KNOWLEDGE ORGANISER GUIDANCE

It is advised that you print the relevant subject knowledge organisers and have them available to you when needed at all times.

An alternative recommendation would be to download the knowledge organisers for your subjects onto your electronic devices so you can access them when needed.

With the knowledge organiser you should make revision cards to help revise and build in time during independent study to test yourself weekly on the content.

While you have independent study, you should use your Knowledge Planner to study the relevant subject's Knowledge Organiser and learn the information provided.

Haggerston School

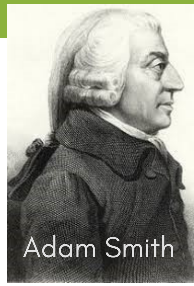
SIXTH FORM KNOWLEDGE ORGANISER

Economics

2023/2024

Aspiration Creativity Character

Economics



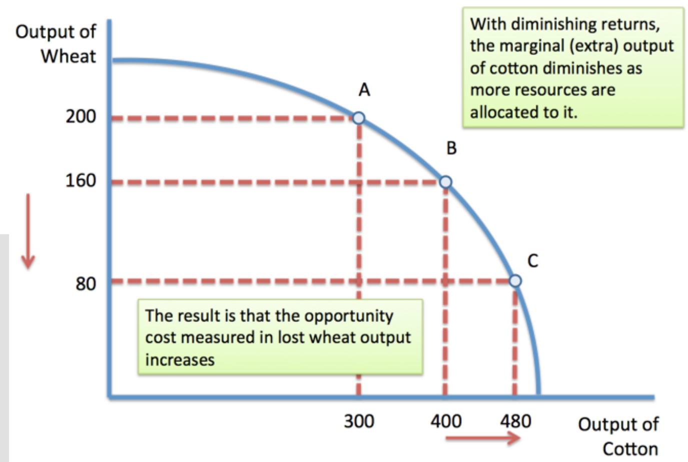
1.1.1 Economics as a social science

- **Social science:** The study of societies and human behaviour using a variety of methods, including the scientific methods.
- **Ceteris Paribus:** All things being equal; the assumption that, whilst the effects of a change in one variable are being investigated, all other variables are held constant.

1.1.2 Positive and Normative Statements

- **Normative statement:** A statement which cannot be supported or refuted because it is a value judgement
- **Positive statement:** A statement which can be supported or refuted by evidence.

PPF, Diminishing Returns and Opportunity Cost

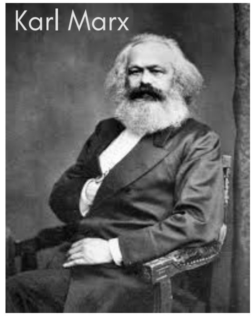


1.1.3 The economic problem

- **Basic economic problem:** Resources have to be allocated between competing uses because wants are infinite whilst resources are scarce.
- **Scarce resources:** Resources that are limited in supply so that choices have to be made about their use.
- **Renewable resources:** Resources, such as fish stocks or forests, that can be exploited over and over again because they have the potential to renew themselves.
- **Non-renewable resources:** Resources, such as coal or oil, which once exploited cannot be replaced.
- **Opportunity costs:** The benefits forgone of the next best alternative.

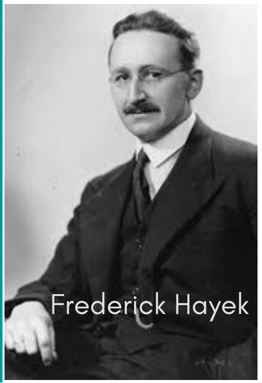
1.1.4 Production Possibility Frontier

- **Production possibility frontier:** A curve which shows the maximum potential level of output of one good given a level of output for all others goods in the economy.
- **Capital goods:** Goods that are used in the production of other goods such as factories, offices, roads, machines and equipment.
- **Consumer goods:** Goods and services that are used by people to satisfy their needs and wants.



1.1.5 Specialisation and the division of labour

- **Specialistion:** A system of organisation where economic units such as households or nations are not self-sufficient but concentrate on producing certain goods and services and trading the surplus with others.
- **Division of labour:** Specialisation by workers, who perform different tasks at different stages of production to make a good or service, in cooperation with other workers.
- **Money:** Any item, such as a coin or a bank balance, which fulfils four functions: a medium of exchange, a measure of value, a store of value and a method of deferred payment.



1.1.6 Free market, mixed and command economies

- **Economic system:** A complex network of individuals, organisations and institutions and their social and legal interrelationships which allocate resources.
- **Free market economy:** An economic system that resolves the basic economic problems mainly through the market mechanism.
- **Mixed economy:** An economy where both the free market mechanism and the government planning process allocate significant proportions of total resources.
- **Command economy:** An economic system where government through a planning process, allocates resources in society.

The functions of money:

- A medium of exchange
- A measure of value
- A store of value
- A method of deferred payment

1.2.1 Rational Decision making

Consumers: Seek to maximise their welfare/utility

Firms: Seek to maximise profits

Governments: Seek to maximise welfare of citizens

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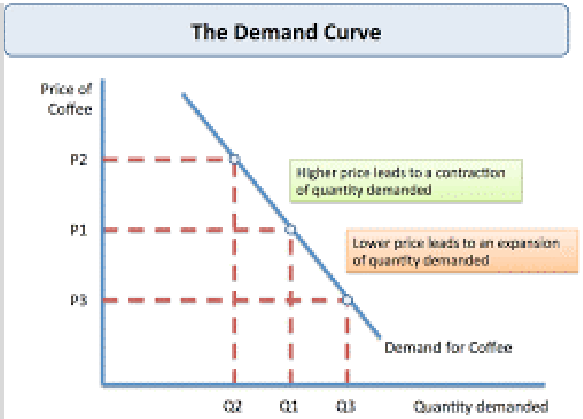
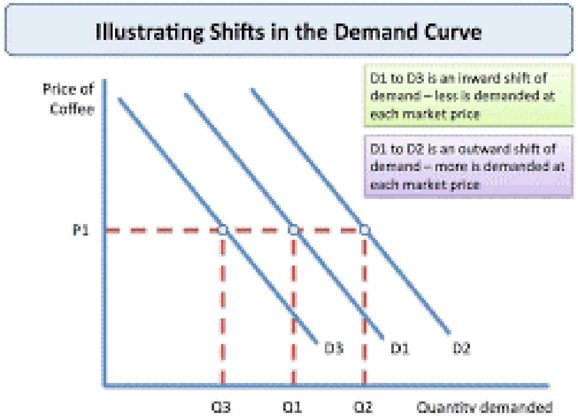
1.2.2 Demand

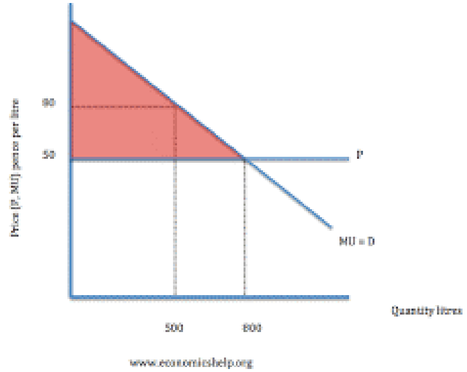
- **Demand:** The quantity purchased of a good at any given price, given that other determinants of demand remain unchanged.
- **Demand curve:** The line on a price/quantity diagram which shows the level of effective demand at any given price.
- **Contraction demand:** When quantity demanded for a good falls because its price rises; it is shown by a movement up the demand curve.
- Extension demand: When quantity demanded for a good increases because its price falls; it is shown by a movement down the demand curve.
- **Consumer surplus:** The difference between how much buyers are prepared to pay for a good and what they actually pay.
- **Law of diminishing marginal utility:** The value or utility that individual consumers gained from the last product consumed falls the greater the number consumed. So the marginal utility of consuming the sixth product is lower than the second product consumed.





Conditions that shift the demand curve:

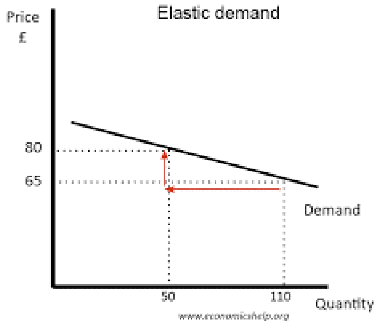
- Price of substitutes & complements
- Changes in population
- Change in fashion
- Change in legislation
- Advertising



$$PED = \frac{\%\text{ change in Quantity Demanded}}{\%\text{ change in Price}} = \frac{\%\Delta\text{in QD}}{\%\Delta\text{in P}}$$

$$YED = \frac{\%\text{ change in Quantity Demanded}}{\%\text{ change in Income}} = \frac{\%\Delta\text{in QD}}{\%\Delta\text{in Y}}$$

$$XED = \frac{\%\text{ change in Quantity Demanded of good x}}{\%\text{ change in Price of good y}} = \frac{\%\Delta\text{in QDx}}{\%\Delta\text{in Py}}$$



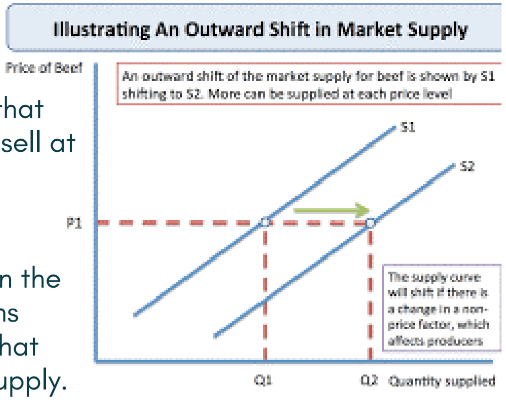
1.2.3 Price, income and cross elasticities of demand

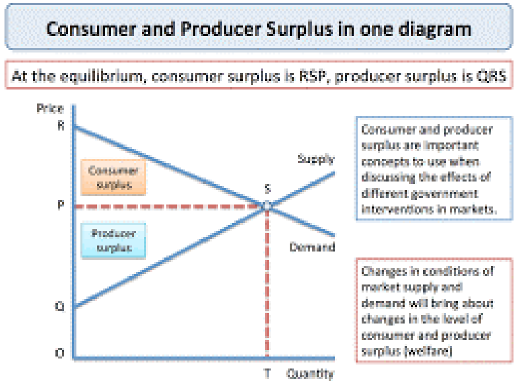
- **Price elasticity of demand (PED):** The proportionate response of change in price.
- **Elastic demand:** Where the PED is greater than 1. The responsiveness of demand is proportionally greater than the change in price.
- **Inelastic demand:** Where the PED is less than 1. The responsiveness of demand is proportionally less than the change in price
- **Unitary elasticity:** Where the value of PED is 1. The responsiveness of demand is proportionally equal to the change in price.
- **Income elasticity of demand:** A measure of the responsiveness of quantity demanded to a change in income. It is measured by dividing the % change in income.
- **Inferior good:** A good where demand falls when income increases.
- **Normal good:** A good where demand increases when income increases.
- **Cross elasticity is demand:** A measure of the responsiveness of quantity demanded of one good to a change in price of another good.
- **Complement:** A good that is purchased with other goods to satisfy a want.
- **Substitute:** A good which can be replaced by another to satisfy a want.

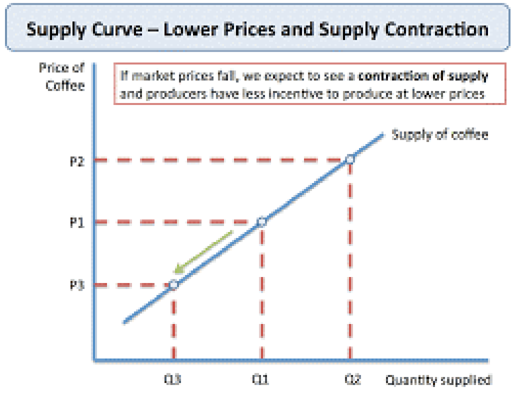
Economics

1.2.4 Supply

- **Supply:**
The quantity of goods that suppliers are willing to sell at any given price over a period of time.
- **Producer surplus:**
The difference between the market price which firms receive and the price that they are prepared to supply.





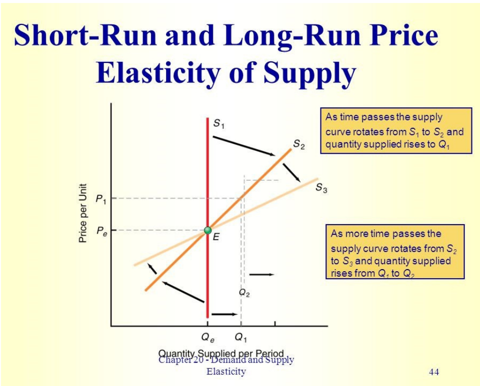


Factors that shift the supply curve:

- Government legislation
- Expectation of future events
- The weather
- Producer cartels
- The goal of sellers

1.2.5 Elasticity of Supply

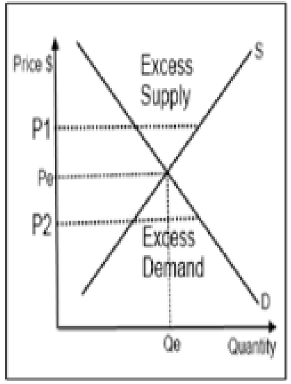
- **Price Elasticity of Supply:** Measure of the sensitivity/responsiveness of quantity supplied of a good or service to a change in the price of that good or service.



1.2.6 Price determination

Key words:

- **Equilibrium:** A situation where the price is at a level where quantity demanded and quantity supplied are equal.
- **Excess Demand:** A situation where at a given price level, the quantity demanded is greater than the quantity supplied.
- **Excess Supply:** A situation where at a given price level, the quantity supplied is greater than the quantity demanded.



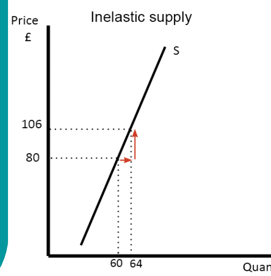
PES > 1 < ∞ = Elastic
PES = ∞ = Perfectly Elastic
PES = 1 = Unitary
PES < 1 < 0 = Inelastic
PES = 0 = Perfectly Elastic

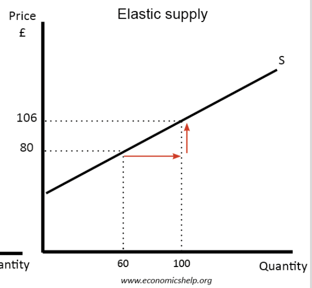
$$\text{Price Elasticity of Supply (PES)} = \frac{\%\triangle \text{in Qs}}{\%\triangle \text{in P}}$$

Determinants of PES:

1. Production time: The shorter the production time, the more elastic the good is (the higher the PES).
2. Excess Capacity: The slower the output level hence the larger the excess capacity, the higher the PES (more elastic).
3. Stock: The larger the amount of finished goods or components for goods, the more elastic the supply is (the higher the PES).
4. Mobility of Resources: If capital and labour are both mobile and can be easily accessed, then the higher the PES (more elastic).

- Time Period: The longer period of time it takes to make the good, following an increase in price, the higher the PES. In the short run, goods tend to be inelastic but over time they become more elastic.





11.2.7 Price Mechanism

- **Price mechanism:** Describes how decisions taken by consumers and businesses interact to determine the allocation of scarce resources between competing uses.

It has three key functions:

1. **Signalling** – Adjust to demonstrates where resources are required i.e. Prices rise to reflect scarcities and surpluses
2. **Incentives** – Consumer choices inform producers or changes to needs and wants.
3. **Rationing** – Prices ration resources when in shortages.

- **Market Failure:** Occurs when signalling and incentive functions fail to operate optimally, leading to a loss of economic welfare.

Economics

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1.2.8 Consumer and Producer Surplus

Consumer surplus:

- A measure of the welfare that people gain from consuming goods and services.
- The difference between the maximum consumers are willing and able to pay for a good or service, and the amount that they actually pay.

Producer surplus:

- Producer surplus is the difference between the price producers are willing and able to supply a product for and the price they get in the market.
- Shown the be the area above the supply curve and below the price.

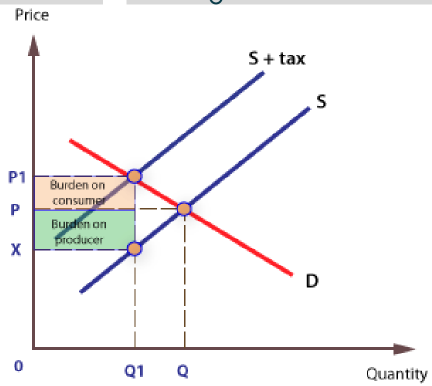
1.2.9 Indirect taxes and subsidies

Indirect tax: Tax imposed by the government that increases the supply costs faced by producers.

Examples include:

- Value Added Tax (VAT)
- Plastic Bag Charge
- Fuel Duties
- Alcohol Duties
- Tobacco Duties
- Sugar Tax

Specific Tax: A set tax per unit e.g. £5 tax per unit sold – this causes a parallel shift in the supply curve



Subsidy: Any form of support – financial or otherwise – offered to producers and sometimes consumer.

Purpose of subsidies:

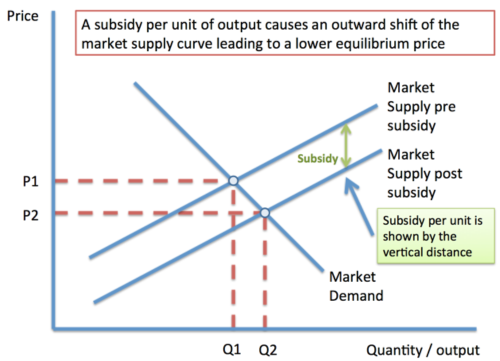
- Help poorer families e.g. food and child care costs
- Reduce the cost of training & employing workers
- Encourage output and investment in fledging sectors
- Protect jobs in loss-making industries e.g. hit by recession
- Make some health care treatments more affordable

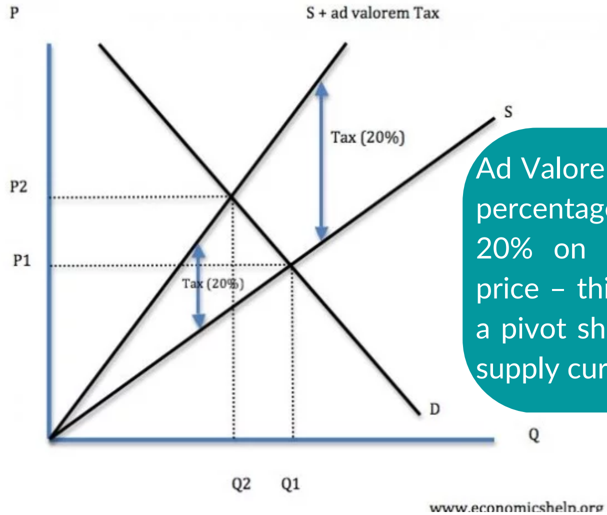
1.2.10 Alternative views on consumer behaviour

Reasons why consumers may not behave rationally:

- Limited ability to calculate and make informed decisions   Bounded rationality
- Influence of social network and peers on decisions made   Herd Behaviour
- Emotion overtaking logic in the decision making process
- Altruism: Doing things for others at a costs to oneself
- Desire for instant rewards
- People stick to default choices   Habitual behaviour

Basic Subsidy Diagram – For Producers





Ad Valorem Tax: A percentage tax e.g. 20% on the unit price – this causes a pivot shift in the supply curve

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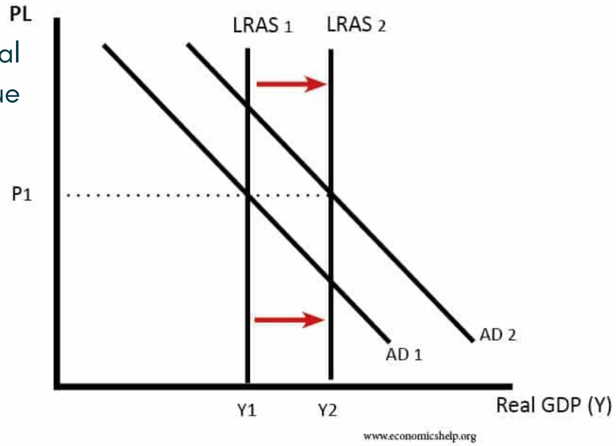
2.1.1 Economic Growth

Economic growth means an increase in real GDP – which means an increase in the value of national output/national expenditure.

- Nominal values mean measuring data at the prices of the day, not taking into account inflation.
- Real values refer to data that is adjusted for inflation over the period.



2.1.2 Inflation

- **Inflation**: A sustained general rise in prices across an economy.
- **Deflation**: A sustained general fall in prices across an economy.
- **Disinflation**: A fall in the rate of inflation.

Measures of inflation:

- **Consumer Price Index (CPI)**
- **Retail Price Index (RPI)**

Causes of inflation:

- **Demand-pull:** Price level increases due sustained increase in demand.
- **Cost-push:** Price level increases due sustained to increase cost of production.
- **Growth of money supply:** More lending leads to more consumer and firm spending and an increase in AD.

2.1.3 Employments and unemployment

Employment: Being in paid work

Unemployment: Those who are not in work but actively seeking work.

Underemployment: Those who are in jobs which do not reflect their skill level.

Measures of unemployment:

- Claimant count – Amount of people on JSA
- International Labour Organisation and UK Labour Force Survey

The causes of unemployment:

- Structural Unemployment
- Frictional Employment
- Seasonal unemployment
- Demand deficiency and cyclical unemployment
- Real wage inflexibility

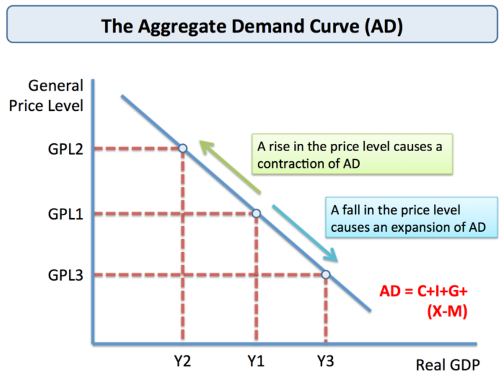
2.1.4 Balance of Payments

Components of BOP:

- **Current Account:** Where payments for the purchase and sale of goods and services are recorded.
- **Capital and financial accounts:** Where flows of money associated with saving, investment, speculation and currency stabilisation are recorded.

The Current Account

- **Trade in goods:** The trade in raw materials, semi-manufactured and finished goods.
- **Trade in services:** Trade of intangible services
- **Current account deficit/surplus:** A deficit exists when imports are greater than exports; a surplus exists when the value of exports are greater than imports



2.2.1 The Characteristics of AD

Aggregate Demand: Total amount of spending on goods and services produced in an economy during a period of time.

Components of AD:

- Consumption (C)
- Investment (I)
- Government Expenditure (G)
- Net-Trade (X-M)

Factors that shift the AD curve:

1. Changes in Expectations
2. Changes in Monetary Policy
3. Changes in Fiscal Policy
4. Economic events in the world economy
5. Changes in household wealth
6. Changes in the supply of credit

2.2.2 Consumption ©

Consumption: Total planned household spending on consumer goods and services produced within the economy.

- As real incomes rise households will tend to spend more.
- As incomes rise, consumers also save more money as well as spending it.
- Other influences on consumer spending:
  - Interest rates
  - Consumer confidence
  - Wealth effects

2.2.3 Investment (I)

Investment: Total planned expenditure undertaken by firms to add to the capital stock.

Gross investment: Total investment on new capital inputs

It is the total amount that the economy spends on new capital goods.

Net investment: Gross investment adjusted for capital consumption (depreciation)

Influences:

- The rate of economic growth
- Business expectations and confidence
- Keynes
- Demand for exports
- Interest rates

2.2.5 Net Trade (X-M)

Net exports = Total Exports - Total Imports

The main influences on the net trade balance:

- Real income
- Exchange rates
- State of the world economy
- Non-price factors

2.2.4 Government Expenditure (G)

The main influences on government expenditure:

- Fiscal policy: Government spending can vary year on year.
- Trade Cycle: Depending on the stage of the economy, government spending will change.

Keynesian LRAS: Keynesian economists argue that the economy can be below full capacity in the long term. Keynesians argue output can be below full capacity for various reasons:

- Sticky wages are sticky downwards
- Negative multiplier effect

2.3.1 The characteristics of AS

Short-run Aggregate Supply: shows total planned output when prices can change but the prices and productivity of factor inputs.

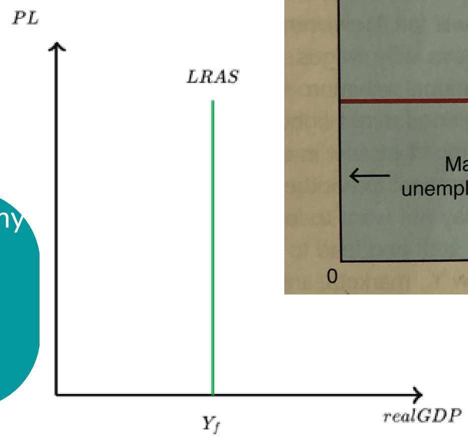
Long-run Aggregate Supply: shows total planned output when both prices and average wage rates can change – it is a measure of a country's potential output and the concept is linked to the production possibility frontier

Factors influencing long-run AS:

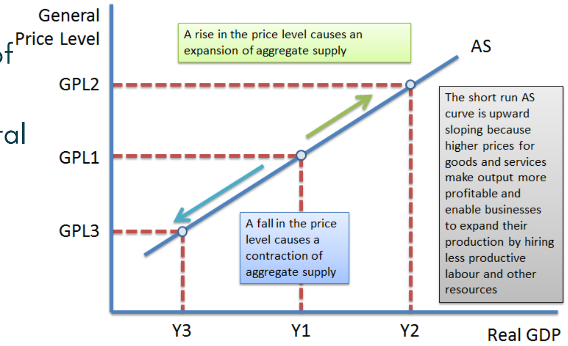
- Technological advances
- Changes in relative productivity
- Changes in education and skills
- Changes in government regulations
- Demographic changes and migration
- Competition policy

2.3.3 Long-run AS

Classical LRAS: Classical economists assume that in the long-run wages and prices are flexible and therefore the LRAS curve is vertical.



The Short Run Aggregate Supply Curve (AS)

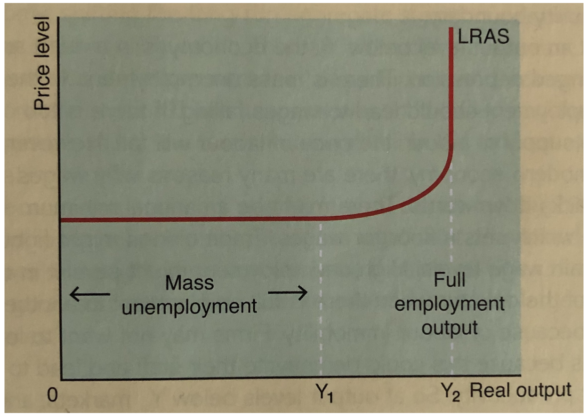


2.3.2 Short-run AS

Factors influencing short-run AS:

- Change in costs of raw materials and energy
- Changes in exchange rates
- Changes in tax rates

When the cost of production increases, the short-run aggregate supply curve decreases, and the costs of production decrease short-run AS increases.



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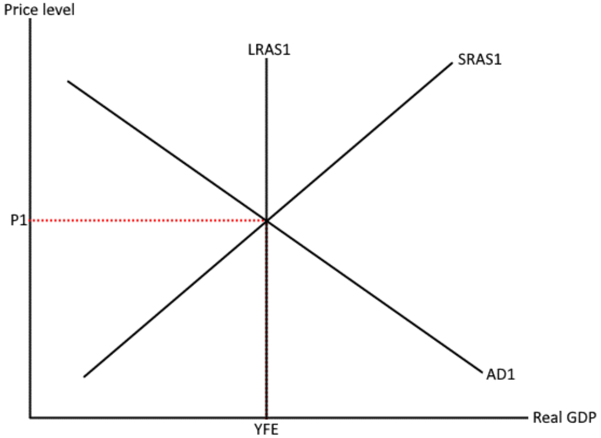
2.4.1 National Income

- **National Income:** The value of output, expenditure or income of an economy over a period of time.
- **Circular flow of income:** A model of the economy which shows the flow of goods, services and factors and their payments around the economy.
- **Income**: Rent, interest, wages and profits earned from wealth owned by economic agents.
- **Wealth**: A stock of assets which can be used to generate a flow of production or income. For example, physical wealth such as factories and machines is used to make goods and services

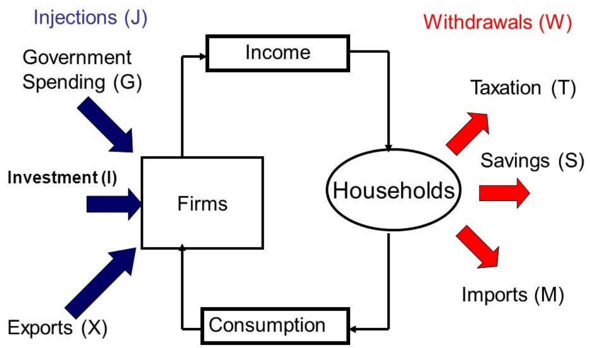
2.4.2 Injections and withdrawals

- **Injections**: In the circular flow of income, spending which is not generated by households including investment, government spending and exports.
- **Withdrawals or leakages:** In the circular flow of income, spending by households which does not flow back to domestic firms. It includes savings, taxes and imports

2.4.3 Equilibrium levels of real national output



The Circular Flow of Income



2.4.4 The multiplier

Marginal propensity to import (MPM): The increase in imports divided by the increase in income that caused them ($\Delta M/\Delta Y$)

Marginal propensity to save (MPS): The increase in saving divided by the increase in income that caused it ($\Delta S/\Delta Y$)

Marginal propensity to tax (MPT): The increase in tax revenues divided by the increase in income that caused them ($\Delta T/\Delta Y$)

Marginal propensity to withdraw (MPW): The increase in withdrawals from the circular flow (S+T+M) divided by the increase in income that caused ($\Delta W/\Delta Y$); this is the same as (MPS + MPT + MPM)

Multiplier ratio: The ratio of the final change in income to the initial change in an injection. It can be calculated as: 1/1-MPC

Multiplier effect: An increase in investment or other injection will lead to an even greater increase in income. (Assuming the injection is not determined by income).

2.5.1 Causes of growth

- **Actual growth:** Economic growth as measured by recorded changes in real GDP over time.
- **Potential growth:** Economic growth as measured by the changes in the productive potential of the economy.
- **Export-led growth:** A rise in aggregate demand caused by a rise in exports

Factors which could cause long-run economic growth

- Land
- Labour
- Capital
- Technological progress
- Efficiency

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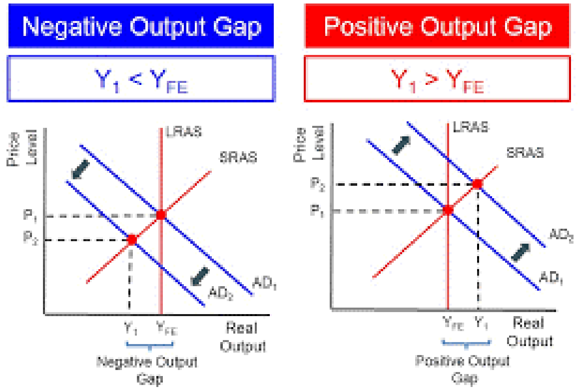
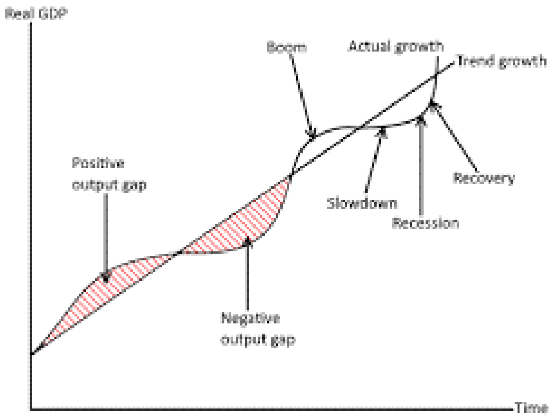
2.5.2 Output gaps

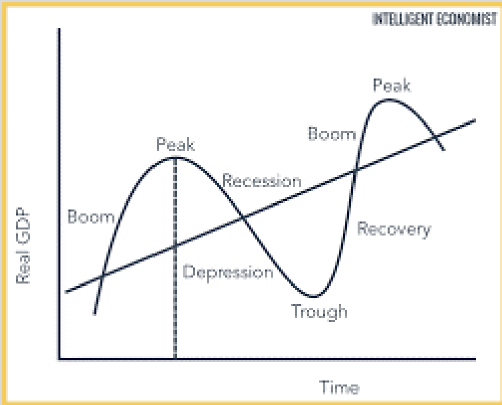
Output gap: The difference between the actual level of GDP and the productive potential of the economy.





2.5.3 Trade (business) cycle

Trade (business) cycle: Regular fluctuations in the level of economic activity around the productive potential of the economy.



2.6.1 Possible macroeconomic objectives

Government objectives:

- Economic growth
- Unemployment and employment
- Low and stable inflation rate, **+/- 2%**
- Balance of payments on current account
- Balanced government budget
- Protection of the environment
- Greater income equality

2.6.2 Demand side policies

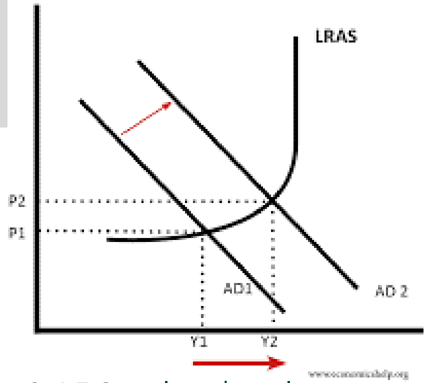
- **Monetary policy:** The manipulation by government of monetary variables, such as interest rates and the money supply, to achieve its objectives
- **Fiscal policy:** The use of taxes, government spending and government borrowing to achieve its objectives

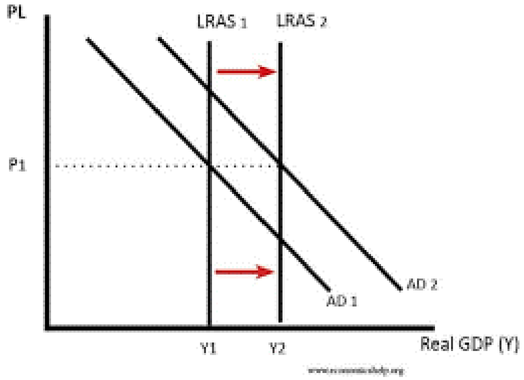
Monetary policy instruments:
Interest rates (Bank of England)
Quantitative easing (Bank of England)
Fiscal Policy Instruments:
Government spending and taxation

In business cycles, the economy veers from recession, when it is operating below its productive potential.
The economy booms when it is above the productive potential.

2.5.4 The impact of economic growth

Benefits	Costs
Increased life expectancyIncrease in living standards Increase in tax revenuesIncrease in business activities	Increasing income inequalitiesIn less developed countries, growth leads to more pollutionIncrease in inflation





2.6.3 Supply-side policies

- **Market-based policies:** Policies designed to remove barriers to the efficient working of free markets.
- **Interventionist policies:** Policies designed to correct market failure.

Market-based policies and interventionist policies:

- To increase incentives
- To promote competition
- To reform the labour-market
- To improve skills and quality of the labour force
- To improve infrastructure

2.6.4 Conflicts and trade-offs between objectives and policies

- Growth vs Inflation
- Growth vs Income equality
- Growth vs Environment
- Growth vs Balance of Payments

Economics

3.1.1 Size and types of firms

Why firms remain small:

- Small firms can be monopolists
- Low barriers to entry
- Few Economies of Scale

Divorce of Ownership from control leading to:

- **Principal agent problem:** This is where there might be conflicts of interest between board members/managers and shareholders
- **Public Sector Organisations:** Organisations owned and controlled by the state, e.g BBC, NHS, TFL and Ofsted.
- **Private Sector Organisations:** Organisations that are owned by individuals or companies, e.g. Tesla, Apple and Microsoft.

3.1.2 Business Growth

How businesses growth:

- **Organic Growth:** Increasing their output through investment in:
  - Developing new products
  - Opening new stores/locations
  - Entering new markets with existing products
- **Inorganic Growth:** Increasing output through merger, takeover and amalgamation with other firms:
  - Forward and backward vertical integration
  - Horizontal Integration
  - Conglomerate Integration

Advantages & disadvantages of Vertical Integration

Advantages	Disadvantages
Vertical integration may reduce risk	Firms may have little expertise in that particular industry
Cost savings, if the firm integrates with suppler or buyer and is more efficient	Firms often pay too much in mergers
Forward integration could give the firm more control over market	Difficulties merging the two firms ibn terms of management structure and culture
More sontrol over price and branding	Key workers in the firm taken over may leave, so the new firm may lose key expertise that made the business successful

Advantages & disadvantages of Organic Growth

Advantages	Disadvantages
Internal growth allows firms to keep organisational structure and management culture	Not fast enough for directors who want bonuses or shareholders who don't want to reinvest profits but want dividends instead
Organic growth is risk-averse	Organic growth has limits product market may become saturated
Safe, stable and sustainable	Diversification is dangerous and could fail (Apple Pippin, Tesco in China)
The only viable option for small firms	Easiest methods for rapid expansion or mergers

Advantages & disadvantages of Horizontal Mergers

Advantages	Disadvantages
Reduces average costs results in economies of scale	Such mergers are rarely ever successful
Reduces competition	Firms usually have to overpay (like buying sneakers on resale, or buying a football player with years left on their contract
Allows one firm to acquire unique assets owned by another firm	Integration of two firms is often poorly mismanaged and key workers can leave
Firms can outgrow in a market where ther is already knowledge and expertise	

Conglomerate Integration

Advantages	Disadvantages
Reduce risj, operate in a different market w/different ups and downs	Lack of expertise
Easier for comglomerate to expand	Pay too much for firm
Opportunity for asset stripping	May lose workers after acquisition as mergers are often handled poorly

Economics

3.1.2 Constraints on business growth:

- Size of the market
- Access to finance
- Owner objectives
- Regulation

3.1.3 Demergers

Demergers: When a firm splits itself into two or more separate firms.

Reasons for demergers:

- Lack of synergies
- Price of separate firms
- Focussed companies

Impact of demergers:

- Businesses
- Workers
- Consumers

3.2.1 Business Objectives

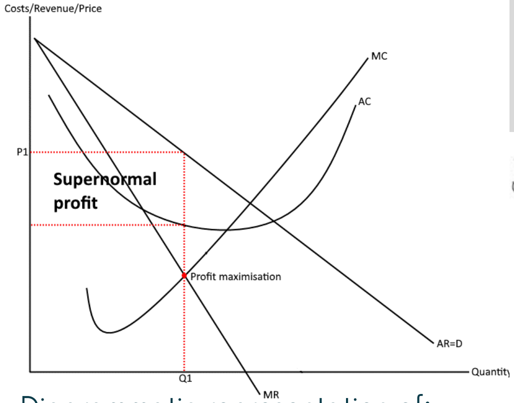
Profit Maximisation: Producing at the point where MC = MR to maximise supernormal profit.

Revenue Maximisation: Producing at the point where MR = 0 to maximise sales revenue.

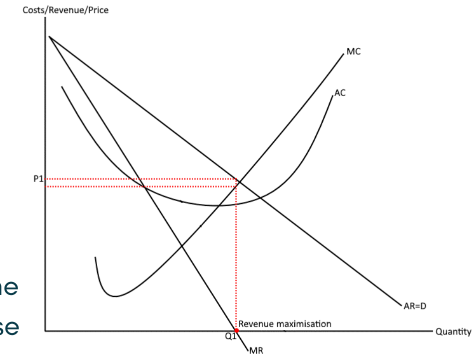
Sales Maximisation: Producing at the point where AC = AR to maximise sales.

- Satisficing: A means of resolving the principal=agent problem by producing at a point where the firm makes high sales and high profits.

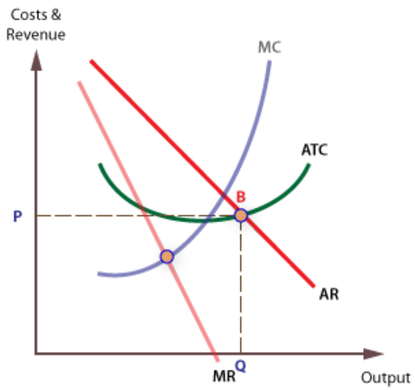
Diagrammatic representation of: Profit Maximisation (MC = MR)



Diagrammatic representation of: Revenue Maximisation (MR = 0)

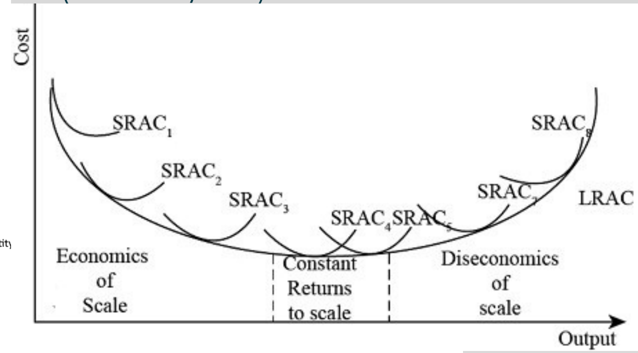


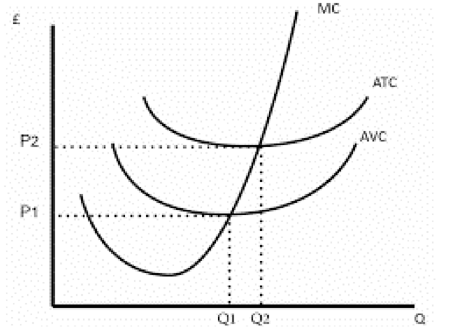
Diagrammatic representation of: Sales Maximisation (AC = AR)



3.3.1 Revenue

- **Total Revenue:** Total revenue earned from selling goods and services (TR = SP x Q)
- **Average Revenue:** The average revenue received from each unit sold (AR = TR/Q)
- **Marginal Revenue:** The additional revenue gained from each additional unit sold (MR = ΔTR/ΔQ)





3.3.2 Costs

- **Total Costs:** The total cost of producing at a given level of output. (TC = TFC + TVC)
- **Average Cost:** The average cost of producing each unit. (AC = TC/Q)
- **Fixed Costs:** A cost which does not vary with output, e.g rent and salaries.
- **Average Fixed Costs:** (AFC = TFC/Q)
- **Variable Costs:** Costs that vary with output, e.g. raw materials
- **Average Variable Cost:** (AVC = TVC/Q)
- **Marginal Revenue:** The additional cost of producing an each additional unit (MR = ΔTC/ΔQ)

3.3.3 Economies and diseconomies of scale

- **Economies of Scale:** Average costs fall as output increases.
- **Optimal level of production:** The output range over which average costs are at a minimum.
- **Minimum efficient scale (MES) of production:** The output level at

Sources of economies of scale:

- Financial
- Managerial
- Technical
- Marketing
- Purchasing

Fun Mums Try Making Pies

Diseconomies of Scale: After the optimal level of production, when average costs rise as output increases.

Sources of diseconomies of scale:

- Communication
- Management issues
- Lack of Motivation

Economics

3.3.4 Normal Profits, Supernormal Profits and losses

Normal Profit: The profit that the firm could make by using its resources in their next best use.

Break-even point: The level of output where total revenue equals total cost.

Supernormal Profit: The profit achieved above normal profit.

- Subnormal Profit (Loss): The profit below normal profit.

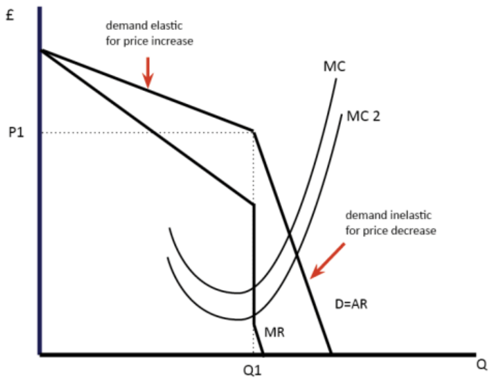
3.4.1 Efficiency

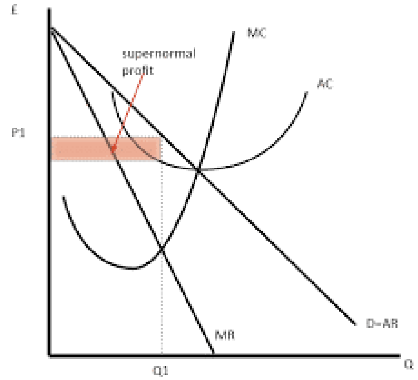
Allocative Efficiency: When firms produce at a level that satisfies the demand for goods and services demanded by consumers.

Dynamic Efficiency: Occurs when resources are allocated efficiently over time.

Productive efficiency: Achieved when production is achieved at lowest average cost.

- X-inefficiency: Inefficiency arising because a firm or other productive organisation fails to minimise its average costs of production at a given level of output.





3.4.2 Perfect Competition

Perfect Competition: Describes a market where there is a high degree of competition.

Characteristics of perfect competition:

- Many buyers and sellers
- No barriers to entry and exit
- Price takers
- Perfect Information
- Homogenous goods

Examples: Primary Sector, e.g. farming, mining, fishing.

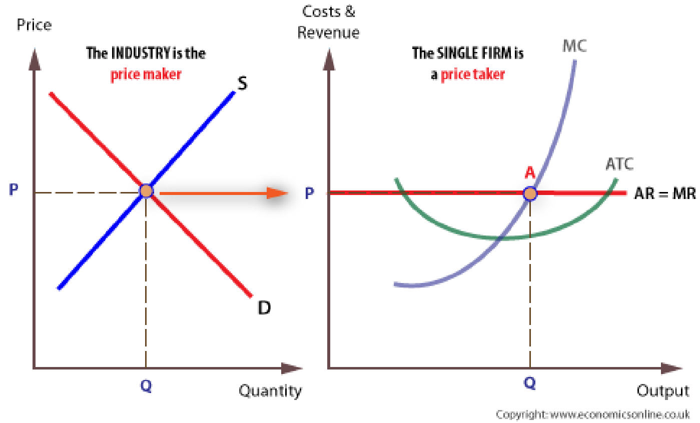
3.4.3 Oligopoly

Oligopoly: An imperfectly competitive market with high concentration of firms.

Characteristics of Oligopoly:

- A few large firms, sometimes there are some small firms.
- High barriers to entry and exit
- Interdependence of firms
- Some product differentiation through branding
- Firms are profit maximisers
- Firms are Price Setters to a greater extent than monopolistic competition but less than monopolies.

Airline A		Raise price	Lower price
	Raise price	£10m / £10m	£3m / £12m
	Lower price	£12m / £3m	£6m / £6m

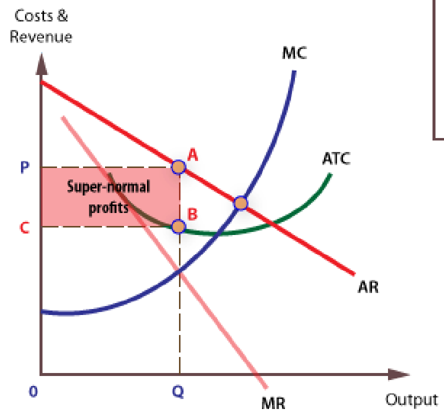


3.4.3 Monopolistic Competition

Monopolistic Competition: Describes a market where there is also high degrees of competition but where firms have some degree of price setting powers.

Characteristics of monopolistic competition:

- Many buyers and sellers
- No barriers to entry and exit
- Firms are profit maximisers
- Difference to Perfect Competition: Products are differentiated.
- As a result, firms have limited price setting powers.



SIXTH FORM KNOWLEDGE ORGANISER

Haggerston School

Aspiration Creativity Character

Theme 4

Economics

GLOBALISATION

Globalisation is the increase in interdependence between countries – economically, politically and culturally.

Comparative Advantage

This is the foundation of globalisation – Countries specialise in goods where they have a comparative advantage – producing at a lower opportunity cost.

Factors behind globalisation:

Fall in transport costs, decline in cost of communication, lowering of trade barriers, rise of MNCs, collapse of communism and rising real incomes

Benefits of globalisation

Consumers have lower prices and greater choice. Reduction in poverty through trade. Businesses have more markets and therefore can gain increased profit and benefit from economies of scale.

Costs of globalisation

Exploitation of workers, external costs related to trade, footloose industries, global instability, increased inequality – the 'race to the bottom'.

WTO – World Trade Organisation

Increases trade through unilateral agreements to reduce tariffs and quotas. Conflict with Trading blocs that lead to trade creation/trade diversion but blocs are preferable to lots of bilateral agreements.

INTERNATIONAL COMPETITIVENESS

International competitiveness refers to the ability of a country to compete in domestic and international markets.

Price factors

Relative unit labour costs, Real exchange rate, labour productivity (education and training, R&D), inflation, 'red tape' costs, infrastructure.

Non-price factors

Quality, design, reliability, availability, after-sales service International competitiveness can be assessed by looking at the Balance of Payments Components of BOP are the current account and the capital and financial accounts.

Current account deficits are mainly due to a lack of international competitiveness but it could be due to increased economic growth.

Policies to reduce the deficit: Reduce demand in domestic country, use Supply-Side policies to boost international competitiveness, use protectionism (WTO issues) or devalue – however J-Curve and Marshall-Lerner Condition must apply

Global imbalances can cause problems as shown with the financial crisis and should not occur in the long run

POVERTY AND INEQUALITY

Absolute poverty is when people are have incomes that fall below the minimum level to meet basic needs ($1.25 a day at PPP- World Bank)

Relative poverty is when people are living below a certain income threshold in a country – normally below 50% of median income(UK it is below 60% of median income)

Factors behind relative poverty and inequality:

Education and training, wage rates, inheritance, ownership of assets, pensions, unemployment, benefits, the tax system.

The degree of inequality can be measured using a Lorenz Curve, where you can also work out the Gini Coefficient – some argue that capitalism (plus globalisation) has made inequality worse as the rich get richer at a faster rate than the poor do as they exploit resources and move capital to anywhere in the world. Inequality is seen to be bad as it can lead to socially undesirable consequences that impact all – *higher crime rate, obesity levels, slower growth*

STRATEGIES FOR DEVELOPMENT

There are many ways development can occur:

Free market approach:

Trade liberalisation – outward looking strategy that promotes FDI, the removal of government subsidies and fixed exchange rates, privatisation – the 'Washington Consensus'(IMF/IBRD)

Interventionist approach:

Inward looking strategy using protectionism and managed exchange rates. Use government finances to develop human capital and infrastructure. Use buffer-stock schemes and promote joint ventures – the China approach?

Other strategies:

Industrialisation – the Lewis 2 sector model/Rostow, development of tourism, development of primary (relate to specialisation), fair trade schemes, aid, debt relief, micro-finance schemes.

Many of these strategies will be overseen by international institutions (World Bank/IMF) and NGOs.

HUMAN DEVELOPMENT

Human development is difficult to measure but the Human Development Index is a composite measure that is used.

HDI includes *GDP per head* (PPP), *health (life expectancy at birth) and education (mean years of schooling and expected years of schooling)* – other measures could be HPI, GPI, access to clean water, internet, doctors

ROLE OF THE STATE

It's the role of the state to promote growth and development, they use:

Public expenditure – capital, current and transfer payments to boost productivity, living standards, equality.

Taxes – progressive/regressive *and direct/indirect to incentivise (**Laffer**), redistribute, achieve macro-objectives*

PROTECTIONISM

The way in which free trade can be prevented – these include tariffs, quotas, subsidies, rules & regulations, embargoes.

Arguments for protection include: *Infant industries, prevention of dumping, correcting a current account deficit, raise tax revenue, retaliation (allowed in WTO rules – countervailing measures)*

EXCHANGE RATES

The rate at which one currency exchanges for another.

Free floating leads to a depreciation/ appreciation

Managed/Fixed leads to devaluation/ revaluation

Remember – **SPICED or WPIDEC**

Causes of changes in a free floating system: *Trade, relative IR, political stability, speculation, state of economy*

GROWTH AND DEVELOPMENT

Many factors hold back development and these include: *Primary product dependency (PPD), volatility of commodity prices, the savings gap – related to the Harrod-Domar model, foreign currency gap, capital flight, demographic factors, debt, access to credit and banking (link back to adverse selection/missing markets in Theme 1), infrastructure, education and skills and the absence of property rights – 'tragedy of the commons'*

FINANCIAL SECTOR

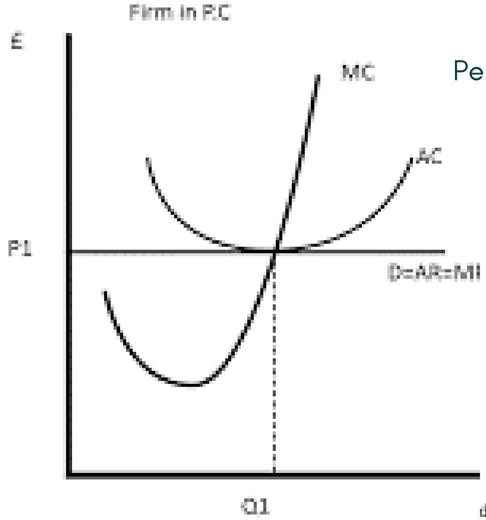
Financial markets are important for growth and development as they:

Facilitate saving (plug savings gap), lend to business/individuals (boost investment – Harrod-Domar), provide markets for equities and currencies/commodities

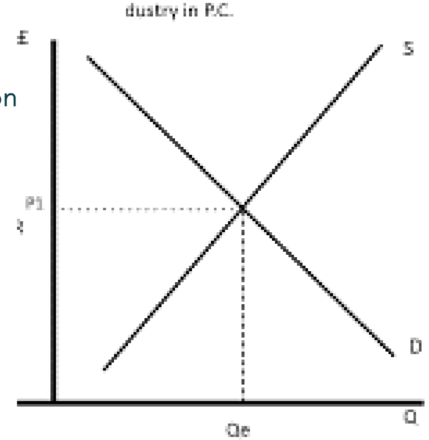
Market failure exists in the financial sector due to: asymmetric information externalities, moral hazard, speculation/bubbles and market rigging

Economics

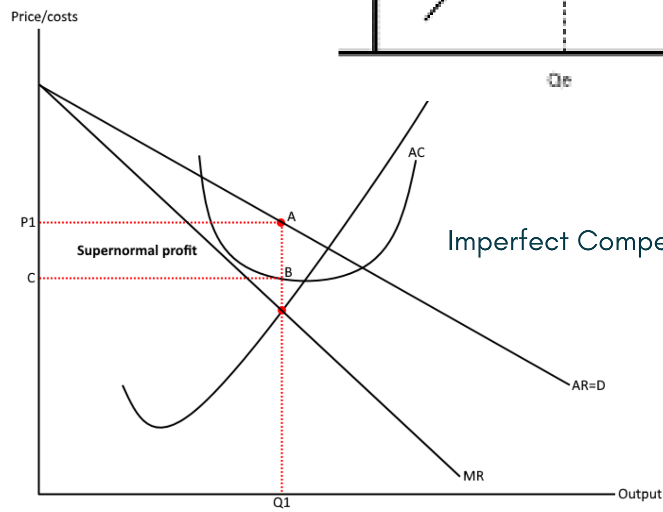
	Comment on the number of firms likely to exist in the industry	Comment on the nature of the product available to consumers	Are there significant barriers to entry for new firms?	How strong is the pricing power of individual firms in the market?	What is the potential to earn supernormal profits in the long run?	What is the likely outcome for allocative efficiency?	What is the likely outcome for productive efficiency?
Contestable market	Any number of firms in the market is possible	Differentiated products are a key part of non-price competition	No – in a contestable market, entry & exit costs are low	Depends on actual competition + threat of competition	Low if the market is highly contestable	High – the strength of competition encourages firms to price competitively	High – competitive pressures likely to get firms to control costs.
Monopolistic competition	Fragmented market – many competing suppliers	Differentiated products	No entry barriers	Limited pricing power if there are many close substitutes	Supernormal profits competed away by the entry of new products	Price > MC therefore not allocatively efficient	Possible loss of productive efficiency if market is saturated with many products
Monopoly	A market dominated by one or a handful of firms	Branded products	Entry barriers important in protecting market power	Strong pricing power including option to price discriminate	Supernormal profits maintained by entry barriers Regulation may limit monopoly profit	Price > MC therefore not allocatively efficient	Scope for very large economies of scale in the case of a natural monopoly
Oligopoly	Highly concentrated market – top five firms have > 60 percent of market share	Branded products	High entry barriers help maintain market dominance of leading firms	Strong price power	Supernormal profits maintained by entry barriers	Price > MC therefore not allocatively efficient and risk of welfare loss from price collusion	Scale economies possible although there is a risk of X-inefficiency
Perfect competition	Many firms none of which have any significant market share	Homogeneous products (they are completely standardized)	No entry barriers at all	No one firm has price setting power – they are price takers	Normal profits in long run equilibrium	Allocatively efficient as price = marginal cost	Limited scale economies but productive efficiency in the long run equilibrium



Perfect Competition



Perfect Competition



Imperfect Competition

The difference between absolute and relative poverty.

Absolute (extreme) poverty:

- When a household does not have sufficient income to sustain even a basic acceptable standard of living
- and enough income to meet people's basic needs
- Absolute poverty thresholds will vary between developed and developing countries

The World Bank now has two "extreme poverty lines":

1. Percentage of population living below $1.90 a day (PPP)
2. Percentage of population living below $3.10 a day (PPP)
3. Percentage of population living below $5.50 a day (PPP)

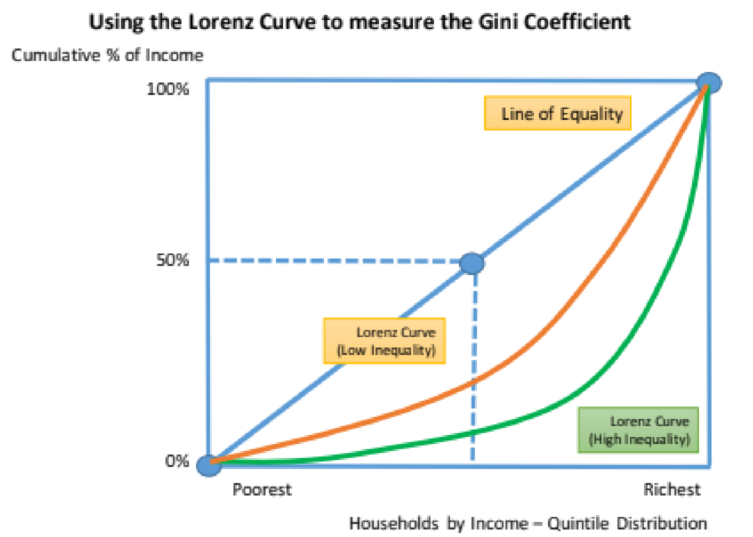
The additional poverty lines of $3.20 and $5.50, reflect national poverty lines in lower-middle-income and upper-middle-income countries

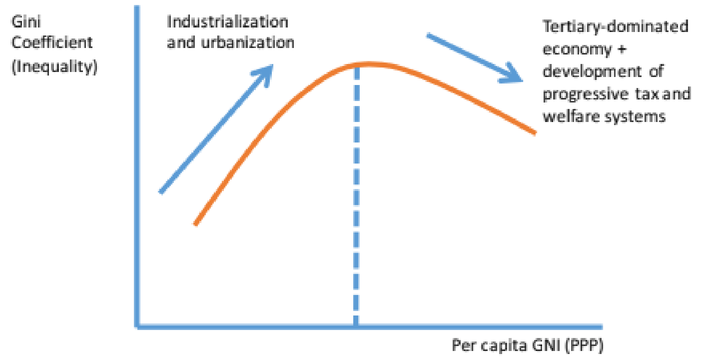
Extreme poverty is multidimensional – it is about more than low income per capita

Relative poverty:

- Relative poverty concerns inequalities of income and wealth within a country
- Relative poverty affects those with a level of household income considerably lower than the median level of income within a country
- The official UK relative poverty line is household disposable income of less than 60% of median income

Median income is preferred by many development economists since the median per capita reveals the progress of a 'typical' person in society and is not influenced to what happens at the tails of the distribution for the lowest and highest income families.





What are the main causes of absolute poverty?

1. Population growing faster than GDP in low-income countries leading to lower per capita incomes.
2. A severe household savings gap – with many families unable to save and living on less than $1.90 per day.
3. Absence of basic government / public services such as education, sanitation, and universal health care.
4. Effects of endemic corruption in government and business.
5. High levels of debt and having to pay high interest rates on loans.
6. Damaging effects of civil wars and natural disasters leading to huge displacements of population.
7. Low rates of formal employment, many people in vulnerable/insecure jobs and earning poverty wages.
8. Absence of basic property rights which for example constraints ability to own land, claim welfare.

SPaG

Grammar: Write in Sentences

A sentence is a group of words that make sense. Sentences start with a capital letter and end with a full stop, question mark or exclamation mark. All sentences contain clauses. You should try to use a range of sentences when writing. There are three main types of sentences.

Simple sentence: A sentence containing one main clause with a **subject** and a **verb**.

He reads.

Literacy is important.

Compound sentence: Two simple sentences joined with a conjunction. Both of these simple sentences would make sense on their own. Varying conjunctions makes your writing more interesting.

He read his book because **it was written** by his favourite author.

Literacy is important so **students had** an assembly about reading.

Complex sentence: A longer sentence containing a main clause and one or more subordinate clause(s) used to add more detail. The main clause makes sense on its own. However, a subordinate clause would not make sense on its own, it needs the main clause to make sense. The subordinate clause is separated by a comma (s) and/or conjunction. The clause can go at the beginning, middle or end of the sentence.

He read his book even though it was late.

Even though it was late, he read his book.

He read his book, even though it was late, because it was written by his favourite author.

How can you develop your sentences?

1. Start sentences in different ways. For example, you can start sentences with adjectives, adverbs or verbs.

Adjective: Funny books are my favourite!

Adverb: Regularly reading helps me develop a reading habit.

Verb: Looking at the front cover is a good way to choose a reading book.

2. Use a range of **punctuation**.

3. **Nominalisation**

Nominalisation is the noun form of verbs; verbs become concepts rather than actions. Nominalisation is often used in academic writing. For example:

It is important to read because it helps you in lots of ways.

Becomes: Reading is beneficial in many ways.

Germany invaded Poland in 1939. This was the immediate cause of the Second World War breaking out. Becomes: Germany's invasion of Poland in 1939 was the immediate cause of the outbreak of the Second World War.

Connectives and Conjunctions	
Cause And Effect	Because So Consequently Therefore Thus
Addition	And Also In addition Further (more)
Comparing	Whereas However Similarly Yet As with/ equally/Likewise
Sequencing	Firstly Initially Then Subsequently Finally After
Emphasis	Importantly Significantly In particular Indeed
Subordinate	Who, despite, until, if, while, as, although, even though, that, which

SPaG: Spelling and Punctuation

Punctuation

Use a range of punctuation accurately when you are writing.

. Full stop Marks the end of a sentence.

, Comma Separates the items on a list or the clauses in a sentence.

' Apostrophe Shows possession (belonging) or omission (letters tak en away).

" " Quotation marks Indicate a quotation or speech.

' ' Inverted commas Indicate a title.

? Question mark Used at the end of a sentence that asks a question.

! Exclamation mark Used at the end of a sentence to show surprise or shock.

: Colon Used to introduce a list or an explanation/ elaboration/ answer to what preceded. A capital letter is only needed after a colon if you are writing a proper noun (name of person or place) or two or more sentences.

; Semi-colon Joins two closely related clauses that could stand alone as sentences. Also used to separate items on a complicated list. A capital letter is not needed after a semi-colon unless you are writing a proper noun (name of person or place).

Brackets Used to add extra information which is not essential in the sentence.

Spelling

Use the following strategies to help you spell tricky words.

1. Break it into sounds (d-i-a-r-y)
2. Break it into syllables (re-mem-ber)
3. Break it into affixes (dis + satisfy)
4. Use a mnemonic (necessary – one collar, two sleeves)
5. Refer to word in the same family (muscle – muscular)
6. Say it as it sounds – spell speak (Wed-nes day)
7. Words within words (Parliament – I AM parliament)
8. Refer to etymology (bi + cycle = two + wheels)
9. Use analogy (bright, light, night, etc)
10. Use a key word to remember a spelling rule (horrible/drinkable for -ible & -able / advice/advise for -ice & -ise)
11. Apply spelling rules (writing, written)
12. Learn by sight (look-cover-say-write check)