



EDEXCEL INTERNATIONAL GCSE (9–1)

ECONOMICS

Student Book

Rob Jones



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ABOUT THIS BOOK

This book is written for students following the Edexcel International GCSE (9–1) Economics specification and covers both years of the course.

The course has been structured so that teaching and learning can take place in any order, both in the classroom and in any independent learning. The book contains four units that match the four areas of content in the specification: The Market System, Business Economics, Government and the Economy and The Global Economy.

Each unit is split into multiple chapters to break down content into manageable chunks and to ensure full coverage of the specification.

Each chapter features a mix of learning and activities. Global case studies are embedded throughout to show a range of situations and businesses within the context of the chapter. Summary questions at the end of each chapter help you to put learning into practice.

Paper 1 is Microeconomics and Business Economics and will test the information in the first two units. Paper 2 is Macroeconomics and the Global Economy and will test the information in the last two units. Knowing how to apply your learning will be critical for your success in the exam. To help with this, there are exam-style questions at the end of each unit and two full practice exam papers at the end of the book.

Learning objectives

Each chapter starts with a list of what you will learn from it. They are carefully tailored to address key assessment objectives central to the course.

Getting started

An introduction to the chapter, letting you think about the concepts you will be introduced to. Questions are designed to stimulate discussion and use of prior knowledge. These can be tackled as individuals, pairs, groups or the whole class.

Activity

Each chapter includes activities to embed understanding through case studies and questions.

GOVERNMENT AND THE ECONOMY 27 UNEMPLOYMENT 215

27 UNEMPLOYMENT

LEARNING OBJECTIVES

- Understand how unemployment is measured
- Understand the different types of unemployment: cyclical, structural, seasonal, voluntary and frictional
- Understand the impact of unemployment on: output, use of scarce resources, poverty, government spending on benefits, tax revenue, consumer confidence, business confidence and society

GETTING STARTED

It is important for a government to keep as many people as possible in work. If people do not work, they make no contribution to national production and their labour is wasted. Also, the living standards of those out of work are not as good as those with jobs. People can be without jobs for a number of reasons. Look at the examples below.

CASE STUDY: KOSTAS MANTALOS

Kostas Mantalos is married with a one-year-old son. He lives on the Greek island of Kos. He works at one of many tourist hotels on the island. He is employed as a waiter and works 12 hours a day, 5 days a week between April and October. Unfortunately, he is not required from November to March. He earns €12 000 a year (plus food and is used to this pattern of work. However, he struggles financially when not working.

▲ A hotel in Kos

CASE STUDY: MAUREEN CONTE

Maureen was employed as a cost accountant by a construction company specialising in the building of oil rigs. However, in January 2015, she was made redundant as the company struggled to survive in an increasingly competitive market. Owing to a fall in the global oil price, there was a huge reduction in the number of oil-related construction projects being started. As a result, Maureen and four of her colleagues were laid off. Maureen hopes to get another job, but she is not confident because she has quite a specialised set of skills.

▲ An oil rig under construction

- 1 Why is Kostas Mantalos not employed after the end of October each year?
- 2 Why was Maureen made redundant?
- 3 Why should a government be concerned about unemployment?
- 4 In pairs, find out the level of unemployment in your country and make comparisons with three other countries of your choice.

THE MARKET SYSTEM 6 FACTORS THAT MAY SHIFT THE SUPPLY CURVE

Figure 6.2 shows the effect of a tax on the supply curve. The supply curve shifts from S_1 to S_2 . As a result, the quantity supplied falls from Q_1 to Q_2 . If indirect taxes are reduced, the supply curve will shift to the right because costs are lower. In Figure 6.2, lower indirect taxes would shift the supply curve from S_1 to S_3 . As a result, the quantity supplied would rise from Q_1 to Q_3 .

Governments use indirect taxes to raise revenue for government expenditure and discourage the consumption of harmful products, such as cigarettes and alcohol. Indirect taxes might also be used to protect the environment. For example, taxes might be imposed on producers if their production methods result in damage to the environment. This is discussed in Chapter 28 (pages 225–238).

SUBSIDIES

Sometimes the government may give money to businesses in the form of a grant. This is called a **subsidy**. Subsidies may be given to firms to try to encourage them to produce a particular product. For example, in the EU, subsidies have been given to farmers to encourage them to produce certain agricultural products. If the government grants a subsidy on a good, the effect is to increase its supply. This is because subsidies help to reduce production costs. As a result, the supply curve will shift to the right, from S_1 to S_3 , in Figure 6.2. This causes the amount supplied at p_1 to rise from Q_1 to Q_3 .

SUBJECT VOCABULARY

consumption: use of goods, services, energy, or natural materials in a particular period of time

subsidy: money that is paid by a government or organisation to make prices lower, reduce the cost of producing goods or providing a service, usually to encourage production of a certain good

DID YOU KNOW?

Government subsidies to producers may have negative effects. For example, producers may lack the incentive to improve efficiency. Another problem is that the government will incur an opportunity cost when spending on subsidies. The money spent might be used on other items of government expenditure, such as education.

ACTIVITY 1

CASE STUDY: SUPPLY AND SUBSIDIES

In 2016, the Sri Lankan government announced that it would provide a Rs37 000 million fertiliser subsidy to the nation's paddy farmers (that is, farmers growing rice). The Ministry of Agriculture said that paddy farmers would receive an annual payment of Rs25 000 for every two hectares of land used to grow rice. In addition, vegetable farmers growing vegetables such as green gram, cow pea, soyabean, Bombay onion and other crops, would also receive a fertiliser subsidy. The government said they would receive Rs10 000 per hectare.

Fertiliser subsidies have been an important feature of Sri Lankan agricultural policy since 2005. The subsidies have accounted for between 2 and 2.5 per cent of total government expenditure over the years. The subsidies have helped to increase paddy production, stabilise the price of rice and helped Sri Lanka to become self-sufficient in rice production.

▲ Paddy farmers in Sri Lanka

- 1 Why is the Sri Lankan government offering subsidies to paddy farmers?
- 2 Using a diagram, show the effect of these subsidies on the supply of rice in Sri Lanka.

Case study

Getting started, Chapter review and Activities are all based around case studies. They are drawn from around the world and will help you see learning applied to real-world contexts.

Did you know?

Interesting facts to encourage wider thought and stimulate discussion.

Subject vocabulary and General vocabulary

Useful words and phrases are colour coded within the main text and picked out in the margin with concise and simple definitions. These help understanding of key subject terms and support students whose first language is not English.

BUSINESS ECONOMICS 25 THE IMPACT OF CHANGES IN THE SUPPLY AND DEMAND FOR LABOUR 177

THE POWER OF TRADE UNIONS

GENERAL VOCABULARY

disputes serious disagreement between two groups of people, especially a disagreement between workers and their employers in which the workers take action to protect their interests

secret ballot way of voting in which people write their choices on a piece of paper in secret

SUBJECT VOCABULARY

closed shop company or factory where all the workers must belong to a particular trade union

secondary picketing workers in one workplace or company strike in order to support the striking workers in a different workplace or company

OFFSHORE ISSUES OF SOME TRADE UNIONS IN THE UK

- The NUJ (National Union of Journalists) represents journalists
- The NUT (National Union of Teachers) represents teachers
- The largest union in the UK is the GMB. It has around 2 million members and is a general union. This means it represents the interests of lots of different types of workers.

EFFECTS OF TRADE UNIONS ON WAGES AND EMPLOYMENT

A strong trade union may be able to force wages up in some labour markets. If a union has the full support of its members, it can put pressure on employers during wage negotiations. When this happens, unions are able to affect wages and employment levels. In Figure 23.7, the equilibrium wage without trade union interference is W_0 , where the supply, SL_0 , and demand, DL_0 , for labour is equal. If a trade union becomes involved, it will force wages up. In this case, trade unions have insisted that wages of W_1 are paid to workers. This means that an employer cannot hire workers below the wage rate of W_1 . As a result, a new supply curve for labour, SL_1 , emerges. This supply curve has a horizontal section, which is perfectly elastic. This means that the employer must pay W_1 for all workers employed up to OL_1 . If the firm needs to hire more workers beyond OL_1 , wages will rise further.

One of the effects of trade union interference here is that the higher wage of W_1 has resulted in fewer workers being employed. Employment has dropped from OL_0 to OL_1 . This is because the demand for labour falls when wages increase. Therefore, it could be argued that trade union interference has increased wages at the expense of jobs for some of its members. However, job losses might be avoided:

- if labour productivity rises at the same time
- if employers are able to pass on wage increases to customers in the form of price rises
- if profit margins are reduced.

Figure 23.8 Australian trade union membership, 1980–2014

Year	Members in %
1980	42.9
1985	37.7
1990	35.2
1995	34.9
2000	30.7
2005	29.9
2010	25.4
2014	16.1

Key facts

Easy to understand, useful information to contextualise learning.

Multiple-choice questions

Each chapter features multiple-choice questions to test your knowledge and prepare you for similar questions in the exam.

THE MARKET SYSTEM 5 THE SUPPLY CURVE 30

MULTIPLE-CHOICE QUESTIONS

1 Which of the following is true of supply?

- If price increases the supply curve will shift to the right.
- If the price falls, the quantity supplied will also fall.
- The amount supplied and the price are inversely related.
- The supply curve is always horizontal.

2 If supply is fixed which of the following is true?

- Demand will also be fixed.
- The supply curve will be vertical.
- Suppliers will not offer any quantity for sale.
- Supply will fall when price rises.

ECONOMICS IN PRACTICE

CASE STUDY: FOTHERGILL & SONS

Fothergill & Sons manufacture a range of wooden products – mainly heavy furniture, such as large tables, benches and beds. One of its profitable lines is park benches, which are often sold to local governments. Many of Fothergill's benches are to be found in local council parks. The number of park benches that Fothergill & Sons is prepared to offer for sale at different prices in a year is shown in Table 5.3.

PRICE (£)	20	40	60	80	100	120	140	160
NUMBER OF BENCHES FOR SALE	0	200	400	600	800	1000	1200	1400

▲ Table 5.3 Supply schedule for park benches made by Fothergill & Sons

▲ Park bench

CHAPTER QUESTIONS

- Draw the supply curve for park benches using the data in Table 5.3.
- How many park benches would be supplied if the price was £110?
- If Fothergill & Sons wanted to supply 1300 park benches per annum, how much would it expect to sell them for?
- Why is supply 0 at a price of £20?
- Discuss whether Fothergill & Sons could supply three times as many park benches.

Economics in practice and Chapter questions

A summary case study and associated questions at the end of each chapter to consolidate your learning.

THE GLOBAL ECONOMY END OF SECTION EXAM QUESTIONS 347

EXAM PRACTICE: 2.2 THE GLOBAL ECONOMY

AD1 1 What is a restriction on the physical quantity of imports coming into a country called? (1)

- Tariff
- WET
- Subsidy
- Quota

AD1 2 Sometimes a business will sell goods below cost in a foreign market. What is this practice called? (1)

- Restrictive trade practice
- Dumping
- Collusion
- Price fixing

AD2 3 Explain one reason for the emergence of multinational corporations. (3)

The Association of Southeast Asian Nations (ASEAN) is one of the largest trading blocs in the world. It has two members from the Southeast Asia region. Some of the largest members include Thailand, Vietnam, Malaysia, Indonesia, Philippines and Singapore.

AD2 4 Analyse the impact of this trading bloc on a member country. (6)

AD3 Like many countries around the world Vietnam has embraced globalisation. In a survey, 95 per cent of Vietnamese respondents agreed that trade was good. The survey also revealed that Vietnamese people thought that trade resulting from globalisation brought jobs and raised wages. The US is one of Vietnam's main trading partners. In 2015, Vietnam sold US\$30 000 million of goods to the USA, making it the top market for Vietnamese exports.

AD2 5 Assess the likely impact of globalisation on a country such as Vietnam. (5)

AD3

AD4

(Total for the Question = 20 marks)

SKILLS

ANALYSIS

CRITICAL THINKING

PROBLEM SOLVING

COMMUNICATION

Exam practice

These exam-style questions are found at the end of each unit. They are tailored to the Pearson Edexcel specification to allow for practice and development of exam writing technique. They also allow for practice responding to the command words used in the exams.

Assessment objectives

Questions are tagged with the relevant assessment objectives that are being examined.

Skills

Relevant exam questions have been assigned the key skills that you will gain from undertaking them, allowing for a strong focus on particular academic qualities. These transferable skills are highly valued in further study and the workplace.

348 ECONOMICS EXAMINATION (PAPER 1) PAPER 1: MICROECONOMICS AND BUSINESS ECONOMICS

PREPARING FOR YOUR INTERNATIONAL GCSE ECONOMICS EXAMINATION (PAPER 1)

PAPER 1: MICROECONOMICS AND BUSINESS ECONOMICS

This complete practice paper will help you prepare for your International GCSE Paper 1 examination.

QUESTION 1

AD1 (a) Which of the following will cause the supply curve for motor cars to shift to the left? (1)

- A rise in incomes
- A fall in indirect taxes on cars
- A rise in the cost of wages paid to car workers
- A fall in the cost of raw materials in car manufacturing

AD2 (b) Which of the following goods or services are most likely to be provided by the private sector? (1)

- Public transport
- Policing
- Environmental services
- Houses

AD1 (c) What is meant by opportunity cost? (2)

AD1 (d) Define the term collusion. (1)

AD1 (e) Define the term supply. (1)

AD1 A hotel in Sri Lanka incurred fixed costs of LKR 400 000 in January 2017. The variable cost per room let in January was LKR 1000. The hotel charged LKR 2000 per night for a room.

AD2 (f) Calculate the profit made by the hotel in January 2017 if a total of 430 rooms were let. You are advised to show your working. (2)

Figure 1 below shows a market in disequilibrium. The current price is £20.

Figure 1

AD2 (g) Calculate the revenue that producers would generate at this price. You are advised to show your working. (2)

Preparing for your International GCSE Economics examination

A full practice exam for both Paper 1 and Paper 2 at the back of the book helps you prepare for the real thing.

ASSESSMENT OVERVIEW

The following tables give an overview of the assessment for this course. You should study this information closely to help ensure that you are fully prepared for this course and know exactly what to expect in each part of the assessment.

PAPER 1	PERCENTAGE	MARK	TIME	AVAILABILITY
MICROECONOMICS AND BUSINESS ECONOMICS Written exam paper Paper code 4EC1/01 Externally set and assessed by Pearson Edexcel Single tier of entry	50%	80	1 hour 30 minutes	January and June examination series First assessment June 2019
PAPER 2	PERCENTAGE	MARK	TIME	AVAILABILITY
MACROECONOMICS AND THE GLOBAL ECONOMY Written examination paper Paper code 4EC1/02 Externally set and assessed by Pearson Edexcel Single tier of entry	50%	80	1 hour 30 minutes	January and June examination series First assessment June 2019

ASSESSMENT OBJECTIVES AND WEIGHTINGS

ASSESSMENT OBJECTIVE	DESCRIPTION	% IN INTERNATIONAL GCSE
A01	Recall, select and communicate knowledge of economic terms, concepts and issues	14–15%
A02	Demonstrate understanding and apply economic knowledge using appropriate terms, concepts, theories and calculations effectively in specific contexts	48–49%
A03	Select, organise and interpret information from sources to investigate and analyse economic issues	23–24%
A04	Evaluate economic information to make reasoned judgements and draw conclusions	12–13%

RELATIONSHIP OF ASSESSMENT OBJECTIVES TO UNITS

UNIT NUMBER	ASSESSMENT OBJECTIVE			
	A01	A02	A03	A04
PAPER 1	7.5%	24.4%	11.8%	6.3%
PAPER 2	7.5%	24.4%	11.8%	6.3%
TOTAL FOR INTERNATIONAL GCSE	14–15%	48–49%	23–24%	12–13%

ASSESSMENT SUMMARY

PAPER 1	DESCRIPTION	MARKS	ASSESSMENT OBJECTIVES
MICROECONOMICS AND BUSINESS ECONOMICS PAPER CODE 4EC1/01	Structure Paper 1 assesses 50% of the total Economics qualification. There will be four questions on the paper, each worth 20 marks. Students must answer all questions. The sub-questions are a mixture of multiple-choice, short answer, data-response and open-ended questions.	The total number of marks available is 80	Questions will test the following Assessment Objectives A01 – 7.5% A02 – 24.4% A03 – 11.8% A04 – 6.3%
	Content summary Each question will be based on a particular topic from the subject content related to microeconomics and business economics. Owing to the nature of economics, there is some interrelation between topics.		
	Assessment This is a single-tier exam paper and all questions cover the full ranges of grades from 9–1. The assessment duration is 1 hour 30 minutes. Calculators may be used in the examination.		
PAPER 2	DESCRIPTION	MARKS	ASSESSMENT OBJECTIVES
MACROECONOMICS AND THE GLOBAL ECONOMY PAPER CODE 4EC1/01	Structure Paper 2 assesses 50% of the total Economics qualification. There will be four questions on the paper, each worth 20 marks. Students must answer all questions. The sub-questions are a mixture of multiple-choice, short answer, data-response and open-ended questions.	The total number of marks available is 80	Questions will test the following Assessment Objectives A01 – 7.5% A02 – 24.4% A03 – 11.8% A04 – 6.3%
	Content summary Each question will be based on a particular topic from the subject content related to microeconomics and business economics. Owing to the nature of economics, there is some interrelation between topics.		
	Assessment This is a single-tier exam paper and all questions cover the full ranges of grades from 9–1. The assessment duration is 1 hour 30 minutes. Calculators may be used in the examination.		



1.1

THE MARKET SYSTEM

Assessment Objective A01

Recall, select and communicate knowledge of economic terms, concepts and issues

Assessment Objective A02

Demonstrate understanding and apply economic knowledge using appropriate terms, concepts, theories and calculations effectively in specific contexts

Assessment Objective A03

Select, organise and interpret information from sources to investigate and analyse economic issues

Assessment Objective A04

Evaluate economic information to make reasoned judgements and draw conclusions

This section looks at the basic economic problem, which is to do with the allocation of scarce resources. The section focuses on the way consumers, firms and the government make choices between different alternatives when faced with a limited budget. It also studies the underlying assumptions behind the behaviour of producers and consumers and the possible reasons why they may fail to maximise their profit or benefit, respectively.

Microeconomics is the study of individual markets. Therefore, this section looks at the way prices are determined in markets by the forces of supply and demand. It covers the factors that might influence supply and demand, and how supply and demand responds to changes in prices. Finally, the chapter addresses the ways in which market forces help to allocate resources in an economy, and what happens when markets fail.

1 THE ECONOMIC PROBLEM

LEARNING OBJECTIVES

- Understand the problem of scarcity
- Understand opportunity cost
- Understand production possibility curves
- Understand causes of positive and negative economic growth

SUBJECT VOCABULARY

goods things that are produced in order to be sold

GETTING STARTED

The planet we live on contains many resources that are used to produce **goods** we like to consume. However, there is a problem. Look at the images below.

CASE STUDY: RESOURCES AND NEEDS



▲ Figure 1.1 Valuable resources



▲ Figure 1.2 Needs

- 1 Describe the resources shown in Figure 1.1.
- 2 Are there enough of these resources in the world? Explain your answer with reference to the images in Figure 1.2.
- 3 In groups, discuss whether your country has enough resources. Draw up a list of measures that your government might take to increase the quantity of resources available. Present your ideas to the rest of the class.

THE PROBLEM OF SCARCITY

SUBJECT VOCABULARY

finite having an end or a limit

GENERAL VOCABULARY

fertile soil ground that is capable of producing crops

GENERAL VOCABULARY

health care activity of looking after people's health, considered to be an industry

needs basic requirements for human survival

wants people's desires for goods and services

SUBJECT VOCABULARY

infinite without limits

FINITE RESOURCES

All countries have resources, such as water, minerals, soil, plants, animals and people. However, in any country there is a **finite** quantity of these resources, which means that the quantity available is limited. As there is only a limited quantity, economists say that resources are scarce. These resources are often referred to as the four factors of production: land, labour, capital and enterprise (see Chapter 14).

Resources are scarcer in some countries than others. For example, in some African countries there are serious shortages of **fertile soil** and water. This means that food production is inadequate. Even where resources exist, a country may not be capable of exploiting them. For example, Ethiopia struggles to produce enough food for its population because only about 4 per cent of its fertile land is irrigated. The problem is not a shortage of water but the failure to exploit some of its huge rivers, such as the Awash and the Blue Nile. The country does not have the financial resources to invest in projects that would make use of the water for agriculture.

UNLIMITED WANTS

Economists distinguish between **needs** and **wants**. Needs are the basic requirements for human survival. Some of these needs are physical and include water, food, warmth, shelter and clothing. If these needs cannot be satisfied, eventually humans would cease to exist. In some countries in the world people do die because such needs cannot be met.

In addition to basic needs, humans also have other desires. These are called wants and may include more holidays abroad, a better house, more meals out, a bigger car, new golf clubs, a better education, improved **health care** and a cleaner environment. These wants are unlimited or **infinite**. People always want more whatever their current circumstances; it is human nature. The problem is made worse because many of the things that people want have to be replaced. Consumers regularly replace cars, computers, shoes, clothes and furniture, for example, either because they are no longer functional, or because better or more fashionable versions have become available.

ACTIVITY 1

CASE STUDY: NEED AND WANTS



▲ Figure 1.3 Different eating arrangements

- 1 How might the two images in Figure 1.3 illustrate the differences between needs and wants?
- 2 Why are resources finite?

THE ECONOMIC PROBLEM

SUBJECT VOCABULARY

basic economic problem allocation of a nation's scarce resources between competing uses that represent infinite wants

scarce resources amount of resources available when supply is limited

GENERAL VOCABULARY

allocate to decide officially that a particular amount of money, time, etc. should be used for a particular purpose

KEY FACTS

In China, many clothes manufacturers use large quantities of labour in production. However, in many Western countries the same goods may be produced using high-tech machinery.

GENERAL VOCABULARY

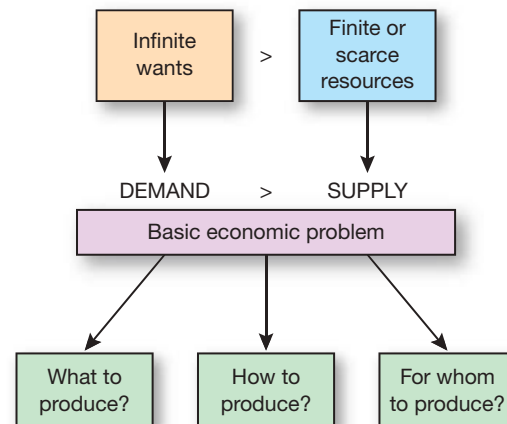
distribution act of sharing things among a large group of people in a planned way

OPPORTUNITY COST

GENERAL VOCABULARY

choices deciding between alternative uses of scarce resources

All countries have to deal with what economists call the **basic economic problem**. The problem, summarised in Figure 1.4, occurs because the world's resources are scarce or finite and people's wants are infinite. Demand for resources is greater than their supply. As a result, decisions have to be made about how to **allocate** a nation's **scarce resources** between different uses. This is what the study of economics is all about.



▲ Figure 1.4 The basic economic problem

To overcome the basic economic problem, important decisions have to be made.

- **What to produce?** Because it is impossible to produce all the goods that people want, a country must decide which goods will be produced. For example, should resources be used to provide more libraries, build more schools, expand the armed forces, make more cars, build more houses, construct more roads, make more toys, print more books, increase state pensions or train more doctors?
- **How to produce?** Goods can be produced using a variety of different production methods. The four factors of production can be organised in different ways to produce the same goods.
- **For whom to produce?** Once goods have been produced, there has to be a method of **distribution**. This means that the goods have to be shared in some way between members of the population. For example, should everyone get exactly the same quantities or should some receive more than others?

There are different solutions to the basic economic problem. This is because different courses of action can be taken when making the decisions outlined above. The way in which they are made depends on what sort of economic system a country has. This is explained in Chapter 11.

Whichever approach is used to solve the basic economic problem, all decision makers are faced with **choices**. Resources often have a number of alternative uses; as a result people have to make a choice about which way to use them. Individuals, producers and governments face this choice.

- Individuals have to choose how to spend their limited budgets. For example, a university student, after all living costs have been met, may have £50 left at the end of the week. This student would like to buy some new books (£20), get the train home for the weekend (£30), go out for a meal with

friends (£30), buy some new computer software (£20) or buy a new pair of designer jeans (£50). Clearly, a choice has to be made because all of these goods together would cost £150.

- Producers may have to choose between spending £100 000 on advertising, training its workforce or buying a new machine.
- A government may have to decide whether to spend £5000 million on increasing welfare benefits, building new hospitals, providing better care for the mentally ill or building a new motorway.

GENERAL VOCABULARY

sacrifice something valuable that you decide not to have, in order to get something that is more important

SUBJECT VOCABULARY

opportunity cost cost of the next best alternative given up (when making a choice)

When making such choices, individuals, firms and governments will face a cost once their choice has been made. This is called the **opportunity cost**. This cost arises because a **sacrifice** has to be made when making a choice. If the government in the example above can place its spending desires in order of preference, the opportunity cost can be identified. Once the government has chosen the best alternative, the opportunity cost will be the benefit lost from the next best alternative. Assume that the government's spending desires are placed in order of preference as below:

- 1 new motorway
- 2 new hospital
- 3 increase welfare benefit
- 4 improve care for the mentally ill.

In this example, the new motorway is the government's preferred choice. Therefore, the £5000 million will be allocated to this project. The opportunity cost in this case is the benefit lost from not building the new hospital, that is, the benefit lost from the next best alternative.

ACTIVITY 2

CASE STUDY : OPPORTUNITY COST

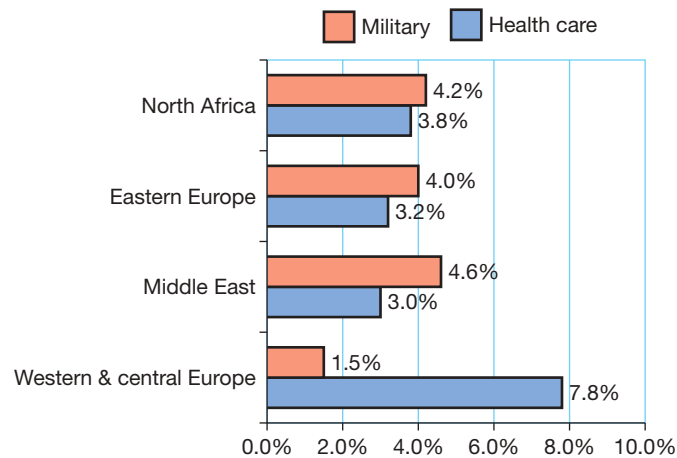
In 2015, according to the Stockholm International Peace Research Institute (SIPRI), the value of global military spending was US\$1 676 000 million. This was about 2.3 per cent of the world's gross domestic product (a measure of world income). This level of spending on military goods often attracts criticism about the possible opportunity costs it incurs. In some regions, more is spent on the military than on health care – Figure 1.5 identifies four of these regions. Figure 1.5 also shows that in western and central Europe spending on health care is far higher than that on military goods. Campaigners often say that government **expenditure** on the military is a waste of resources. They recommend spending at least some of this money on meeting human needs. For example, the Global Campaign on Military Spending called for a 10 per cent cut in worldwide military spending. It said the money saved should be used for development purposes. In support of this campaign, Kazakhstan's President Nursultan Nazarbayev said that all nations should give 1 per cent of their military spending to the United Nations Special Fund for Global Development. In 2015, the UN Food and Agriculture Organisation said that a redirection of just 13 per cent of the global military budget could **eliminate** extreme poverty and hunger.

SUBJECT VOCABULARY

expenditure spending by a government, usually a national government

GENERAL VOCABULARY

eliminate to get rid of something unnecessary or unwanted



▲ **Figure 1.5** Spending on health care and military goods in a selection of regions (as a percentage of GDP)

- 1 Suggest one reason why spending on health care in western and central Europe is far higher than that on military goods, compared with the other regions shown.
- 2 What is meant by opportunity cost? Use this case as an example in your answer.

PRODUCTION POSSIBILITY CURVES (PPCs)

SUBJECT VOCABULARY

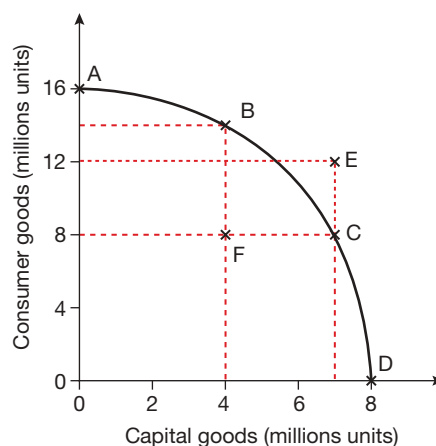
capital goods those purchased by firms and used to produce other goods such as factories machinery, tools and equipment

consumer goods those purchased by households such as food, confectionery, cars, tablets and furniture

production possibility curve (PPC) line that shows the different combinations of two goods an economy can produce if all resources are used up

Deciding which goods to produce and the concept of opportunity cost can be illustrated using **production possibility curves (PPCs)**. A PPC shows the different combinations of two goods that can be produced if all resources in a country are fully used. It shows the maximum quantities of goods that can be produced. A PPC for a country is shown in Figure 1.6. It is assumed that the country can produce **consumer goods** or **capital goods**. What does the PPC show?

- At point A, 16 million units of consumer goods are produced and zero capital goods.
- At point D, 8 million units of capital goods can be produced and zero consumer goods.
- At point B, a combination of 14 million units of consumer goods and 4 million units of capital goods can be produced.
- At point C, a combination of 8 million units of consumer goods and 7 million units of capital goods can be produced.
- At point F, a combination of 8 million units of consumer goods and 4 million units of capital goods can be produced. At this point, not all resources in the country are being used – there are unemployed resources. This is because point F is inside the PPC. A country should aim to push production so that it is on the PPC. At points A, B, C and D resources are fully employed.
- The combination of goods represented by point E is not possible. This is because it is outside the PPC. The country does not have the resources to produce 12 million units of consumer goods and 7 million units of capital goods.



▲ Figure 1.6 A production possibility curve for a country

WHAT HAPPENS WHEN AN ECONOMY MOVES FROM ONE POINT ON THE PPC TO ANOTHER?

For example, what happens if the economy in Figure 1.6 moves from B to C? By moving along the PPC, an opportunity cost is incurred. At point B, 14 million units of consumer goods are being produced and 4 million units of capital goods. By moving to C, the production of capital goods rises to 7 million units but production of consumer goods falls to 8 million units. To gain another 3 million units of capital goods, 6 million units of consumer goods are being sacrificed. The lost production of consumer goods (6 million units) is the opportunity cost.

The choice between different combinations of consumer goods and capital goods is an important one for a country. If a country produces more capital goods, it will probably be able to produce more consumer goods in the future. This is because capital goods are used to produce consumer goods. However, by doing so there will be fewer consumer goods today and some people will have less in the short term.

CAUSES OF POSITIVE AND NEGATIVE ECONOMIC GROWTH

SUBJECT VOCABULARY

economic growth increase in the level of output by a nation

GENERAL VOCABULARY

proportion part of a number or an amount, considered in relation to the whole

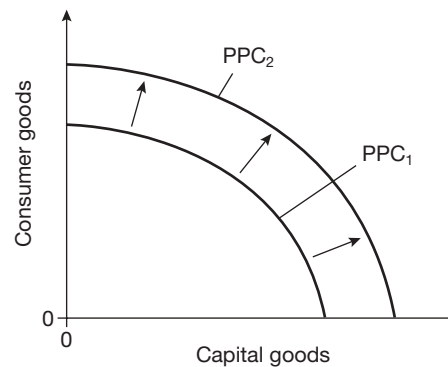
vocational training that teaches you the skills you need to do a particular job

At a particular point in time, a country cannot produce combinations of goods that lie to the right of the PPC. However, over a long period of time, an economy would expect to raise the production of all goods. This is called **economic growth**. There are several reasons for this.

- **New technology:** As time passes, new technology is developed and this benefits businesses. For example, new machines such as robots, computers, telecommunications and the internet have been used by businesses to help increase productive potential. New technology is usually faster and more reliable in production and therefore more output can be produced.
- **Improved efficiency:** Over time, resources are used more efficiently. New production methods, such as kaizen (continuous improvement) and lean production (using fewer resources in production), for example, have been developed and adopted. These more efficient methods replace the old ones and more output can be produced with fewer resources.
- **Education and training:** An economy can boost the productive potential of a nation by educating and training the population. A country's economy becomes more productive as the **proportion** of educated workers increases. This is because educated workers can more efficiently carry out tasks that require reading and writing analysis, evaluation, communication and critical thinking. However, a country has to find the 'right' balance between academic and **vocational** education.

■ **New resources:** Some countries find new resources that enable them to produce more. For example, in recent years, the USA has raised its productive potential by producing more oil through fracking. Fracking involves shooting a mixture of mostly water and sand under high pressure against rock until it fractures or breaks. The sand fills the fracture, forcing oil out of the rock formation. Fracking now provides the USA with around 50 per cent of its oil needs. This is up from just 2 per cent in 2000.

If countries can produce more, the PPC will shift outwards. This is shown in Figure 1.7, PPC_1 represents an original PPC, while PPC_2 shows a new PPC resulting from improved efficiency, for example. Combinations of goods not previously possible can now be enjoyed. To generate economic growth in this way, a government needs to ensure that investment levels are adequate. Economic growth is discussed in more detail in Chapter 25.



▲ Figure 1.7 Effect of improved efficiency on the PPC

GENERAL VOCABULARY

agricultural practice or science of farming

Finally, it is possible for the PPC to shift inwards. This would represent negative economic growth, that is, where a country's productive potential actually falls. It may be caused by resource depletion: where a country runs out of a natural resource, such as oil or coal. The productive potential of a country can also be reduced by weather patterns. For example, dry weather might prevent some nations from meeting their **agricultural** production targets. Economic growth in a particular country might also be negative if large numbers of highly qualified, skilled and experienced workers moved overseas. This might happen if these workers could earn more money employed in another country. Wars, conflict and natural disasters might also result in negative economic growth.

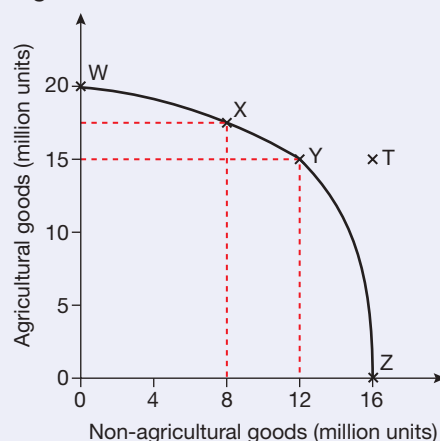
MULTIPLE-CHOICE QUESTIONS

- ▶ 1 Which of the following questions is associated with the basic economic problem?
 - A When to produce?
 - B Who should produce?
 - C What to produce?
 - D Where should production be located?
- ▶ 2 Which of the following might be considered a need rather than a want?
 - A Shelter
 - B Holiday
 - C Smartphone
 - D Pet dog

ECONOMICS IN PRACTICE

CASE STUDY: PRODUCTION POSSIBILITY CURVES

A country is able to produce agricultural and non-agricultural goods. It is currently at point X on the production possibility curve, as shown in Figure 1.8.



▲ Figure 1.8 PPC of a country producing agricultural and non-agricultural goods

CHAPTER QUESTIONS

- 1 What is meant by a production possibility curve? Use this case as an example in your answer.
- 2 According to the PPC, the decision makers in this country must make what key choice?
- 3 Why is point T on the diagram currently unobtainable?
- 4 The country is considering a movement from X to Y. What will be the opportunity cost of such a movement?
- 5 Using a diagram, assess the effect that the discovery of fresh oil reserves might have on the PPC of this country.

2 ECONOMIC ASSUMPTIONS

LEARNING OBJECTIVES

- Understand the underlying assumptions in economics
- Understand why consumers might not maximise their benefit
- Understand why producers may not maximise their profit

SUBJECT VOCABULARY

variables something that affects a situation in a way that means you cannot be sure what will happen

GENERAL VOCABULARY

assumptions things that you think are true although you have no definite proof

irrational not based on clear thought or reason

GETTING STARTED

Economics is a social science that studies how individuals make decisions about the allocation of scarce resources. It often uses economic models to help predict the behaviour of **variables** (such as inflation, unemployment, consumer spending and wages) and to explain the cause of certain events. In using these models, economists are required to make some **assumptions** about the behaviour of individuals. Look at the example below.

CASE STUDY: MAKING CHOICES

In general, economists assume that an individual behaves rationally when making a choice. This means that an individual will make a thoughtful and logical decision when choosing between different courses of action. For example, a young student, Anita, is given Rs5000 to spend on anything she chooses up to that value. She draws up a list of the things she would like to buy and places them in order of preference. The items, each of which cost Rs5000, are shown in Figure 2.1. Option A is her most preferred option and option D is her least preferred.



◀ A Meal out to treat her friends



◀ B Ticket for India v England at Rajkot



◀ C A new outfit for a future wedding



◀ D Flight to Mumbai to visit her brother

▲ Figure 2.1 Items that Anita would like to buy

- 1 Why it would be **irrational** for Anita to choose option C given the information above?
- 2 What is the opportunity cost of choosing option A?

UNDERLYING ASSUMPTIONS IN ECONOMICS

GENERAL VOCABULARY

rational based on clear thought or reason

SUBJECT VOCABULARY

maximise to increase something such as profit, satisfaction or income as much as possible

SUBJECT VOCABULARY

revenue money that a business receives over a period of time, especially from selling goods or services

REASONS WHY CONSUMERS MAY NOT ALWAYS MAXIMISE THEIR BENEFIT

When making economic decisions, individuals are usually faced with limitations. In 'Getting started' above, Anita could not buy all the things she wanted. She was limited by the amount of money she had available (Rs5000) and therefore had to choose one from four different options. However, to help her make the decision, she placed the four items of expenditure in order of preference. By doing this, she was able to select option A. This is **rational** because according to her list option A is the most preferred option, that is, the one that will give her the most satisfaction. Economists assume that individuals behave in a rational way. They make the following two assumptions in relation to rationality.

1 CONSUMERS AIM TO MAXIMISE BENEFIT

When making economic decisions, economists assume that consumers will always choose a course of action that gives them the greatest satisfaction. This will help them **maximise** benefit. In 'Getting started' above, Anita chose to spend her Rs5000 on the most preferred item in her list, that is, the meal out with her friends. This is a rational decision; economists assume that consumers will always do this. Two other examples of consumer rationality are outlined below.

- If a consumer is faced with buying exactly the same product from three different suppliers, the consumer will always buy from the supplier that offers the cheapest price. To pay more for a product than is necessary is irrational. For example, why would a consumer pay €1.14 for a litre of petrol at a filling station, when less than 500 metres away another is selling the same petrol for €1.09 per litre?
- If a consumer is faced with buying a product from three different suppliers at the same price, the consumer will buy the best quality product. To buy a product of lower quality would be irrational.

2 BUSINESSES AIM TO MAXIMISE THEIR PROFIT

When business owners make decisions, they will always choose a course of action that has the best financial results. This is because economists assume that business owners will want to make as much profit as possible. Owners are assumed to be rational when making financial decisions about their businesses. Two examples are outlined below.

- If a business owner can buy some raw materials from three different suppliers, the owner will always buy the cheapest available as long as the quality is the same. To pay more for raw materials than is necessary would be irrational.
- When setting a price for a product, a business owner will always choose the highest price that the market can stand. For example, if a business owner can sell a product for €5 in a market, that owner would not charge €4.50. This would be irrational. By charging the highest possible price, business owners will be maximising **revenue** and therefore maximising their profit. Economists assume that business owners will always do this.

In some circumstances, a consumer may fail to maximise their benefit when making a choice. There are three possible reasons that help to explain this.

- It is possible that some consumers have difficulty in calculating the benefits from consuming a product. This is because measuring the satisfaction gained from consuming a product is often very difficult. It is hard to quantify (express in numbers) the satisfaction gained from consumption. For example, in 'Getting

started' above, how can Anita measure precisely the satisfaction gained from going out for a meal, going to the cricket match, buying a new outfit and visiting her brother? They are four very different acts of consumption. Anita has overcome the problem by placing the choices in order of preference. However, she may have overestimated or underestimated the possible satisfaction that any one of the four acts of consumption gives her. As a result, she may not have maximised her benefit when choosing the meal out.

- Some consumers develop buying habits that may affect their ability to make rational choices. For example, over a period of time some consumers stay loyal to a particular brand. Once they become used to a brand, they continue to buy it habitually. Even when other brands on the market offer better value, they maintain their loyalty. This seems irrational but such behaviour can be observed. For example, many people buy the same newspaper all of their lives. They may start by choosing a particular title and then carry on purchasing this paper out of habit. They may ignore new publications and other options continually. This behaviour is not uncommon. Businesses are aware of this behaviour and many try to develop brand loyalty through their marketing activities. If businesses can establish a strong brand and build up a loyal customer base, they can often charge higher prices.
- Another reason why some consumers do not maximise their benefit is because they are influenced by the behaviour of others. Young consumers may adopt some of the buying habits of their parents. For example, when young people leave home for the first time and make purchases that their parents once made, they may choose the same brands as their parents. This may be because they trust their parents or because they are familiar with the brands. It may not be because they prefer these brands to others. For example, it is reckoned that 59 per cent of people aged between 18 and 24 open their first bank accounts at the same bank as their parents. Also, some consumers are influenced by their friends or peers; they may copy their purchases in an effort to fit in or because they submit to pressure from their peers.

ACTIVITY 1

CASE STUDY: MAXIMISING CONSUMER BENEFIT

PandaCheck is a Chinese price comparison website. Like price comparison websites all over the world, they help consumers to find the cheapest deals when shopping online. The website is designed to help online shoppers find the best prices, search for current promotions, and learn some tips and tricks when ordering goods from China. For example, if you wanted to buy a battery for an ASUS laptop computer, you would type 'ASUS laptop battery' into the search engine and click on the search button. You would then see a list of the prices charged by all the Chinese online shops that stock the product. The user can change the order of the list but most people would probably want the list to show the cheapest suppliers at the top. Each listing gives a description of the product written by the supplier. This extra information may help consumers in their selection.

- 1 What is meant by a rational consumer?
- 2 How will PandaCheck help consumers to maximise their benefits?
- 3 Discuss one reason why a consumer may fail to maximise their benefits when making a purchase.

REASONS WHY PRODUCERS MAY NOT ALWAYS MAXIMISE THEIR PROFIT

It is possible that some business owners may not maximise their profits. Three key reasons may explain this.

- The performance of some businesses may be influenced by the behaviour of other people in the organisation. In some businesses, not all decisions are made directly by the owners. Business owners sometimes **delegate** decision making to others who may have different objectives to those of the owners. For example, managers in the sales department of a business may try to maximise sales revenue. They may do this because their salaries are linked to sales levels (the more they sell, the more **commission** they get). However, maximising sales may not result in the maximisation of profit. This is because to sell larger and larger quantities the price will eventually have to be lowered. When the price is lowered, the profit made on each extra unit sold will fall (and may become negative).
- Some producers have alternative business objectives. Although profit may be important to them, other issues may also be important. Consequently, by focusing on other objectives, it may not be possible for the producer to maximise profits. For example, some businesses focus on customer care; they may try to exceed customer expectations by providing high-quality customer service. This may mean that they spend more money on training their staff in giving good customer service. As a result, the extra costs incurred in training will reduce profitability.
- Some commercial **enterprises** operate as charities. They are sometimes called not-for-profit organisations. They aim to raise awareness and money for a particular cause. For example, UNICEF is an international charity that provides **humanitarian** and developmental help to children and their mothers. It collects money from donations and operates a number of commercial activities to generate revenue. This money is used to fund its humanitarian and developmental activities. Economists cannot assume that such organisations seek to maximise their profits, since they have other aims.
- Also, an increasing minority of businesses are being set up as social enterprises. These are organisations that operate commercially but aim to maximise improvements in human or environmental well-being. For example, MitiMeth is a Nigerian social enterprise that aims to find solutions to ecological problems. For example, many of Nigeria's waterways are 'clogged-up' with destructive water hyacinth plants. MitiMeth uses these nuisance plants (after they have been dried out in the sun) to make handcrafted products such as baskets, tableware and even jewellery. The sale of these products generates revenue but one of the key aims of the business is to solve an ecological problem.

Finally, consumers will be prevented from maximising their benefits, and producers from maximising their profits if they do not have access to all the information available. For example, if a consumer does not know that a particular product can be purchased at a lower price in another location, that consumer will not be able to maximise benefit due to a lack of information. However, in recent years, access to the internet and developments in social media, mean that the flow of information around the world has increased. This helps both consumers and producers to maximise their benefits and profits.

SUBJECT VOCABULARY

enterprises companies, organisations or businesses

GENERAL VOCABULARY

commission amount of money paid to someone according to the value of goods, shares or bonds they have sold

delegate to give part of your power or work to someone else, usually someone in a lower position than you

humanitarian concerned with improving bad living conditions and preventing unfair treatment of people

MULTIPLE-CHOICE QUESTIONS

- ▶ 1 Which of the following would help consumers and producers to maximise their benefits and profits, respectively?
 - A Lower prices
 - B Access to more information
 - C Improved transport networks
 - D Better quality products
- ▶ 2 Which of the following is a reason why consumers may not maximise their benefits?
 - A Some consumers are very poor
 - B Opportunity costs may be too high
 - C Some consumers may develop buying habits that are hard to give up
 - D Some consumers save a high proportion of their income

ECONOMICS IN PRACTICE

GENERAL VOCABULARY

retailer business that sells goods to members of the public, rather than to shops

CASE STUDY: MAXIMISING PROFIT?

ANNA'S SWIMWEAR

Anna Freeman runs a small company that manufactures swimwear. Most of her sales are made online to individual consumers. However, in 2015, she received an order for 3000 swimsuits from a **retailer** 100 kilometres away. She accepted the order and agreed to deliver the swimsuits herself. However, Anna needed to hire a van for 24 hours in order to make the delivery. She contacted three budget van hire companies and gathered the information shown in Table 2.1.

HIRE COMPANY	HIRE FEE (24 HOURS)	DISTANCE CHARGE	INSURANCE CHARGE	TOTAL
A	US\$40	5 cents per km	US\$12	
B	US\$59	Zero	zero	
C	US\$30	10 cents per km	US\$15	

▲ Table 2.1 Costs of hiring a van from three different van hire companies



▲ A self-drive hire van

SUBJECT VOCABULARY

administration activities involved with managing and organising the work of a company or organisation

MÉDECINS SANS FRONTIÈRES (MSF)

Médecins Sans Frontières (Doctors Without Borders) is an international not-for-profit medical humanitarian organisation. It employs 36 000 staff across 65 different countries. Its aim is to save lives and reduce the human suffering of people who are in danger by delivering medical care. MSF provides assistance to:

- victims of natural or man-made disasters
- victims of armed conflict
- other groups of people in distress.

MSF helps all people regardless of their gender, race, religion or political beliefs. In 2016, MSF helped refugees in Europe escaping from war, persecution and poverty. In Yemen, MSF provided lifesaving care to people affected by conflict. MSF also had units in Syria, South Sudan, Central African Republic and Iraq.

In 2015, MSF raised £42.7 million from donations. Eighty-six per cent of this money was spent on its medical operations, 12 per cent on fundraising and just 2 per cent on **administration**.



▲ MSF medical staff at work

CHAPTER QUESTIONS

- 1 Calculate the total cost to Anna of hiring a van for 24 hours from each van hire company shown in Table 2.1.
- 2 According to economists, which company would Anna select? Explain your answer.
- 3 Why might some of Anna's customers find it difficult to measure the benefit they get from buying a swimsuit?
- 4 Discuss why MSF does not aim to maximise profit. Give at least two reasons in your answer.