refers to people who are 'between jobs'. Most economis unemployment as a problem.

- **Seasonal Unemployment**

  Workers in tourist-reliant industries tend to suffer from structural unemploy find they are out of work during certain periods. Generally, seasonal unempl in winter.

- **Demand Deficiency And Cyclical Unemployment**

  Unemployment occurs when an economy is in recession. In order to cut back firms will reduce the number of resources it uses. One of these resources is la jobs and the level of unemployment will rise. This is likely to occur whenever recession or not, because firms will restrict supply by making resources redu meet the lower demand levels.

- **Real-wage Inflexibility**

  If the actual wage rate exceeds the market equilibrium wage rate then there more people would be willing to supply labour than people would be willing supply of labour represents unemployed labour.

  If the market equilibrium wage rate fell because demand for labour fell, for example, the actual wage rate may remain at the same point rather than falling. This is because the labour market is inflexible to changes and wages are 'sticky'; wages do not change or are slow to change. This happens because people won't accept falling wages because they are lower than their expectations. If the labour market was more flexible then it would follow the equilibrium more closely and unemployment would be reduced.

The value or q
skills, knowl
level. Investing
the quality of

For example: *G*
in human capi
skill of a worker
offers is th

Impact of Unemployment…

On Firms

- Falling incomes and falling spending will mean firms will find demand falls fo revenue.
- However, if firms did want to increase supply, there would be a pool of unuse flatten their supply curves (make supply more elastic).

On Individuals

- Unemployed workers are not receiving an income and will find they are less a
- Workers out of work will find their human capital falling as they forget skills a
- Those who are unemployed for a long period of time will find it harder to acc for two reasons. First, their human capital has fallen. Second, employers may shortlisting candidates because they take the stance that 'if other employers would they waste time coming to the same conclusions'.
- Claiming unemployment benefits has a stigma attached to it. Unemployed w and higher levels of depression.
- Consumers will reduce their spending if their incomes fall.

On the Economy and Society

- High unemployment can cause people to lose confidence in the economy.
- Falling incomes mean living standards will fall.
- Because the money spent by government comes from taxes, increased gover likely to be followed by higher taxes in the future.
- Higher levels of national debt are likely to cause higher taxes.
- Research has found that higher levels of unemployment can lead to increase
- Communities can become run down if there are high levels of unemploymen can cause local shops to close and also cause a fall in living standards.
- Higher levels of unemployment can increase inequality and strengthen an un those without jobs lose their incomes and potentially fall into poverty.
- Unemployment, however, can have some advantages. Structural unemploym improving and evolving as resources are being reshuffled to more productive
- If there is lots of unemployed labour in the market, it means firms can expand because there is a pool of readily available workers. Equally, there will be no cost of production remains relatively low.

The Government

- Higher levels of unemployment mean there are more people claiming jobsee spending will increase
- Lower employment means fewer people are receiving incomes and the gove revenue from incomes and national insurance, for example.
- Falling incomes and falling consumption means the government will receive goods and services.
- Falling tax revenue and increased government spending will mean the gover expenditure deficit, which may lead to higher levels of national debt.

The Benefits of Employment

If somebody becomes employed then they will gain an income. This increase in in
easier to buy the goods and services that they need, which will improve living star
purchase the goods that make them happy, which will also increase living standar
that with increased incomes comes increased spending, which will benefit firms as
to buy their goods.

If more people are earning incomes and firms are making more profits from the in
government will gain more revenue from taxes. This in turn will go back into the e
spending on roads or hospitals, for example. Equally, as employment rises, there w
unemployed and the government can reduce its spending on unemployment ben

If people have jobs it gives them a chance to improve their skill set and increase th
only good for the worker but also for the overall economy, which will benefit from
because, like any capital, investing in human capital will improve the efficiency and
its maximum productive potential.

2.5.4. Questions

11. a) Name four possible causes of unemployment.
b) Can you explain these causes?

12. a) What are the two main measures of unemployment?
b) How do these measures attempt to quantify unemployment?
c) How accurate are these measures?

2.5 Keywords

Economic cycle:	A pattern of peaks and troughs in growth experienced
Inflation:	An increase in the price level of goods and services ov
Deflation:	This occurs if the price level is falling.
Disinflation:	This occurs if the rate of inflation is falling.
Aggregate demand:	Total spending on all goods and services in an econom
Aggregate supply:	Total output in an economy.
Claimant count:	A measure of unemployment: the number of people c benefits.
Employment:	A term for those who are of working age and have a jo
Unemployment:	The percentage of people in an economy who are ec employment.
Underemployment:	This occurs if a person is employed but does not work c like, or does not fully utilise their skill set.

2.6 Introduction to Macroeconomic Pol

2.6.1 Possible Macroeconomic Objectives

Ultimately the government aims to create economic stability and remain on the lo because, as discussed earlier, this indicates the economy and society have develo increased. In order to maintain long-term growth rates, the government has a set aims to meet. You only need to know the first four of these objectives for your ex

1) **Economic growth**
   Economic growth indicates more jobs, increased income and greater opport sustainable level of economic growth.

2) **Low unemployment (less than 5%)**
   The government aims to have full employment because this indicates the ec productive potential. In the UK 5% is considered the natural rate of unemplo level the government aims for.

3) **Low and stable rate of inflation (less than 2%)**
   Price stability is important for economic agents to function properly. As discu a stagnant and potentially diminishing market; therefore, the government ai inflation at around 2%.

4) **Balance of payments current-account equilibrium**
   A balanced current account means there is a balance of injections and withdr than the other it can cause the economy to boom above or deflate below its

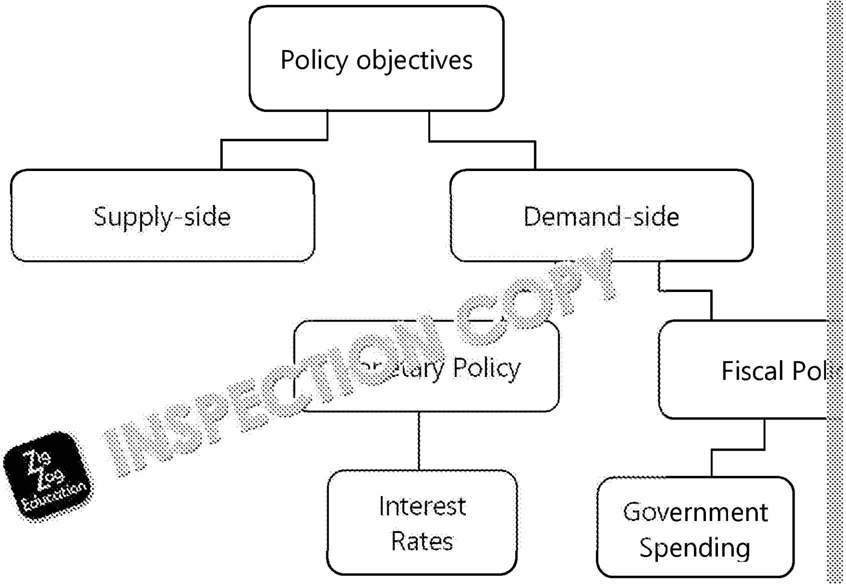
5) **Balanced government budget (tax revenue = spending)**
   The government budget refers to the levels of government spending compa High debt levels are unsustainable for a government and can lead to financia recession has highlighted. In order to have sustainable government finances need to equal spending.

6) **Protect the environment**
   In order to meet growing demand from infinite wants and population growt resources are used up, leading us to a bottleneck. Without a healthy environ to function, whereas a healthy environment is beneficial for well-being as we imperative to protect and maintain it.

7) **Greater income equality**
   A more equal distribution of income creates a fairer economy and allows the efficiently to increase living standards; however, a gap is still needed in order relative poverty will create greater income equality.

The main government objectives can be achieved using various policies. Each poli instruments', which are variables that the government can control in order to mar the various policy objectives. These instruments control the economy by influenci or aggregate supply.

Policies that use instruments to influence aggregate supply are called 'supply-side
instruments to influence aggregate demand are called 'demand-side policies'. The
policies: monetary policy and fiscal policy. These policies are discussed below in th



2.6.1. Questions

1. **a)** What are the economic objectives of the government?
b) Explain why each of these is an objective of government.

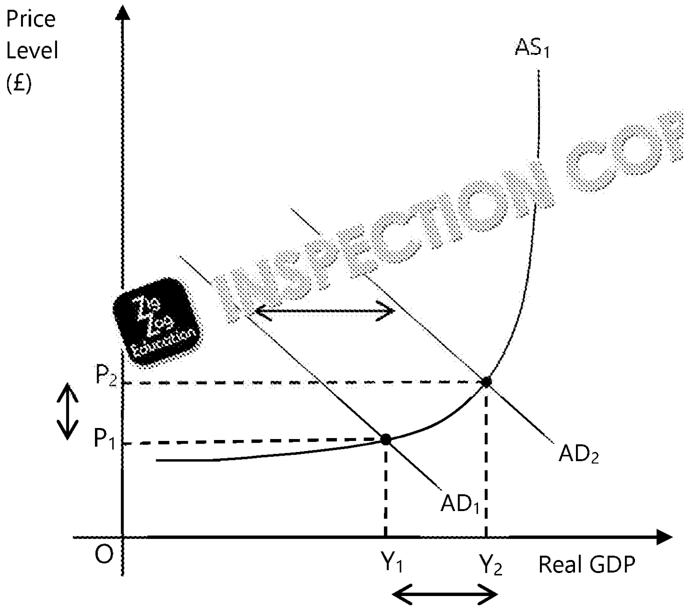
2. **a)** What are the three types of macroeconomic policies?
b) What are the demand-side policy tools and how can each of thes
manipulate the economy?
c) Who is in charge of the three policies?

2.6.2 Policy Instruments

Fiscal Policy

Fiscal Instruments: Government Spending and Taxation

Government spending is an injection into the economy and taxation is a withdrawal instruments work in a similar but opposing fashion and come together to create an can directly change this ratio by choosing to tax at a different level or choosing to s



Deflationary fisc tries to 'deflate' or because it is head boom. To deflate reduce governme taxation. This will to AD_1, price level Y_2.

Inflationary fisca tries to 'inflate' or because it is in a r the government w and/or decrease t curve from AD_1 to inflation.

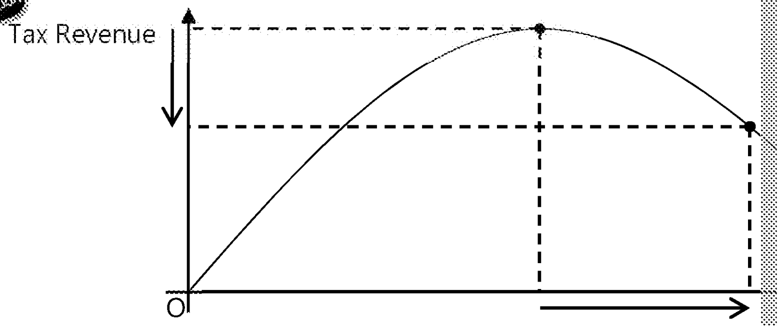
Government budget (fiscal) deficit is when the money coming into the governm out in the form of government in the form of tax revenue and government spend government debt; government debt is the result of a deficit and is accumulated o government may need to borrow in order to cover its deficit, thereby creating a d

Government budget (fiscal) surplus is when the money coming into the govern money leaving (government spending).

Impact of Taxes on...

- **Incentive to Work**
  Some people may be put off working longer hours, or getting a job with hig taxes mean they will be taxed more highly. Therefore, increasing taxes may c instead encourage people to work less or remain unemployed.

- **The Laffer Curve (Tax Revenues)**
  The Laffer curve describes a negative parabola relationship between tax reve the tax rate will increase the amount of tax revenue the government receives increasing tax revenue will only [illegible]tivise people to work and encourage means tax revenue will [illegible] from an increase in tax rate beyond this poi that will provide the highest tax revenue.



- **Income Distribution**
  Progressive taxes can be used to correct uneven distributions of income. This that is raised from the tax goes towards benefits and payments to lower-inco

- **Real Output and Employment**
  Taxes are a leakage from the circular flow of income. Therefore, higher taxes deflate and economic growth rates will fall. A deflating economy will mean e because firms will cut back production in order to compensate for the increa tax could discourage people from entering the labour market, or even encou market. This will mean the employment rate will fall, and in turn growth rates can be seen by an inward shift in the PPF.

- **Price Level (Inflation)**
  Higher taxes would increase the costs of production and firms would respon on the burden of the tax. If this happens continuously, then this can cause inf price spiral as workers ask for higher wages to cover the costs of goods. Equa workers will have less disposable income and may ask for higher wages in or increased taxes, which will lead to inflation as firms increase prices to cover t

- **Trade Balance**
  Increasing direct taxes will reduce the level of disposable income that people people will have less to spend on imports and thus imports will fall. This coul

- **FDI Flows**
  Lowered tax levels will entice foreign firms and multinational corporations to foreign direct-investment flows can inflate the economy and increase growth the tax rate will deter foreign firms from entering the country because their r

Evaluation Points

There are a variety of things that affect the effectiveness of fiscal policy, it is a goo as you will gain 'evaluation' marks in the exam.

- The size of the multiplier will determine how effective fiscal policy is because by the government. A large multiplier means the government need only mak large effects whereas a small multiplier will not bolster changes to tax or spe changes are needed.
- The economy is complex and hard to measure. It is difficult to determine whe business cycle and where the AS and AD curves are. Therefore, the governme information or misjudge by how much it should cut/increase spending and t overshoot or undershoot by incorrectly using fiscal policy and create further
- Inflationary fiscal policy will worsen the budget deficit because tax revenue f spending will rise. Although this doesn't determine the effectiveness of the p policy and can create issues in the future.
- The principal problem with fiscal policy is there are time lags between deciding actual implementation of the policy because it takes time to pass regulations, fo more public workers. However, once implemented, the effects of fiscal policy ar problematic because the government cannot respond quickly to a fluctuating m Equally, even if the government had perfect information and changed their inst economy, there is no knowing what will happen in the future. External shocks that can cause the economy to react differently to policy predictions or the remnant the economy could result in further failures, especially if the government's effor
- Economists often see reduction in government spending as a necessity to re policy objectives. However, the government has a difficult 'catch-22' choice t spend money on policies that improve people's lives, on vitals public services support and, therefore, reductions in spending can mean harsh cuts for the p they need. So any economic advantage from a reduction in government spe any reduction in living standards.
- Deflationary fiscal policy may reduce inflation but can create demand-deficit production and the economy's growth rate begins to slow down. Inflationary unemployment but it can cause demand-pull inflation.

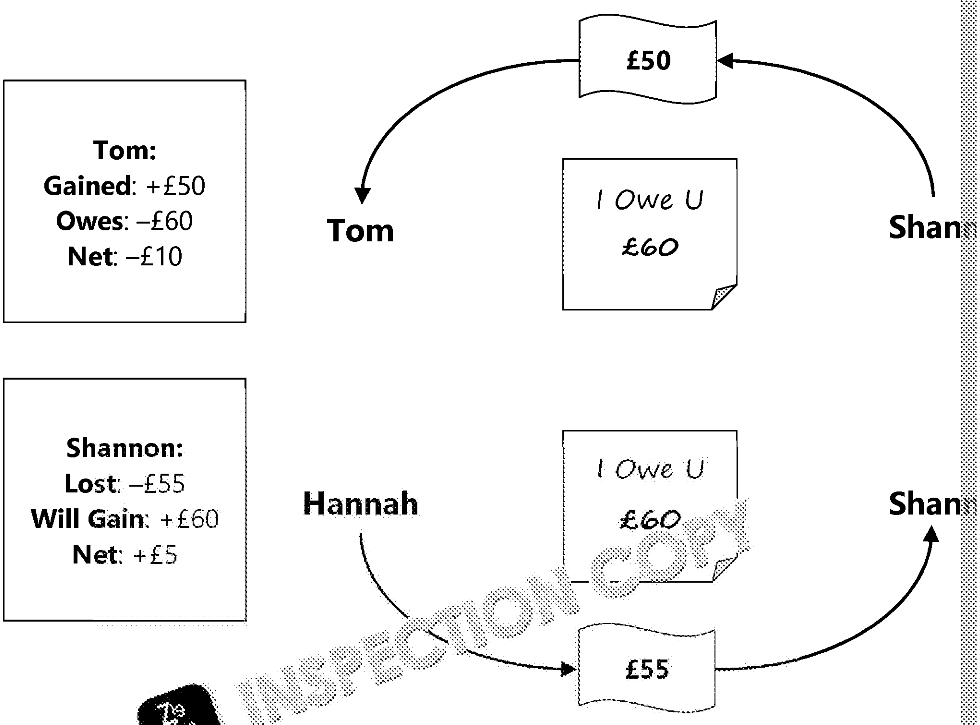
Monetary Policy

Quick explanation of the Finance Market

Banks lend to others because, although they are currently without money, the bor plus interest. Therefore, the lender (the bank) will make money overall in the long

If the lender needs money, they of course can't use their own because they have l then find money elsewhere; rather than borrowing themselves, they will 'sell on' t Shannon lends Tom £50; in return Tom will pay Shannon £60 next month. Shanno and cannot wait until next month. She tells Hannah that Tom owes her £60 and if will owe Hannah £60. This way, Shannon has received the money she lent, plus ha have earnt £5 from lending Shannon £55. This can be repeated again and again w system is complicated and with numerous transactions, it can be hard to keep trac when the borrower cannot pay back the loan (defaults on their loan).

Cash, notes and coins, can buy things. Liquidity is the ease by which something ca are relatively liquid as you can get cash from them quickly from a cash point. A ri a pawn shop and exchange it for cash; however, there is difficulty in finding a sho and finding someone who will buy the ring. A house is more illiquid than a ring beca someone to buy a house because people need longer to make a decision on larg bureaucratic procedures that slow down the sale of a house. Loans can be turned when she sold the loan to Hannah. Some loans are more liquid than others. Gove and are fairly liquid. When a government needs to borrow money, it will sell a bor that says 'I, the government, owe you £££'. Say Tom was the government and Sha have sold a government bond to Shannon for £50, with the bond stating that To owner of this bond £60 next month. The UK government, for example, is a very tru to default on its loan. Therefore, being a low-risk loan, the bond would be highly



***Monetary Instrument**: Interest Rates and Quantitative*

Monetary policy is set in a different way to fiscal policy and this is mainly because directly controlled by the government. As discussed before, interest rates affect co however, there are a few more steps between.

First, you need to understand the role of a 'central bank'. There are many tasks a ce controlling stock of foreign reserves, maintaining the exchange rate, issuing notes The Bank of England is the UK's central bank and it maintained the exchange rate

floating exchange-rate market. It still holds the stock of foreign reserves and issues
Its main role is to maintain stability of prices (inflation control), which is done by se

The base interest rate is the rate of interest the Bank of England charges to comm
from them. Commercial banks are those that you see on the high street; they are
businesses use to borrow money from and store their savings in. If the Bank of En
then commercial banks are likely to raise their interest rates to cover their increase
then mean the cost of borrowing for businesses and consumers will increase and
their spending and investment.

The Bank of England was given the role of inflation targeting because the govern
rates during times of election in order to boost consumer confidence and votes. I
disruption to the economy, inflation targeting was given to an independent body,
the Monetary Policy Committee (MPC). If the Bank of England does not meet its i
report back to the government with an explanation of why.

The Bank of England may also use 'quantitative easing' to encourage banks to lend
borrowing. The Bank of England does this by effectively printing more money for it
money, it assumes it has more money and with these new funds, the Bank of Engla
government bonds from commercial banks. This means banks will gain money, via
exchange of physical coins and notes. The money they gain from their sale of bond
lend money to economic agents. Quantitative easing is used when there is a lack o

Monetary policy is seen as a blunter policy than fiscal policy because it targets the
fiscal policy could be targeted to selected markets.

Tight (deflationary) monetary policy is implemented when inflation is expected
attempt to restrict aggregate demand by increasing interest rates and/or increasi
diagram from fiscal policy, this will cause the AD curve to shift inwards from AD_2 t
has GDP.

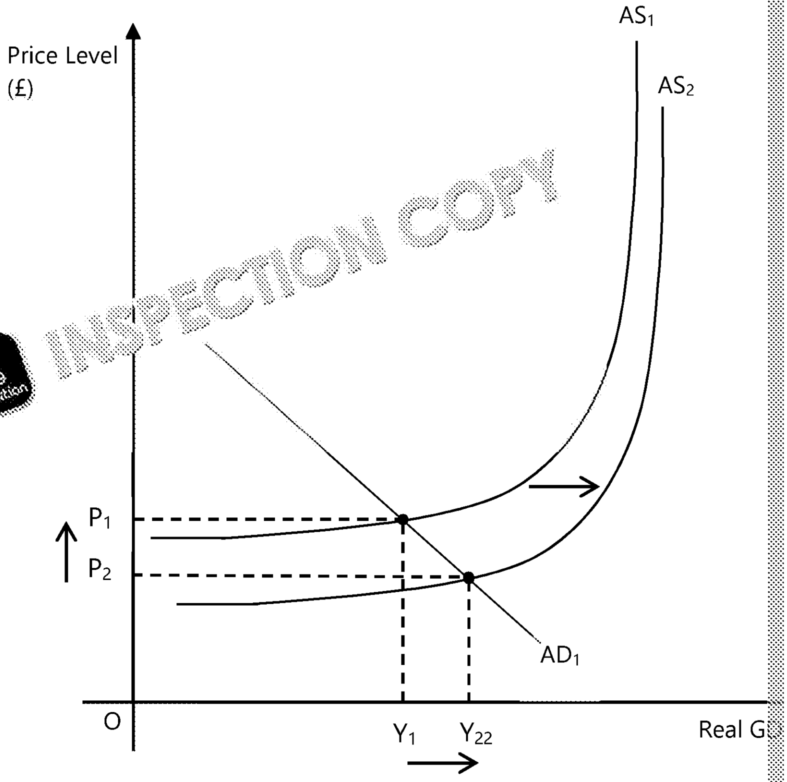
Loose (expansionary) monetary policy is when inflation is expected to fall belo
its monetary policy by decreasing interest rates and/or increasing the money supp
shift outwards to AD_2; price level has risen and so has GDP.

Evaluation Points

- Commercial banks may not pass the change in the base rates on to consume
  effectively, the interest rate has not changed and there is no change to econ
- If confidence or expectations are out of sync with the economy, then econom
  respond in the same way regardless of the changing instruments.
- There can be time lags between when monetary policy is implemented and w
  because it may take economic agents time to adjust their consumption and i
  interest rates.
- There may be a credit crunch and commercial banks may not have the funds
  consumers.
- Tight (deflationary) monetary policy may reduce inflation but can create dem
  firms cut back production and the economy's growth rate begin to slow dow
  may cut unemployment but it can cause demand-pull inflation.

Supply-side Policies

There is a wide range of things that affect the aggregate supply, none of which th of control over as it does with demand-side policies instruments. The main way th aggregate supply is through spending on supply-affecting investments or by char are some conditions which affect aggregate supply and explanations of how the g affect those conditions.



Market-based policies: There is very little government intervention with market- policies is to support and use the forces of the free market to increase efficiency, supply. Market-based policies try to boost aggregate supply by improving the abi and by removing any barriers.

Interventionist policies: Interventionist policies are the opposite of market-base quite an active role within the economy. Its role is to intervene in order to correct generate and to guide an economy to a better equilibrium.

Different Policies

- **Promote Competition**

  If there are lots of producers in a market, there is more competition bet producers an incentive to find ways to cut production costs because then the price, thereby gaining more customers. To do this, the government could giv companies, or reduce barriers to entry (obstacles that may prevent a firm fro laws that prevent monopolies (large firms that others cannot compete agains or subsidies for domestic firms, there will be an influx of foreign firms which the market. By both reducing taxes on imports, allowing foreign firms to ente subsidies to domestic firms, an economy can increase competition while still remain. This will boost LRAS because domestic production has not been repl the competition drives the firms to become more productive, thereby pushin can also boost competition. Governments are not worried about increasing r profits; therefore, they aren't very competitive. By giving the business to the competition, as the new owners will compete against other market players.

- **Reform Labour Market**
  Reforming the labour market refers to the quantity and quality of labour and forces acting freely within this market. Structural unemployment is a result of labour. Trades unions are another barrier to the free-market system. Trades u to an individual worker by bringing individuals together as one large body. T power when it comes to negotiations over wages and working conditions. By economy can gain workers and thereby increase its ability to produce goods. supply, laws around migration are supply-side policies. By increasing minimu willing to work. Equally, by reducing unemployment benefits, this would disin benefit and encourage them to work. However, unemployment benefits are t incomes and so there is a trade-off between protection and incentive.

- **Quality of Workforce (Skills and Education)**
  If the government invested in schools by, for example, buying new learning t have a better education system, creating a more productive workforce. Equal government gives an incentive for children to continue with higher education workers will also help to improve the human capital of an economy. This is pa structural change to an economy because it will help the mobility of workers

- **Infrastructure**
  Spending on infrastructure means investing to improve the physical condition for example, investing in transport systems such as railways and roads or inve offices or houses. By improving these factors society will be happier and the e will function more smoothly. If there is adequate housing, then the workforce would be happier, if the roads were smoother and straighter, then the lorries could move between factories more easily.

  To see what the government is spending on infrastructure now for the economy, visit: *https://www.gov.uk/government/organ*

- **Quality of Capital and Production Processes**
  Investment into research and development will create a technological advanc machines are invented and more efficient methods of production are created because a more productive and efficient economy can produce more goods. investment will indicate increased capital stock. Greater quantity of capital (m possibility for more production.

Strengths and Weaknesses of…

Demand-side Policies

+ Although demand-side policies have a time lag of about a year, they are muc policies and are therefore used to respond to changes in the economy.
– Classical economists believe any increase in aggregate demand will only caus
– Although the government can manipulate the economy, the global market h government has no control over. The government policy is weak to external s
– Data collection is slow and long-winded. The information provided to govern inaccurate but also out of date, causing the government to react slowly and

Supply-side Policies

+ Shifting the aggregate supply curve outwards will not cause inflation, as it cre prices through competition and improvements to production.
+ Increasing aggregate supply is an increase in production, as long as it is met demand (movement along the AD curve). This indicates a rate of economic g resources are generally improved or increased in the long term.
+ Increasing production and economic growth will mean there is job creation, w of unemployment.
+ By improving the productive capacity of an economy and reducing the costs

become more competitive in the global market. This will mean that exports w
will improve.

- Supply-side policies have long time lags. Improving the quality of the workfo
can take 13 years, as children start aged 4–5 and finish aged 17–18.
- These policies can be very costly, which would have a negative impact on the
- Although the government can manipulate the economy, the global market h
government has no control over. The government policy is weak to external s
- Data collection is slow and long-winded. The information provided to govern
inaccurate, but also out of date, causing the government to react slowly and

Exchange Rate Policies

Quick Recap
Check through Chapter 2.4.4 to refresh your memory of exchange rates.

Exchange Rate Systems:

- **Floating**
A floating exchange rate system simply means a country allows the value of i
to the market forces of demand for its currency and (the somewhat cont
Decreases and increases in a country's currency are described as depreciates
under a floating exchange rate regime.

  Appreciation is when a country's currency increases in value, e.g. the pound
rate was £1=$1.50 (each pound costs $1.50) but is now £1 = $2 (each pound

  Depreciation is when a country's currency falls in value, e.g. the pound will h
rate was £1 = €2 (each pound cost €2 to buy) but is now £1 = €1 (each poun

- **Fixed**
A fixed exchange rate is when a country's governing body or central bank ke
terms of another, at the same level. Revaluation and devaluation of a country
bank's decision (mediated through the IMF) to increases or decreases a coun
another currency.

  Revaluation is when a country's central bank decides to increase the value o
£1=$2 to £1=$2.50

  Devaluation is when a country's central bank decides to decrease the value o
£1 = $3 to £1 = $2.

- **Managed**
A managed exchange rate is when the monetary authorities of a country influ
the country's currency via buying and selling the currency itself or by changin
the foreign-exchange markets, authorities such as the Bank of England, are a
country's currency in terms of another.

Why Might the Government Want to Intervene in the Foreign-exchan

- **Current Account of the Balance of Payment**
A devalued or depreciated currency will increase international competitivene
appear cheaper in relation to other countries. As a response, the demand for
equally the demand for imports will fall as domestic consumption is switched
This will reduce any current-account deficit a country may have and potentia

- **Economic Growth and Unemployment**
If the exchange rate changes such that a country's goods become more comp
is a boost in their exports and domestic demand as people swap to buying th

industries will increase production in order to meet this new demand, thereby
and higher employment levels through the increased demand for labour.

If an economy's goods become less competitive, then there would be a declin
potentially leading to negative growth, and unemployment could begin to ris

- **Rate of Inflation**
  If the exchange rate changes such that the pound depreciates, then imports
  will increase the costs of production for those firms that import raw materials
  consequently push the price up, leading to inflation. Equally, the increase in
  in exports will also cause inflation.

  If a country's currency appreciates, then it may experience falling inflation rat
  particularly if it is reliant on exports.

- **FDI Flows**
  If the exchange rate falls, then it will be cheaper for foreign companies to inv
  attract [illegible] Foreign Direct Investment (FDI) into the economy. On the other
  appreciates, then it would be more costly for foreign firms to invest. As a co

- **Exchange Rate Stability**
  Large fluctuations in the exchange rate can indicate economic instability. This
  and prevent firms from investing and deter foreign investment. Equally, it is
  perform their business if there is foreign market instability, especially for thos
  global market.

2.6.2. Questions

3. *'Supply-side policies are better for the economy than demand-side po reason they are not used is because the time lags mean politicians w time for elections.'* To what extent do you agree with this statement?

4. How does fiscal policy conflict with other policies and the government

2.6.3 Potential Policy Conflicts and Trade-offs

There may be conflicts between macroeconomic objectives, i.e. in the process of i objective is impaired. The most famous trade-off is the one that is shown by the P

Economic Growth and Negative Externalities

Pollution and environmental degradation is a social cost (remember negative exte environment is not accounted for in the market system. Economies generally requ which will use up more of the finite resources. With more production comes the in with the expansion of new factories, offices, hospitals, etc. comes the consumptio currently inhabited by nature. China is a clear example of the trade-off between h their low levels of clean air and healthy environment. Countries are particularly da during their industrialisation stage, where environmental concerns are quickly forg growth rates and switch to more capital-intensive forms of production.

Inflation Versus Unemployment (Phillips Curve)

In 1958, Bill Phillips hypothesised a relationship between unemployment and infla high unemployment in the economy (spare resources), then firms could offer relati would be w[illegible]n income. Another way to look at this is in terms of competitio competition within the labour market as the supply of jobs was low relative to the Whereas, when the economy was near full employment, attempting to expand wo would have to offer wages that were higher than the market equilibrium in order workers away from their current jobs. So, as unemployment fell, expanding produ and prices would increase to compensate.

Long-run and Short-run Phillips Curve

The economy went through a period of stagflation in the 1970s that seemed to di off. Stagflation is when the economy has both high levels of inflation and unempl between the both. It was instead theorised that expectations had adjusted to the new expectations of inflation were incorporated into wage negotiations. Equally, t at the time meant the market was restricted from adjusting to the market equilibr unemployment (remember the Keynesian idea of sticky wages). With this idea, the curve was created. The relationship in the short run remains true to Phillips' relatio in the short run so that decreasing unemployment still results in increasing inflatio long run, however, it appears there is no such relationship and therefore the Philli long run. It is believed that the long-run Phillips curve lies at the natural rate of un accelerating inflation rate of unemployment and the rational expectation theories relationship between unemployment and inflation.

Further Your Economic Knowledge...

Natural Rate of Unemployment

The natural rate of unemployment is the level of unemployment that the labour market is in equilibrium. Any attempts to decrease unemp be temporary and the economy will gravitate towards this level in the l those w[illegible] a job at the wage level and those who are willing and employment. This means it includes frictional and structural une at the current wage rate but are not working because they are wa do not have matching skills to the current structure.

Inflation will increase if unemployment is less than its natural rate. Eq unemployment is greater than its natural rate. For this reason, the na also be called the non-accelerating inflation rate of unemployment (N

Issues From Managing the Macroeconomy

The economy is complex and hard to measure. It is difficult to determine where th
cycle and the AS and AD curves. There are often a lot of uncertainties within econ
policies are incompatible. An example of this this has been shown in the previous
economics is a study of human and business behaviour and is therefore somewha
uncertainties can mean policymakers are unable to choose the best policy.

Equally, policymakers are usually politicians who have to consider public opinion.
unpopular policy is the better option for the overall economy, and often the best
policies) have time lags that surpass those of election dates. These time lags can e
poor policies for the long-run but have initial short-run advantages; for example,
may pick policies that increase growth rates to reduce unemployment but create

Different Macroeconomic Perspectives

Economists and politicians have different views about the best way to run an econ
about the extent to which the government should intervene in markets. In the US,
favour much less government intervention than the Democratic Party. This stems
efficiency of markets, and the ability of governments to intervene successfully

In the UK, the aftermath of the financial crisis of 2008 has led to a fierce clash of v
in the economy. As a recent example (2015), the Conservative Party plan to move
wage, lower welfare system (with lower taxes and lower government spending, to
contrasts sharply with the Labour Party's approach under Jeremy Corbyn, which a
spending to redistribute wealth more equitably.

Other contentious macroeconomic issues have included the debate on whether th
and whether the government should tackle the recession through austerity measu
an alternative strategy, involving more gradual deficit reduction and less severe sp

Unintended Consequences

Often, policies are implemented using correctly collected data, strong theory, accu
intentions, but they can have unforeseen and unintended consequences. For exan
suggest taxing petrol in order to account for the external cost on the environmen
intended to encourage consumers to reduce their consumption of petrol or purch
efficiently and are cleaner for the environment with, perhaps, the tax revenue bein
helpful policies. However, often it is cheap cars that use petrol inefficiently and are
'Greener' cars are often expensive. The tax, therefore, is more likely to affect those
who cannot afford to spend money on 'cleaner' cars. The implementation of this t
consequence of worsening uneven income distribution.

Another unintended consequence and policy problem is that of the minimum wag
minimum wage, or increasing the minimum wage, is designed to ensure that proc
to meet their basic needs. However, adding a minimum wage takes the market aw
rate, the wage rate at which the demand for labour from firms (the prices firms are
the supply of labour from individuals (the price at which individuals are willing to
minimum wage (which is above the market equilibrium), more individuals are tem
and, therefore, the number of workers who are available for work increases. Equal
the market equilibrium to the minimum wage, the less willing firms are to pay the
offering jobs for the workers (and instead employing capital, or simply just decidi
and more workers means there is a surplus of labour; this surplus is unemploymen
improve living standards and increase the wages of workers may instead increase
affects the economy and also means there are some (those who are unemployed)

2.6.3. Questions

5. What are market-based policies?

6. What are interventionist policies?

7. **a)** What does the Phillips curve show in terms of meeting all the gov
b) Name and explain three conflicts that might arise in the governm

2.6 Keywords

Macroeconomics:	The branch of economics that looks at economie such as aggregate supply and demand, price lev unemployment.
Fiscal policy:	The use of taxation and public spending by a gov economy.
Monetary policy:	Policy that is used by governments or central ban affecting the cost or supply or money. Measures u rates and quantitative easing.
Monetary policy committee:	A committee of the Bank of England that has resp rates in the UK.
Trade-off:	The idea that something must be sacrificed in ord
Positive externality:	A benefit that is enjoyed by a party or parties that prices.
Negative externality:	A cost that is incurred by a party or parties that is

Keyword Glossary

Add value:	When a business turns the sum of raw materials into a more. Value added is calculated as: selling price of p create product/service.
Aggregate demand:	Total spending on all goods and services in an econo
Aggregate supply:	Total output in an economy.
Branding:	This is the image that businesses create for a product/
Claimant count:	A measure of unemployment, the number of people
Competitive advantage:	Firms that positively distinguish themselves from the co competitive advantage, or *the edge*, over their rivals
Conglomerate integration:	Merging of multiple businesses that are all at different
Deflation:	This occurs if the price level is falling.
Differentiation:	This covers the ways in which a company gains comp through branding, price, marketing and customer ser
Disinflation:	This occurs if the rate of inflation is falling.
Employment:	A term for those who are of working age and have a
Economic cycle:	A pattern of peaks and troughs in growth experience
Economic development:	A term used to describe actions by governments and improve living standards and economic health.
Efficiency:	How much a business can achieve through a minimum
Fiscal policy:	The use of taxation and public spending by a govern
Fixed exchange rate:	When a country's governing body or central bank ke terms of another, at the same level.
Floating exchange rate:	A system which allows the value of a currency to fluc market forces of demand and supply.
GDP per capita:	A measure of national income divided by the popula
Globalisation:	A broad notion referring to the idea that the world is interconnected.
Horizontal integration:	When two or more businesses merge at the same sta
Human Development Index:	An index that ranks countries based on a measure of education.
Inflation:	An increase in the price level of goods and services c
Kaizen:	Employees are organised into groups (quality circles) continuously analysing and improving the practice of
Loyalty:	Brand loyalty (for a product, service or company) occ stay with a business and make repeat purchases.
Macroeconomics:	The branch of economics that looks at economies as aggregate supply and demand, price levels, real gro
Managed exchange rate:	A system in which the government intervenes to minir exchange rate, possibly targeting a specific rate.
Monetary policy:	Policy that is used by governments or central banks to affecting the cost or supply of money. Measures used quantitative easing.
Monetary Policy Committee:	A committee of the Bank of England that has respons the UK.
Negative externality:	A cost that is incurred by a party or parties that is not
Nominal GDP:	Measurement of gross domestic product that has not
Objective:	A business's objectives are those goals/targets require
Overutilisation of capacity:	When a business produces more goods/services than can cause stress on overworked staff and minimises t maintenance of equipment.
Positive externality:	A benefit that is enjoyed by a party or parties that is n
Productivity:	A company's hourly rate of output per each input.

Profitability:	How profitable a business is, comparing gross, operat revenue.
Promotion:	This is how businesses build awareness of a product/se direct selling and online advertising.
Real GDP:	Measurement of gross domestic product that has bee
Sponsorship:	When a business supports another person/business in such as the sponsorship of sporting events.
TQM:	a constant, company-wide culture of quality manag
Trade-off:	The idea that something must be sacrificed in order t
Trading bloc:	A group of countries that have agreed to reduce or e
Underutilisation of capacity:	When a business produces fewer goods/services thar to staff being underworked, which may demotivate t on employees they do not need.
Unique Selling Point (USP):	This is a feature that makes a product/service appea
Vertical integration:	When two businesses merge from different stages of t
Unemployment:	The percentage of people in an economy who are e in employment.
Underempl[illegible]:	This occurs if a person is employed but does not work to, or do not fully utilise their skill set.

Answers

2.1. Answers

1. a) Explain how a business benefits when it successfully communicates its values wi

Students should show an understanding of the advantages of a business sharing it of direction for the company and ensure that every employee works towards the sa

b) i) Look up the UK branch of The Coca-Cola Company (*www.cokecce.co.uk*) and

Students should find The Coca-Cola Company's three core values at http://w business

- *accountability*
- *customer focus*
- *being team driven*

ii) Explain how communicating these values to the public can benefit The Coc

Students should show an understanding that members of the public are draw clear and aligned with their own. The Coca-Cola Company's value of accoun potential investor or customer who considers sustainability of great importan [illegible]en [illegible] attract potential employees who wish to work in a dynamic, co

2. a) What is profitability?

Students should show an understanding that profitability describes not how much of the business's ability to turn revenue into profit.

b) Identify and explain two ways in which a business can increase its profitability.

Answers might include:

- *decreasing selling prices in order to increase sales overall*
- *increasing brand awareness through advertising and promotion*
- *producing a greater quantity of goods in order to spread costs and achieve e*
- *by the same token, purchasing raw materials in bulk in order to spread costs*

3. Monty Video Ltd is an online video-streaming service. The company serves 250,000 v throughout the UK.

a) The company is looking to buy out one of its competitors. Identify whether this integration.

This is horizontal integration, as Monty Video Ltd is looking to buy a firm that is a

b) Two directors at Monty Video Ltd wish for the business to grow organically rath one reason why the directors may feel this way.

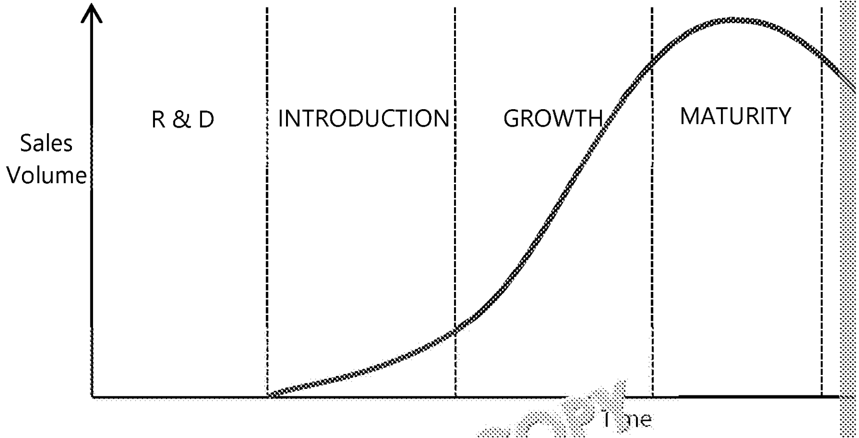
Students should show an understanding of the benefits of organic growth. These n

- *slower than inorganic and, therefore, easier to manage*
- *few cultural clashes*
- *any increase in market power remains with the company rather than being s might integrate with it*

4. Copy out and complete the following sentences using the phrases *organic, inorganic,*

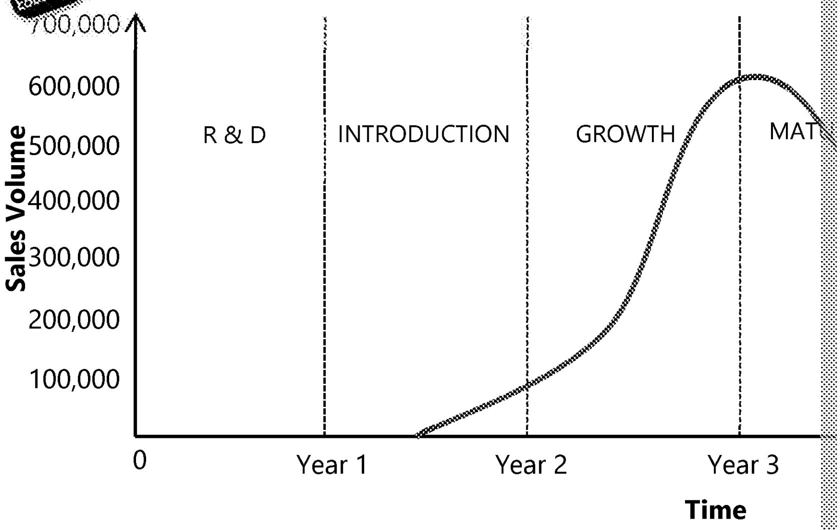
When a business grows internally, we call this **organic** *growth. A business experiencing forms of integration. An example of* **horizontal** *integration might be when one newsag while* **conglomerate** *integration describes when one business buys up many different b production process. An example of* **vertical** *integration would be if a greengrocer bough different levels of the production process.*

5. **a)** Copy out and complete the following product life cycle, putting each section in



b) The soap manufacturer Squeaky Kleen [illegible] that the sales for one of its produ one and a half years of rese[illegible] development. It was then introduced to the were reaching 100,0[illegible] [illegible] the product was generating 600,000 sales but Sales of Bub[illegible] continued to decrease and the product was finally put to res

C[illegible] the product life cycle below and complete it with a line to show the lif



6) Explain one benefit and one drawback for governments offering funding to businesse

Possible benefits include:

- *By creating more jobs, an investment in the local economy is made.*
- *The funded business may put some of its earnings back into local infrastructure.*
- *An area with successful businesses can help to attract more successful businesses skilled workers.*

Possible drawbacks include:

- *Offering grants is expensive.*
- *If the businesses are foreign, they may decide to se[illegible] [illegible]rnings back to their the local economy.*
- *Firms that do specialised work may [illegible] their own specialised workers, bypassi*

7. Jam and Banana is a [illegible] that specialises in the production of a wide variet etc.). Th[illegible] [illegible]ed and operated by three friends, who started Jam and Ban in 2008[illegible] d Banana's products are handmade and so the company's consumer b

a) Ide[illegible] n the following graph (Area A or Area B) where you think Jam and Ban

Area B

b) Explain how Jam and Banana could potentially move itself into the other area of

Students should show an understanding that in order to appear in Area A of the g focus on only one or two products/services, rather than an array of items. By mark could significantly increase the quantity of sales it generated.

However, simply focusing on product will not be enough: the business will also ne that enough consumers become aware of its brand. Once enough consumers are the company will have to manufacture many more products than it currently does also look into cutting costs so that it can afford to produce the desired quantity.

8. Which of the following digital elements has had the most effect on the consumer? Ex

Price-comparison sites *Viral marketing* *Social med*

Students can choose any of the three digital elements as long as they make a logical ar

Price-comparison sites:

- *more power in the hand of the consumer*
- *word of mouth (i.e. customer reviews) holds more weight with people looking to b*
- *businesses must keep up with price trends and so offer the most attractive deals*

Viral marketing:

- *a good story can create a chain reaction of sharing, which draws attention*
- *giving a brand a personality helps people relate to it*

Social media:

- *focuses on the user (i.e. the consumer), delivering a highly personal experience*
- *digital word of mouth through people sharing company updates*
- *brands can capitalise on current events via social media, which connects the consu*
- *communication with the company is near instant*

9. Identify how firms benefit from staying small with regards to innovation, reputation a
each focus

Students should show an understanding of how small businesses benefit with regards to architec

a) *Innovation: may include product differentiation (as firms become experts in their r customers are more willing to pay high prices for niche items).*

b) *Reputation: may include firms having a short chain of command (helping commu relationship with stakeholders.*

c) *Architecture: may include flexibility (firm's ability to react to consumer needs) or c more personal approach).*

10. Haverford West Caravans is a small business owned and operated by a young couple, caravans to tourists for anywhere from one night to six months. They have experience times and demand for their caravans has increased significantly.

John would like to expand the business by hiring more employees, while Nikolai belie

Decide who you think is correct in this situation and explain why this is.

Some students may decide that John's opinion on expanding the business is correct. If s may include reasons such as:

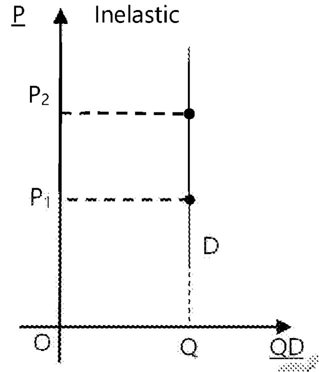
- *economies of scale for Haverford West Caravans*
- *enhanced brand awareness*
- *revenue increase through higher number of sales*
- *spreading the fixed costs of the business across more consumer demand*

Reasons to keep the business small could include:

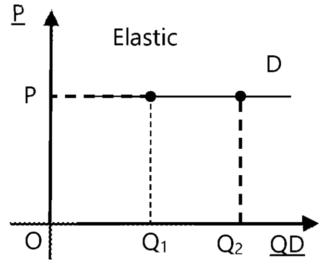
- *Better customer service*
- *Less risk of going bankrupt*
- *Easier to manage*

2.2. Answers

1. **a)** What is meant when a good has a relatively price-inelastic demand?
   The change in price induces a relatively smaller change in quantity demanded.
   b) Draw a perfectly price-inelastic demand curve.



2. **a)** W[illegible] a good has a relatively price-elastic demand?
   A [illegible] small change in price can cause a relatively large change in quantity
   b) Dr[illegible] perfectly price-elastic demand curve.



3. The price of a fizzy drink has increased from £2 to £2.50, while the demand has fallen customers.
   a) What is the price elasticity of demand?

$$\% \text{ change in price} = \left[\frac{(£2.50 - £2.00)}{£2.00}\right] \times 100 = 25\% \qquad \% \text{ change in QD} = \Bigg[$$

$$\text{PED} = \frac{-30}{25} = -1.2$$

   b) Does this value indicate the good is price elastic or price inelastic?
   The good is relatively elastic.
   c) What is the total revenue of the fizzy-drink company before and after the price
   Before: $TR = P \times Q$ $£2{,}000 = £2 \times 1000$
   After: $TR = P \times Q$ $£1{,}750 = £2.50 \times 700$
   d) Does this indicate the fizzy drink company was at the top end or bottom of the
   At this point, a price decrease (going from £2.50 back to £2.00) would result in an the company is operating at the top end of the dem[illegible]e.

4. Bill Oddity plans to open a birdseed shop. He has projected that he will sell 25,000 ba like to charge a mark-up of 20%. Use the table below to calculate the price per unit (b customers.

a)

Total budgeted fixed costs	£1,500
Budgeted variable cost per unit	£0.25
Mark-up percentage	20%
Budgeted sales in units	25,000

Total cost:
= total fixed cost + total variable cost
= £1,500 + (£0.25 × 25,000)
= £1,500 + 6,250
= £ 7,750
Mark-up:
= total cost x mark-up percentage
= £7,750 × 0.20
= £1,550
Total cost + mark-up
= [illegible] + [illegible]
= [illegible]
Budgeted selling price per unit
= (total cost + mark-up) ÷ budgeted sales in units
= £9,300 ÷ 25,000
= £0.37 (0.372 to 2 dp)

b) What would happen to the price per unit if Bill increased the mark-up percentag would pay this price? Explain your answer.
If Bill increased the mark-up to 30%, the budgeted selling price would rise to £0.4 increase from the previous figure and so consumers will probably still pay this. Sin general, it is likely to be price elastic. Due to this, Bill Oddity should do enough m seriously overcharging in comparison to other retailers. If he does overcharge, con over a product as price elastic as bird seed.

5. Identify and explain two factors that can influence a business's pricing strategy.
Students can explain any of the following factors:

- *Competitor businesses can affect the way consumers see a product/service*
- *The pricing objective of the business, e.g. looking to increase profits, market share,*
- *Costs, i.e. how cheaply can a product be made?*
- *There may be a price war, meaning new businesses are unable to enter the marke*
- *Who the business is selling to*
- *Where the business sits in the marketing mix, e.g. are they price leaders or price-t*
- *The price and income elasticity of demand can influence how much a business fee*
- *Where the product is in its life cycle can significantly affect a business's pricing de*

6. A beverage company wants to introduce a new fizzy drink to the market, but without (newspapers, TV, radio, etc.). How else could the company promote their new produc
Alternative forms of promotion for the drink include public relations, sales promotions, communications. Learners should name possible activities that relate to each form of pr offering free in-store samples).

7. Why are so many companies using social media as a way to advertise their brands? D involved?
Possible reasons might include changes in communication and the popularity of the In taking advantage of key events and generating user-created content that helps boost y communication: consumers can say negative things about your brand and it might sno communications also need thorough planning, just like any other medium, to prevent i

8. There follows a four-stage distribution flow diagram.

Name an example for each stage of the flow diagram, e.g. producer = dairy f

Example answers:
Producer = electronics manufacturer or dairy farm
Wholesaler = supplier to supermarkets or book warehouse
Retailer = high street shop or online store
Consumer = family buying produce or business needing machinery

9. An economy's average income rose from £25,000 to £32,500 a year while the quantity

These formulae are needed for the following parts of the question

$$\% \text{ change} = \left[\frac{(New\ value - Old\ value)}{Old\ value}\right] \times 100 \qquad YED = \frac{\Delta \text{ Quantity Demanded } \%}{\Delta\ Income\ \%}$$

$$\% \text{ change in income} = \left[\frac{(32{,}500 - 25{,}000)}{25{,}000}\right] \times 100 = 30\%$$

a) Good A rose from 190 to 250 units. What is the income elasticity of demand?

$$\% \text{ change in QD} = \left[\frac{(250 - 190\ )}{190}\right] \times 100 = 31.6\%$$

$$\text{YED } = \frac{31.6\%}{30\ \%} = 1.05$$

b) Good B rose from 180 to 190 units. What is the income elasticity of demand?

$$\% \text{ change in QD} = \left[\frac{(190\ \ - 180\ )}{180}\right] \times 100 = 5.56\%$$

$$\text{YED } = \frac{5.56\%}{30\ \%} = 0.19$$

c) Good C fell from 230 to 200 units. What is the income elasticity of demand?

$$\% \text{ change in QD} = \left[\frac{(200\ \ - 230)}{230}\right] \times 100 = \ -13\%$$

$$\text{YED } = \frac{-13\%}{30\ \%} = -0.43$$

d) Which good(s) is a...

- **i)** Normal good
  Goods A and B
- **ii)** Luxury
  Good A
- **iii)** Inferior good
  Good C
- **iv)** Necessity
  Good B

2.3. Answers

1. Explain which of the following factors can have a positive influence on a business's pr
   Students should show an understanding that the following can have a positive influence one correct answer:
   - *Increasing the responsibility of employees: with more responsibility, employees ca company and so motivation is increased.*
   - *Purchasing equipment that is more suited to the production task: if the equipment then this new equipment should make production more efficient and, therefore, m*
   - *Reducing employee wages: improving the training process of new employees: thes learning curve less steep for new employees, which keeps productivity at a steadie*

2. Identify and explain two ways in which productivity helps a business become more co
   Students should show an understanding of how productivity relates to competition and this, including (but not limited to):
   - *High productivity allows businesses to meet consumer demands and, as a result, s customers.*
   - *Reducing costs: increasing productivity, which helps a business stay price competiti consumers, gaining high percentages of the market.*
   - *Reducing cost per item means that businesses keep their profits as high as possib low costs. This flow of profit can then be reinvested into the company in orde*
   - *Efficiency of service: relates to consumer demands. Productivity helps businesses ir offer at any one time, which allows them to provide customers with a more efficie*

3. Put the following statements into the correct categories.

Drawbacks of underutilisation	Drawba
The fewer goods a firm produces, the higher the fixed costs per unit.	*Quality might be ignor of products becoming*
Workforces lack motivation as there is little drive to over-achieve.	*Maintenance of equipn simply not enough tim*
Firms are unable to meet sudden spikes in demand.	*Motivation of employe work is too intense.*
	Firms are unable to me

4. Explain the difference between full capacity and spare capacity.
   Students should show an understanding that full capacity describes how a business is u production. Spare capacity tells us that there is some capacity left over and so the busin

5. Identify two differences between quality control and quality assurance.
   Quality assurance is a proactive measure that involves managerial decisions. Businesse that best ensure their goods are produced to the highest quality.
   Quality control, on the other hand, is a reactive measure. It involves the correction of bu are made available on the market.

6. Explain one reason why a greengrocer might choose to implement the just-in-time m
   Students might explain any of (but not limited to) the following:
   - ***Time saver:** since most produce is perishable, the greengrocer does not have time deliveries of items [illegible] that the business will need to produce for the very ne*
   - ***Money saver:** having too much stock on the shelves is wasteful and so this helps*
   - ***Advantage:** once consumers learn that the greengrocer's produce is fresher than can benefit from a positive reputation.*
   - ***Less obsolescence:** the business needs only to sell the good for which there is den*
   - ***Less risk to goods:** with fewer goods in storage, perishable items are less likely to*

7. Explain why businesses aim to decrease their average costs.

Students should show an understanding that, by reducing their average costs, businesse including (but not limited to):

- *Fewer costs allow the business to generate more profit from the revenue for every*
- *As firms lower their costs, they can turn this into lower price tags, which may attra higher profits overall.*
- *By attracting more customers through low costs, the businesses stand to secure a*
- *The profits that companies make can be reinvested in order to improve product qu reputation.*

8. Smart Talkies Ltd is a manufacturer of smartphones and tablets. One of the company' its mobile phone range, which no other company currently offers. As a result, Smart T react and so is planning to manufacture a more advanced version of the competitor's

The current lead time for Smart Talkies Ltd (the time between making a business deci months. Identify whether this lead time should be longer or shorter. Please explain yo

Students should show an understanding of the importance of short lead times. Naturall slowly than others, but the smartphone industry is a rapidly changing one and so stude nine months is too long. If the company wishes to compete with its rivals, it will need to months' time the company finally releases its answer to the competition, there could al product on the market. Students may also wish to point out that, if the business reduces suffer through lower levels of quality.

2.4. Answers

1. Explain how the following have contributed to globalisation in the last 50 years:
   - **a)** Information communication technology (ICT)
     People are able to communicate far more easily than they could 50 years ago. So can connect with someone on the other side – and often for free – and so our abili another has very few limits.
   - **b)** Transportation
     As transportation improves, people and businesses are able to move their resource wish to take advantage of country specialisation, e.g. if one country is better at m may choose to base its production line there. It matters less than it did 50 years a production line, since transportation of goods is so much more convenient nowad

2. Copy out and complete the sentences below, using the following three phrases:
   migration *international trade* *investment flows*
   Globalisation is made up of three main characteristics:
   1. Rising *international trade* as [illegible] product increases
   2. Increased *investment flows*, which involves the buying and selling of business as
   3. *Migration*, which describes the movement of people and workers between natio

3. **a)** What is GDP?
   Gross Domestic Product: the total value of goods and services produced in one ec
   b) How can GDP be adjusted to account for population size?
   By dividing the total GDP of a country by the population, GDP can be calculated p

4. How does GDP differ from HDI?
   While GDP shows us the sum market value of all the goods and services produced by a figures: education, health and real gross national income (GNI) per capita.

5. Why is international trade important for countries with an export-led growth approac
   Because countries that take this approach are relying on selling their exports to their fo into the economy. Therefore, the economic situation of their trading partners and the 'c market are important for these countries.

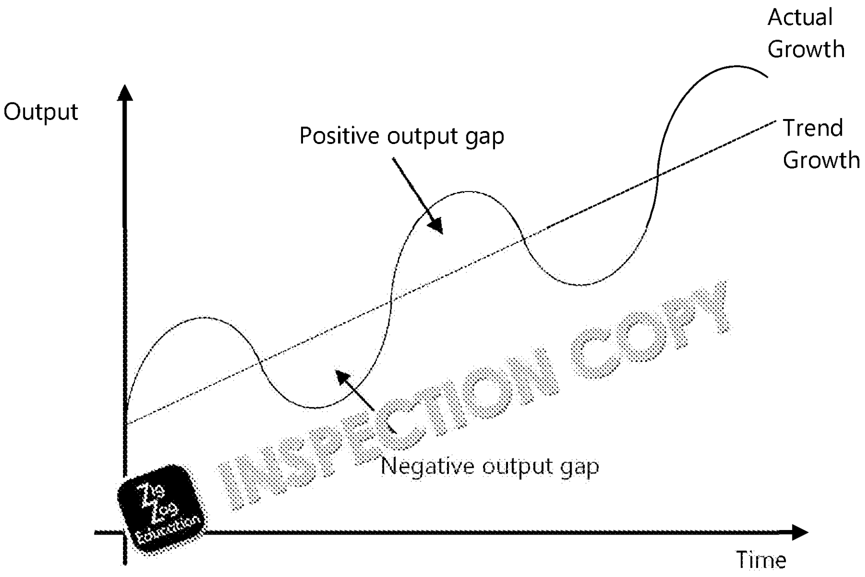
6. **a)** Explain when a country has an absolute advantage and when it has a comparati
   A country has an absolute advantage over another when it can produce the good country has a comparative advantage over another when it is able to produce the the other.
   b) 'Division of labour should always be used because it only has beneficial effects.'
   Because workers haven't spent time switching between tasks, division of labour ca efficient. Equally, workers will become better at their individual tasks as they repe more productive. However, repetitive tasks can mean that workers may make mis or complacent.

7. **a)** Explain the meaning of 'exchange rate'.
   This is the amount of money for which a currency can be exchanged – in other wo compared to another.
   b) Explain the meaning of 'depreciation'.
   This is the decrease in the value of a currency in comparison to the currencies of o

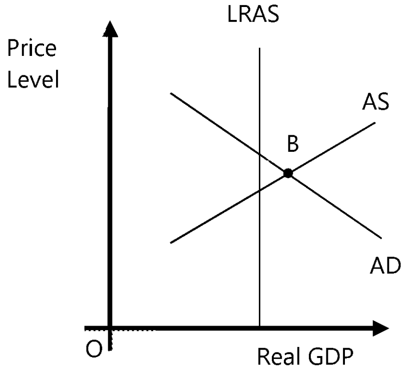
8. A Chinese consumer decides to buy a British good. Explain why this transaction, *ceter* pound to appreciate and the Chinese yuan to depreciate.
   In order to purchase a British good, the Chinese buyer must convert their Chinese yuan increases the demand for the British pound, and therefore its price too, while increasing decreasing its value.

2.5. Answers

1. Draw an economic cycle diagram.
   a) Label the positive output gap(s).



   b) Illustrate this gap / these gaps using an AS/AD diagram.



   c) Using the concept of capacity, explain what is happening within the economy.
   There is very little capacity; if anything, the economy is producing beyond its capa producing beyond its PPF, and is overusing the resources it has to produce more g available are currently able to produce.
   d) What is happening to inflation, unemployment, confidence and the government
   As an economy enters a positive output gap, inflation rises and unemployment fal there is often a time lag with consumer confidence. Any government budget defici consumption and employment increases tax revenue and falling unemployment n

   At the height of a boom, inflation is very high, unemployment is very low and con budget is likely in a surplus at this point.

   As an economy leaves a boom and [illegible] towards a recession, inflation will begin begin to rise. Confidence will begin to fall; however, there is often a time lag with budget surplus will begin to decrease and become a deficit.

2. What are the effects of economic growth on consumers, firms, the government and li
Consumers and workers:
Increased growth means the economy is expanding and there will be job creation, mea and the negativities associated with unemployment will fall. This means people can inc wealth or people will consume more goods. Economic growth indicates firms will enter production, meaning there are more goods available for consumers with the potential c

Firms:
Economic growth indicates firms have increased production or new firms have entered production, firms will gain more revenue and higher profits. This means they are more increasing capital and/or labour.

The government and economy:

Higher employment from the increased job creation means expenditure on benefits will
receive more tax revenue from income tax and high levels of consumption mean the go
revenue from sales of goods and services. Further to this, more firms or increased produ
receive more tax revenue from profits. Expectations for the economy and confidence wil
investment and consumption. Economic growth usually entails inflation. This means UK
than foreign goods. UK exports will fall and imports will rise; this is likely to worsen the

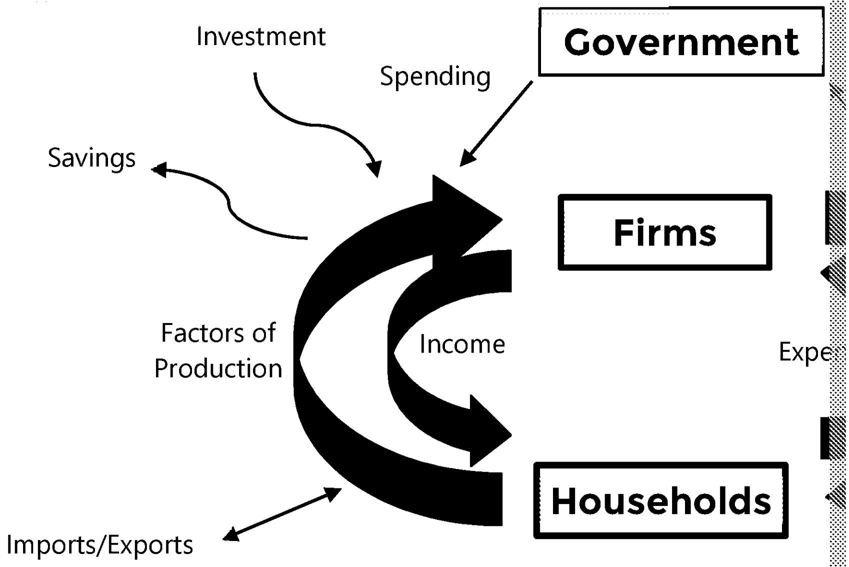
Living standards:

Economic growth is associated with improved living standards, although this is not alwa
indicates higher employment which should decrease the level of poverty in an economy
worsen inequality, depending on how the gains from growth are distributed.

3. **a)** What is an injection and what is a withdrawal?
An injection is money is being added to the economy, whereas a withdrawal is mo

b) List the six injections and withdrawals.
Injections: exports, [illegible] government spending
Withdrawals: [illegible], savings, tax

4. **a)** Draw a circular flow diagram with all the injections and withdrawals.



b) Explain how income flows around the economy.
As firms purchase factors of production from households, they provide a wage/inc
and services from firms, they provide expenditure.

c) What would happen if injections were bigger than withdrawals?
The income coming into the economy would be greater than the money leaving o
would grow.

d) What would happen if the government increased the tax rate?
The size of the withdrawals from the economy would be greater, so the economy w

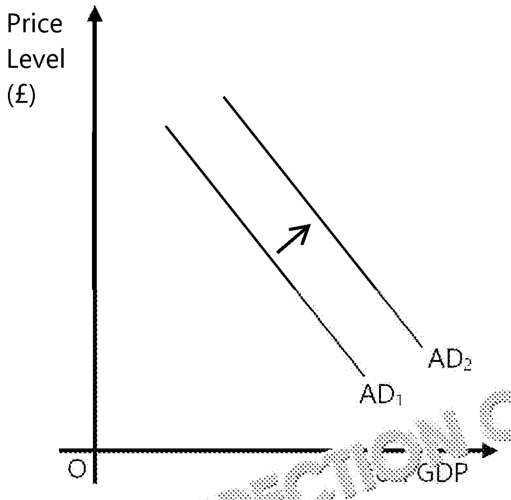
5. **a)** For a firm, how are the short run and the long run defined?
A firm is in the long run when it is able to change all its factors of production. A fi
to change [illegible] production.

b) What factors could affect long-run aggregate supply?
Technological advances, relative productivity, worker human capital, government
and competition policy could all affect long-run aggregate supply.

c) What factors could affect short-run aggregate supply?
The price of inputs (costs of production); for example, raw materials and energy, th
affect short-run aggregate supply.

6. Fill in the blanks:
$AD = C + I + G + (X - M)$
That is: aggregate demand = consumption + investment + government spending + (ex

7. **a)** Complete this diagram showing aggregate demand by labelling the curves, the



b) What has happened to this curve?

The curve has shifted to the right, indicating an increase in aggregate demand.

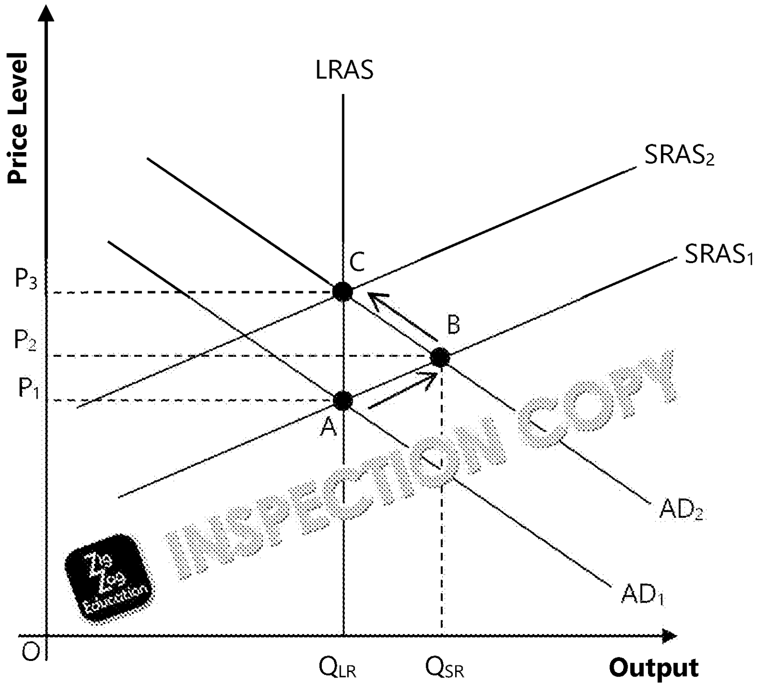
c) **i)** What four main factors can shift the AD curve?

Changes in consumption, investment, government spending and net exports can s

ii) For each factor, explain two to three reasons the curve has made this shift.

- **Consumption**: (1) If disposable income has increased, then people ha increase consumption. (2) The government might have lowered intere of borrowing and reduces the opportunity cost of spending (saving). their money rather than save it and increases their ability to consume cause might result from an increase in asset or house price. If people' wealthier and are more likely to increase their spending. (4) If people economy, they will feel happier about spending their money and wor they are more likely to increase their consumption. Increased consum (AD) and push the AD curve outwards.
- **Investment**: (1) Increasing economic growth will increase people's in likely to increase and there will be greater demand for firms' product expanding their businesses in order to match their supply with the in increases with economic growth. (2) If exports have increased, perhap fallen, or because foreign consumers' incomes have increased, then e expanding their businesses in order to match their supply with the in increased. (3) If the central bank lowers interest rates, then the cost o of investing (saving) have fallen. This will encourage firms to invest th If there is greater access to credit, then it will be easier for firms to bo to invest. (5) If the government chooses to create regulations that en investment is likely to increase as a response, assuming the policies a
- **Government expenditure**: (1) If the economy is in a recession then t its spending in order to stimulate the economy. (2) Alternatively, the encourage economic activity.
- **Net trade**: (1) If UK incomes fall, then UK consumers are likely to dec This could lead to a positive net trade which will increase aggregate then UK goods will appear cheaper in relation to foreign goods. Impo consuming domestically produced goods, and exports will increase a This will mean there is a positive net trade and increased aggregate d [illegible] boom, then everybody's income will rise. Exports will increa purchase more UK goods. Alternatively, UK consumers will also be m this may outweigh the increase in exports. However, because the agg this indicates that exports are greater than imports. (4) If the governm protectionist measures implemented on UK goods, then foreign cons of UK goods. Increased exports will increase aggregate demand. (5) If then the relative price will not matter as much since foreign consume the UK export based on non-price factors. This will increase aggregat

8. Use a diagram to show how an outward shift in the AD curve will cause an increase in sustainable if the LRAS shifts too (use a classical LRAS).



This is the diagram we're after. It shows how in the short term an increase in AD causes SRAS also shifts and output returns to Q_{LR} (but the price level is higher).

9. What is the difference between inflation, deflation and disinflation?
Inflation is a rise in general price level, whereas deflation is a fall in general price level. meaning general price level has increased, but the increase is less than it was previousl

10. How do real and nominal GDP differ?
Real GDP accounts for inflation, whereas nominal inflation is merely the value.

11. **a)** Name four possible causes of unemployment.
Answers could include: structural, occupational, geographical, technological, fricti real-wage inflexibility

b) Can you explain these causes?
***Structural**: This occurs when there a major change in the industries an economy steel industry. Workers may struggle to find suitable jobs if all their experience rel*
***Occupational**: When there is a mismatch between the skills required for the job a linked to structural unemployment.*
***Geographical**: When people cannot move locations to find a job.*
***Technological**: When people's jobs are replaced by more efficient machines.*
***Frictional**: This occurs as people change jobs.*
***Seasonal**: If people are employed in seasonal work, th[illegible]en the seasons chang*
***Demand-deficient**: If the economy is in a recession, [illegible] firms will cut back on p demand for labour.*
***Real-wage inflexibility**: If the real wage rate is below the market equilibrium, labour.*

12. **a)** What are the two main measures of unemployment?
ILO unemployment rate and claimant count

b) How do these measures attempt to quantify unemployment?
***ILO unemployment rate**: The Labour Force Survey (required by the ILO) deter in/out of work and who are seeking work. From this, they are able to calculate an*
***Claimant count**: This counts the number of people who are claiming unemploy working population.*

c) How accurate are these measures?
Neither measure is completely accurate as they only calculate the statistics from a account generally underestimates the number of people in unemployment.

2.6. Answers

1. **a)** What are the economic objectives of the government?
   Sustainable, positive economic growth; low unemployment; law and stable inflatic account equilibrium; balanced government budget; environmental protection; less

   b) Explain why each of these is an objective of government.
   Sustainable positive economic growth can bring about greater living standards. Er and help boost the economy through increased incomes, whereas unemployment resources so the government aims to keep this value as low as possible. Inflation i diminishes people's savings and incomes while also increasing living costs. Theref this low and stable so firms and households can anticipate and plan for the price r unsustainable as more money is leaving the economy than entering. The governm than it earns (tax revenue) and so aims to have a balanced budget. It's a moral im protect the environment; equally, the UK can be fined by the EU if it doesn't do so. good living standards and some economists argue it can boost economic growth.

2. **a)** What are the three types of main macroeconomic policies?
   Fiscal, monetary and supply-side policies.

   b) What are the demand-side policy tools and how can each of these be changed i
   Fiscal policy:
   - **Tax**: Tax is a withdrawal from the circular flow of economy and reduces dis aggregate demand, inflation and growth.
   - **Government spending**: The government can inject money into the econo and stimulate an economy out of recession.

   Monetary policy:
   - **Interest rates:** The Bank of England is able to set interest rates to control i and investment.
   - **Quantitative easing**: Banks are unlikely to lend to people if they do not ha Quantitative easing helps liquidity traps and enables greater ease of borro consumption and investment.

   Supply-side policy:
   - There is a variety of things a government can invest in in order to boost ag reducing income tax or lowering tariffs on imports.

   c) Who is in charge of the three policies?
   The government is in charge of fiscal policy and supply-side policy, whereas the B monetary policy.

3. 'Supply-side policies are better for the economy than demand-side policies. The only the time lags mean politicians won't see results in time for elections.' To what extent

   Unlike demand-side policies, which can cause inflation, shifting the aggregate supply c on prices through competition and improvements to production. This indicates a rate o sustained as resources are generally improved or increased in the long term. Equally, in growth will mean there is job creation, which will help reduce the level of unemploymer capacity of an economy and reducing the costs of production, an economy will become market. This will mean exports will increase and any trade deficit will be improved.

   However, supply-side policies have long time lags; improving the quality of the workfor take 13 years. Data collection is slow and long-winded; the information provided to go but also out of date, causing the government to react slowly and possibly incorrectly. Fu can manipulate the economy, the global market has some influences that the governm government policy is weak to external shocks. Supply-side policies can also be very cost impact on the government budget.

   In addition, supply-side policies cannot solve economic crises caused by a lack of dema problems require demand-side policies to solve them.

4. How does fiscal policy conflict with other policies and the government's objectives?
   Increased government spending may help to boost an economy out of a recession; how result in increased taxes in the future. This tax increase not only conflicts with any futur incentives to work and could worsen income distribution depending on how the tax is i government spending may mean cutting benefits or reducing investment in schools or h impact on the living standards within an economy. After the 2008 recession, the govern government debt by cutting spending; however, this was met with outrage by the public adverse effect on education quality. Cutting benefits also has the potential to worsen in those who may need the benefits for survival.

5. What are market-based policies?
Market-based policies aim to work alongside market forces to manipulate the economy

6. What are interventionist policies?
The government has a direct role with interventionist policies and intervenes to make d

7. **a)** What does the Phillips curve show in terms of meeting all the government's obje
The Phillips curve shows that an economy cannot have both low inflation and low between the two.

b) Name and explain three conflicts that might arise in the government's objective
There is a conflict between economic growth and inflation. Economic growth usua aggregate demand. An increase in aggregate demand not only increases growth b Therefore, as an economy grows, it will tend to see growing rates of inflation, too. increasing prices is to increase aggregate supply; classical economists believe this growth because without moving the LRAS curve any increase in aggregate demar the long run.

There is also a conflict between economic growth and the current account. As the rise, people will spend more on imports. As imports rise this could worsen a trade as the economy grows and inflation rises, domestic goods will appear more expen [illegible] exports will fall. Falling exports and rising imports could create a negative

Lastly, economic growth also conflicts with the government's environmental objec negative externalities. Pollution and environmental degradation is a social cost. P accounted for in the market system. Economies generally require more inputs as t the finite resources. With more production comes the increased use of fossil fuels factories, offices, hospitals, etc. comes the consumption of space, which may curre clear example of the trade-off between high rates of economic growth and low lev environment. Countries are particularly damaging to the environment during thei environmental concerns are quickly forgotten with the rapid rise in growth rates, intensive forms of production.

Other conflicts of objectives are possible, including the Phillips curve trade-off (un potential trade-off between growth and inequality.