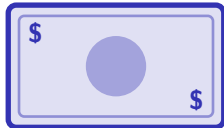


Microeconomic Decision-makers

IGCSE Economics ■ Topic 3

IGCSE Economics



What we will cover

- 1 Money & banking
- 2 Households
- 3 Workers & wages
- 4 Firms & integration
- 5 Economies of scale
- 6 Market structures



Money and banking

Money beats **barter** . Its four jobs:
medium of exchange, store of value, unit of
account, deferred payment. A **central bank**
sets rates; **commercial banks** serve people.



*Money is anything widely accepted in
trade*

Money and banking – four functions

Money does four jobs, and an answer is expected to name them:

- a **medium of exchange** – you swap money for goods, so you do not need barter.
- a **store of value** – you can hold money now and spend it later, because it keeps its value.
- a **unit of account** – money measures and compares the value of things. That is what a price is.
- a **means of deferred payment** – you can buy now and pay later.

Why money replaced barter, and what it must be

barter

swapping goods directly – and it needs a **double coincidence of wants**: you must find someone with what you want *and* who wants what you have

durable

it lasts a long time

portable

easy to carry

divisible

can be split into small amounts for small payments

acceptable

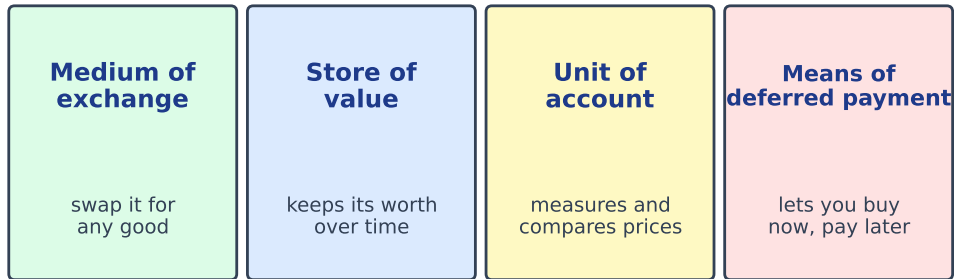
everyone will take it in payment

limited in supply

scarce enough to keep its value, and hard to fake

Each characteristic answers a way barter failed. That is the connection the question is looking for, not a memorised list.

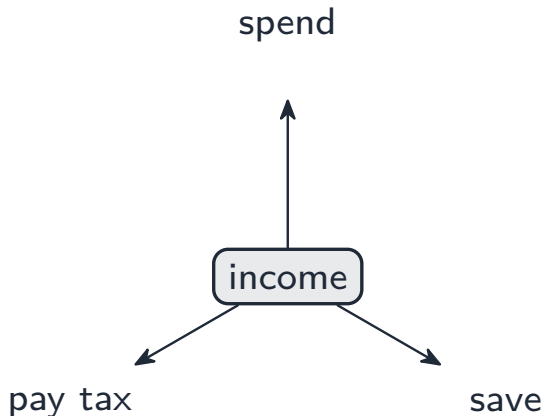
Money and banking – four functions, in detail



Exam: list all four functions — medium of exchange, store of value, unit of account, deferred payment

Money's four functions: a medium of exchange, a store of value, a unit of account, and a means of deferred payment.

Households



A **household** can spend, **save** or pay tax.

Higher **interest rates** reward saving & make **borrowing** dearer; **confidence** raises spending.

Workers and wages

Wages depend on skills, danger & how hard the worker is to replace.

Division of labour splits a job into specialised tasks, raising output.



Specialisation raises output per worker

Choosing a job

When a worker chooses an **occupation** (a type of job), two kinds of factor matter:

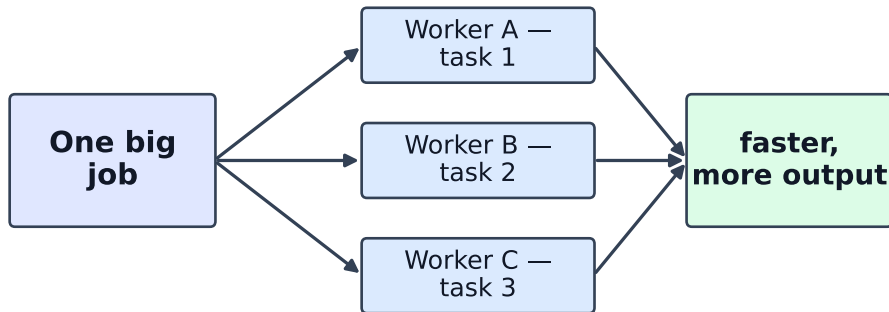
- **wage factors** – the pay. The **wage** is the money you earn. Higher pay attracts more workers.
- **non-wage factors** – everything else: working hours, holidays, how safe or pleasant the job is, whether you enjoy the work, distance from home.

Workers and wages – specialisation

Division of labour , also called **specialisation** , means splitting a job into small tasks, with each worker doing one task again and again.

- **Advantages**: workers get faster and better at their one task, and less time is wasted moving between tasks – so output rises.
- **Disadvantages**: one task is boring, so workers make mistakes or leave; if one worker is absent the whole line can stop; and each worker learns only one skill.

Workers and wages – specialisation, in detail



Exam: specialisation raises productivity — but monotony and interdependence are trade-offs

Splitting one big job into single repeated tasks, one per worker, raises output per worker.



Firms and integration

Firms grow by joining together:

- **horizontal** – same stage
- **vertical** – different stages
- **conglomerate** – different industries

Three kinds of merger

Horizontal merger

A **horizontal merger** : two firms at the same stage of the same industry – market share, and economies of scale.

Vertical merger

A **vertical merger** : a supplier or a customer – securing an input, or a route to market.

Conglomerate merger

A **conglomerate merger** : unrelated industries, joined to spread risk.

Barriers to entry

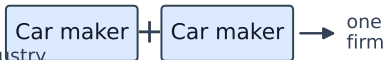
Barriers to entry – high set-up costs, patents, brand loyalty – are what let the merged firm keep the gains.

A firm's **objectives** are not only profit: **growth** , **survival** and market share each justify a different merger.

Firms and integration, in detail

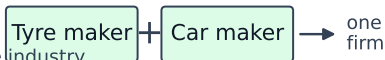
Horizontal

same stage, same industry



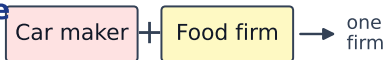
Vertical

different stages, same industry



Conglomerate

different industries



Exam: horizontal = same stage; vertical = supply chain; conglomerate = different industries

Firms grow by joining together:

horizontal – two firms at the **same** stage of one industry.

vertical – **different** stages of the same industry.

conglomerate – **different** industries altogether.

Business failure

Firms can suffer **business failure** (they close down) for many reasons: costs too high, too few sales, poor management, too many rivals, not enough cash.

Labour-intensive and capital-intensive

- **labour-intensive** production uses a lot of **labour** (many workers) and little machinery – for example, hand-made crafts.
- **capital-intensive** production uses a lot of capital (machines) and few workers – for example, a modern car factory.

Demand for and supply of factors

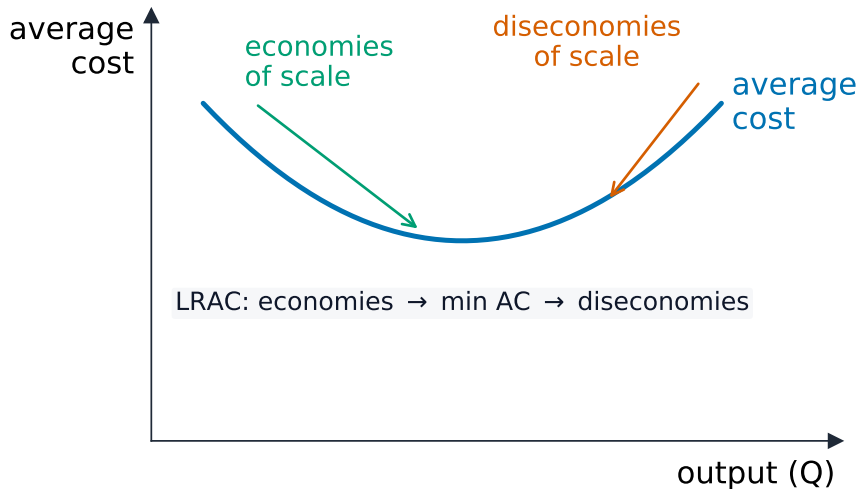
Firms buy **factors of production** (**land** , labour, capital, and **enterprise**).

The price and amount of each factor are set by its own demand and supply, just like any market.

Economies of scale

As a firm grows, average cost falls – **economies of scale** . Grow too big & it rises again – **diseconomies of scale** .

Economies of scale, in detail



As a firm grows, average cost falls – **economies of scale** .

Markets range from a **monopoly** (one seller, high prices) to **perfect competition** (many sellers, low prices). More competition usually means lower prices & more choice.



Competition shapes price and choice

Market structures – continuum



- firms must keep prices low and quality high, or buyers go elsewhere.
- firms work hard to cut costs and make new products.

Competition versus monopoly

	Consumers	Firms
competition	lower prices, more choice, better quality	lower profit; must work hard to survive
monopoly	higher prices, less choice	higher profit and an easy life, but may grow lazy

The market structure that is most comfortable for the **firm** is the one that is worst for the **consumer** – which is why governments regulate it.

Why workers earn different amounts

- skills & qualifications
- danger / difficulty of the job
- demand for the job

all affect a worker's wage

Wages depend on skills, the difficulty of the job, and demand

Why wages differ

skill and training

a long training restricts supply, so the wage is higher

danger and unpleasantness

a compensating wage differential for work few will do

trade unions

groups of workers bargaining together – a strong union can raise pay and improve conditions

the demand for the product

a worker's wage depends on the value of what they produce

discrimination

pay differences not explained by skill or productivity

government

a **minimum wage** sets a legal floor

Wages are a **price** – set by the demand for and supply of that kind of labour. Every explanation should say which side of that market moved.

Why one worker earns more than another

Qualifications

Qualifications and training restrict supply: fewer people can do the job, so the wage is higher.

Danger and hours

Compensating differentials – unpleasant, risky or unsocial work pays more to attract anyone at all.

Bargaining power

A union, a professional body or a scarce skill raises the wage above what an individual could negotiate.

Average revenue

An employer will pay up to what the worker adds: **average revenue** per worker sets the ceiling on any wage.

Every wage difference is a supply story, a demand story, or a bargaining story. Name which one.

Exam tips

- Money's four functions: a **medium of exchange**, a **store of value**, a **unit of account**, and a **means of deferred payment**.
- Key formulas: $\text{profit} = \text{total revenue} - \text{total cost}$; $\text{total revenue} = \text{price} \times \text{quantity}$; $\text{average cost} = \text{total cost} \div \text{number of units}$.
- **Fixed costs** do not change with output (rent, insurance); **variable costs** do (materials, power). $\text{Total cost} = \text{fixed} + \text{variable}$.
- **Economies of scale** make average cost *fall* as a firm grows; growing *too* big brings diseconomies of scale (average cost rises).
- Know the merger types: **horizontal** (same stage of the same industry), **vertical** (different stages of one industry), **conglomerate** (different industries).



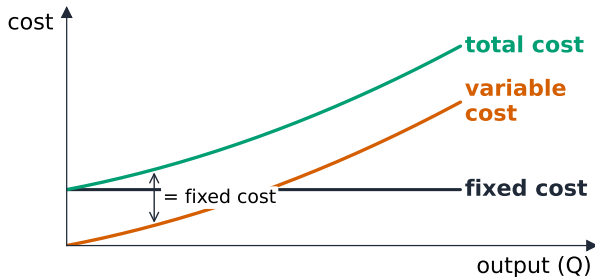
Worked example – profit and average cost

Fixed costs £2,000, **variable cost** £3/unit,
500 units sold at £10 each.

- Total cost = $2,000 + (3 \times 500) = \text{£}3,500$
- Total revenue = price $\times$ quantity
= $10 \times 500 = \text{£}5,000$
- Profit = $TR - TC$
= $5,000 - 3,500 = \text{£}1,500$
- Average cost = $\frac{3,500}{500} = \text{£}7$ – below the
£10 price, so each unit adds £3.

Do it in order: $TC \rightarrow TR$
 $\rightarrow$ profit. Profit per unit
= price – AC. Watch
which costs are **per unit**
and which are for the
whole output.

Fixed, variable and total cost lines against output



$$TC = FC + VC \quad \cdot \quad \text{gap between } TC \text{ and } VC \text{ is } FC$$

Fixed cost stays the same as output rises; variable cost rises; total cost is fixed plus variable, so the gap between total and variable cost is the fixed cost.

Competitive markets

A competitive market has many firms selling similar goods, and it is easy for new firms to enter.

- firms must keep prices low and quality high, or buyers go elsewhere.
- firms work hard to cut costs and make new products.

Topic 3 – key takeaways

1

Money

exchange, store, account, deferred payment

2

Households

spend, save or borrow; rates & confidence

3

Firms

integration; economies of scale
lower cost

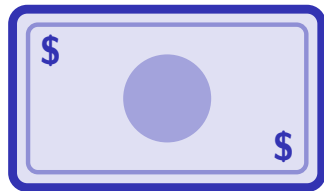
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Markets

monopoly to perfect competition

Check yourself

- 1 What problem does money solve?
- 2 What does a higher interest rate do to saving?
- 3 What does division of labour raise?
- 4 How many sellers does a monopoly have?



Answers 1. the difficulty of barter 2. makes saving more rewarding 3. output / productivity 4. one