

Microeconomic decision-makers

IGCSE Economics

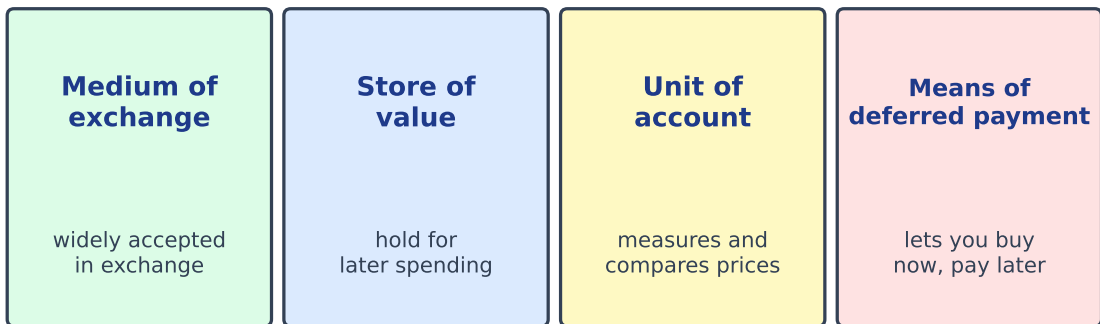
Money and banking

Long ago, people swapped goods directly. This is called **barter**. Barter is hard: you must find someone who has what you want *and* wants what you have. **Money** solves this problem.

■ The functions of money

Money does four jobs:

- 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, although inflation may reduce what it can buy.
- a **unit of account** – money measures and compares the value of things (this is the price).
- a **means of deferred payment** – you can buy now and pay later.



Explain the relevant function; inflation can reduce purchasing power

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



Money – banknotes and coins – works as a medium of exchange, a store of value, a unit of account, and a means of deferred payment

■ The characteristics of money

Good money must be:

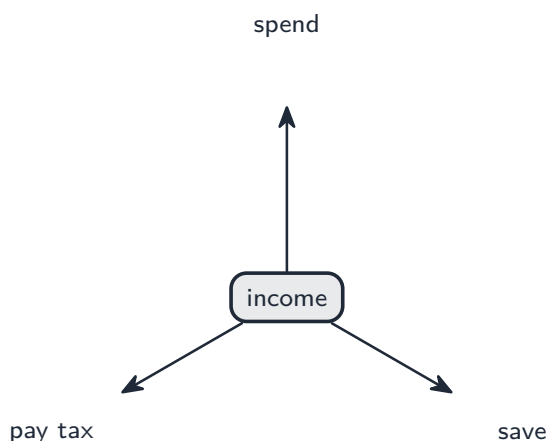
- **durable** – it lasts a long time.
- **portable** – easy to carry.
- **divisible** – can be split into small amounts for small payments.
- limited in supply, hard to copy, and widely accepted for payment.

■ Banks

- A **central bank** is the government's bank. Its roles include issuing currency, serving government and banks, and managing monetary policy. Its policy decisions can influence **interest rates** ; it does not set every bank loan rate.
- **commercial banks** are the ordinary banks that people and **firms** use. They take deposits, lend money, and arrange payments. Deposits are not a promise that money keeps its purchasing power.

Households

A **household** is a person or group living together and making money decisions. Each household must choose how much to spend, save, and borrow.



A household can spend, save or pay tax with its income

- **saving** – is income that is not spent now.
- **borrowing** – is spending money you do not have yet, and paying it back later (usually with an extra charge).

Three main things change these choices:

- **income** – more income can allow more spending and saving; debts and household needs also matter.
- **interest rates** – a higher interest rate makes saving more rewarding and borrowing dearer. This tends to encourage saving and discourage borrowing, other things unchanged. A household with little spare income may still be unable to save.
- **confidence** – if people feel sure about their jobs and the future, they may spend and borrow more. Worry may encourage saving, if they can afford it.

Workers

■ 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 tends to attract workers, but conditions and access to training also matter.
- **non-wage factors** – everything else: working hours, holidays, how safe or pleasant the job is, whether you enjoy the work, distance from home, and the chance to move up to a higher job.

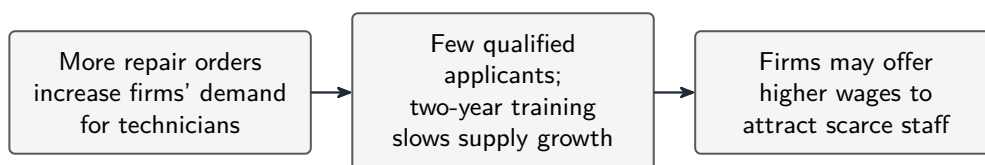
Weekly job facts	A	B
Weekly hours	40	40
Wage	£400	£440
Travel cost	£20	£60
Journey each way	10 minutes	60 minutes
Hours	daytime	night shifts
Training	offered	none

Original decision case. Is B necessarily better? Use the facts above.

Worked decision. Wage after travel = weekly wage – weekly travel cost. A: £400 – £20 = £380. B: £440 – £60 = £380. A offers shorter travel and training. B may suit someone who prefers nights; the decision depends on preferences, not gross pay alone.

■ Why workers earn different amounts

Workers are not all paid the same. The reasons include:



Demand and limited supply together explain the pressure on pay.
Training alone does not guarantee a high wage.

More repair orders and slow growth of technician supply may raise wages

- **skill** and **qualifications** – scarce skills can restrict labour supply. If firms also demand those skills, pay may be higher. Years of study alone do not guarantee high pay.
- **danger** – risky or dirty jobs may pay more to attract workers.
- **trade unions** – a trade union is a group of workers who join together to bargain for better pay and conditions. Strong unions can raise pay.
- **discrimination** – unfair treatment because of gender, race, or age can cause unfair pay gaps.

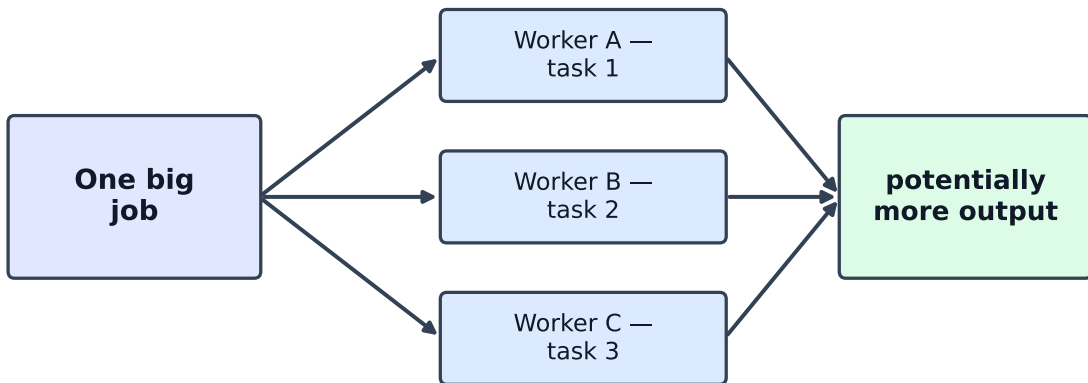
Original wage case. A town has few qualified repair technicians and many applicants for assistant jobs. Repair orders rise, but technician training takes two years. More orders increase firms' demand for technicians; slow supply expansion may encourage higher pay. This explains a possible difference without claiming every qualified worker earns more. Average revenue means revenue per unit sold, not per worker or a universal wage ceiling.

■ Division of labour

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; less time is wasted moving between tasks; this can raise productivity and output. If costs do not rise proportionately, unit cost falls.

Disadvantages: doing one task is boring, so workers may make mistakes or leave; if one worker is absent, the whole line can stop; each worker learns only one skill.



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

Division of labour: splitting a job into small repeated tasks can raise output per worker

Original productivity case. The same three workers make 30 boxes in one hour before specialisation and 45 after. Other inputs are unchanged. Calculate productivity before and after.

Worked answer. Productivity = output ÷ (workers × hours). Before: $30 \div (3 \times 1) = 10$ boxes per worker per hour. After: $45 \div (3 \times 1) = 15$ boxes per worker per hour. Repetition can save switching time. If total hourly cost is unchanged, cost per box falls. An absent packer could stop completion of boxes.

Firms

■ The size of firms

Firms come in many sizes, from one person to huge companies. We can measure size by the number of workers, the amount of **capital** used, or the output.

Some firms stay small because: the **market** is small; the product is personal (like a hairdresser); the owner wants to stay in control; or there is little money to grow.

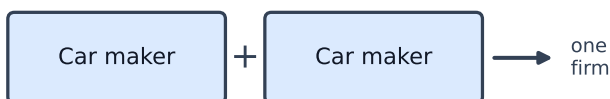
■ How firms grow

Firms grow by selling more, or by joining with other firms. When two firms join, it is a **merger**. In a takeover, one firm gains control of another. There are three types:

- **horizontal merger** – two firms at the *same* stage of the *same* industry join (two car makers).
- **vertical merger** – two firms at *different* stages of the same industry join (a car maker and a tyre maker). “Backward” is towards the supplier; “forward” is towards the seller.
- **conglomerate merger** – two firms in *different* industries join (a car maker and a food company).

Horizontal

same stage, same industry



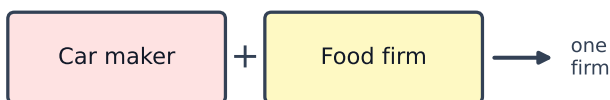
Vertical

different stages, same industry



Conglomerate

different industries



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

The three types of integration: horizontal (same stage), vertical (different stages of one industry), and conglomerate (different industries)

Original classification case. A bakery joins another bakery, its flour mill, bread shops, or a clothing producer. Classify each and explain a possible benefit.

Worked answer. Another bakery is horizontal integration: bulk buying may lower cost, but rivalry falls. The flour mill is backward vertical integration: greater supply control, but milling needs different skills. Bread shops are forward vertical integration: control of outlets, with retail management costs. Clothing is conglomerate integration: spreading risk, with no guarantee either business succeeds.

■ Business failure

Original survival case. Monthly revenue is £4,000; costs are £4,500. Profit = TR – TC = £4,000 – £4,500 = –£500. Tomorrow a £2,000 bill is due, but cash available is £300 with no agreed loan. Payment shortfall = £2,000 – £300 = £1,700. A loss and a cash shortage are different threats to survival.

Firms can suffer **business failure** (closure) because of high costs, low sales,

poor management, strong rivalry, insufficient cash or falling **demand** .

Firms and production

■ Labour-intensive and capital-intensive

- **labour-intensive** production uses relatively more **labour** than capital equipment – for example, hand-made crafts.
- **capital-intensive** production uses relatively more capital equipment than labour – for example, a modern car factory.



Automated car production illustrates capital equipment and specialised stages; the photograph alone cannot measure productivity

Original production choice. Method A makes 100 shirts daily with ten workers and simple tools. B makes the same quantity and quality with two operators and automated equipment. A uses relatively more labour; B uses relatively more capital. B may suit stable large orders and scarce labour. A may suit custom orders or limited finance. Compare equipment costs, wages, training, availability and flexibility; counting workers alone does not decide profit.

■ Productivity

Productivity means output per worker (or per machine) in a set time. Higher productivity means more output per worker in the same time. Unit cost falls only if total cost does not rise proportionately. Training, better machines and management can improve productivity.

■ Demand for and supply of factors

Firms buy **factors of production** (land, labour, capital, and **enterprise**). Factor prices and quantities are influenced by demand, supply, bargaining and policy. Product demand, factor prices, availability and productivity affect what firms use. For example, if many firms want skilled workers, their wages may rise if supply cannot expand enough.

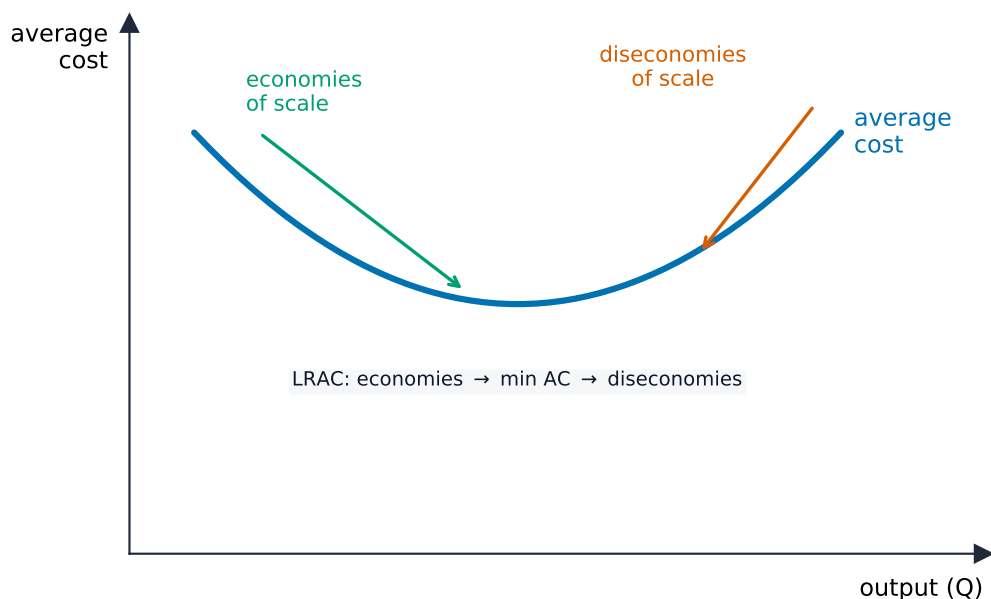
Original factor choice. A shirt producer receives more orders. Trained workers are available, but new automated machines take six months to deliver and need costly installation. Hiring workers can expand output sooner; machinery may suit later, stable orders if its productivity justifies its cost. Higher wages alone do not make machinery available or worthwhile.

■ Economies and diseconomies of scale

As a firm grows and makes more, the cost of each unit can change:

- **economies of scale** – a larger scale of production lowers long-run average cost. Reasons: buying materials in bulk is cheaper, big machines work more efficiently, and large firms borrow money cheaply.
- **diseconomies of scale** – a larger scale of production raises long-run average cost because coordination or other problems outweigh gains. Reasons: a huge firm is hard to manage, messages travel slowly, and workers may feel less important.

Original scale calculation. Compare long-run alternatives with all inputs adjustable. A small plant makes 1,000 units monthly at total cost £8,000; a larger plant makes 2,000 at £14,000. Average cost = $TC \div \text{output}$. Small: $£8,000 \div 1,000 = £8$ per unit. Large: $£14,000 \div 2,000 = £7$ per unit. Total cost rises, but average cost falls: economies of scale. Bulk discounts or specialised equipment could explain it. This differs from spreading unchanged rent over more output in an existing plant.



This illustrative long-run curve shows possible economies and diseconomies of scale; growth does not guarantee either outcome.

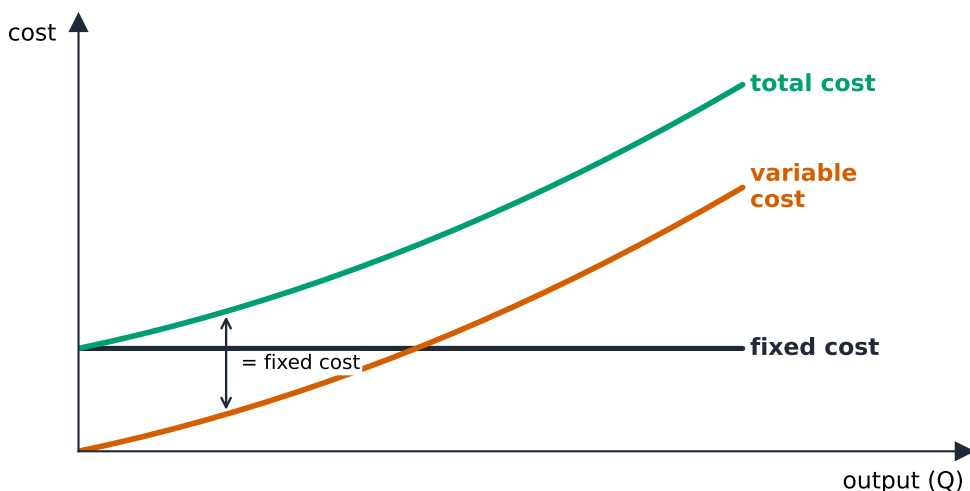
These can be *internal* (caused by the firm's own size) or *external* (caused by the whole industry growing).

Firms' costs, revenue and objectives

■ Costs

A **cost** is money a firm spends to produce. Costs split into:

- **fixed costs** – costs that do *not* change with output within a given period and range, such as rent and insurance. You pay them even if you make nothing.
- **variable costs** – costs that *change* with output, such as materials and production-related electricity. More output means more variable cost.
- **total cost** – fixed cost plus variable cost.
- **average cost** – the cost of *each* unit: total cost divided by the number of units made.



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

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.

■ Revenue

Revenue is the money a firm gets from selling its goods.

- **total revenue** – the price multiplied by the quantity sold.
- **average revenue** – total revenue divided by the quantity sold (this is the same as the price).

■ Profit and other objectives

Profit is what is left after costs:

$$\text{profit} = \text{total revenue} - \text{total cost}$$

Worked example. A firm has fixed costs of £2,000 and variable costs of £3 per unit. It makes 500 units and sells them at £10 each. Find its total cost, total revenue, profit and average cost.

- variable cost = $3 \times 500 = £1,500$, so total cost = $2,000 + 1,500 = £3,500$.
- total revenue = $10 \times 500 = £5,000$.
- profit = $5,000 - 3,500 = £1,500$.
- average cost = total cost $\div$ units = $3,500 \div 500 = £7$ per unit.

The firm makes a profit because the price (£10) is above the average cost (£7).

Most firms want as much profit as possible. But firms can have other **objectives**

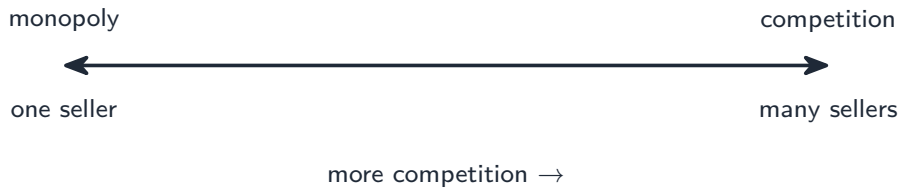
:

- **survival** – a new firm first just wants to stay open.

- **growth** – getting bigger, to gain economies of scale and market power.
- social objectives – some firms aim to help people or protect the environment, not only to earn profit.

Types of markets

Markets differ by how many firms there are and how hard it is for new firms to join.



Markets can have one supplier or many rival suppliers

■ Competitive markets

A competitive market has many firms selling similar goods, and it is easy for new firms to enter. This is strong **competition**. In such a market:

- buyers may switch suppliers, putting pressure on prices and quality.
- rivalry can encourage cost reduction and new products.

Consumers may gain lower prices, wider choice and better quality. These gains depend on information, switching costs and how strongly firms compete.



Alternative suppliers can create pressure to compete on price, quality and choice

Original competition case. Shop A sells a loaf for £2; nearby B sells an equally fresh, equally sized loaf for £1.80. Customers know both prices and can switch easily. A may lose sales, encouraging a price cut, better quality or lower cost. This pressure is weaker if customers value differences or find switching difficult.

■ **Monopoly**

A **monopoly** is a market with only *one* firm, or one firm that controls most of it. New firms find it hard to enter because of **barriers to entry** – for example, very high start-up costs, or the one firm controlling key supplies.

In a monopoly:

- limited alternatives can give the firm power to raise prices; demand and regulation still limit its decisions.
- there is little pressure to improve quality or cut costs.
- but a large monopoly may gain economies of scale, and may use its profit to pay for research.

■ **Competition versus monopoly**

	Consumers	Firms
competition	may improve price, choice and quality	pressure to compete and control cost
monopoly	less choice; price and quality depend on decisions	market power; possible scale gains and inefficiency

■ **Exam connection: June 2025, 0455/22**

Q2(a) asks for two possible merger advantages. Q3(c) asks how division of labour benefits firms. Develop a chain from specialisation to time saved, higher productivity and possible lower unit cost.

Q3(d) asks whether consumers benefit from one shampoo producer. The official scheme supports reasoning on both sides: scale gains may lower prices and profits may finance research; weaker rivalry may raise prices, reduce choice or allow inefficiency. Judge whether savings reach consumers and quality improves. Monopoly does not guarantee high profit or consumer harm.

Exam tips

- For calculations, name the equation, substitute values and give units. Distinguish totals from per-unit figures.
- For explanations, develop a causal chain. For discussions, weigh possible outcomes and judge the conditions that change them.

Vocabulary card meanings

means of deferred payment: A function of money that lets debts be settled later.
occupation: The kind of paid work a person does. skill: An ability a worker has built through practice. division of labour: Splitting work so each person specialises in one task. business failure: A firm closing because it cannot continue to trade.