Unit 3 The individual as producer, consumer and borrower

Activities: Guidance and answers

Activity 3.1 How specialization began
Frame 1 shows that Og the caveman is clearly very disappointed with his effort to produce spears and pots. He is not very good at making these items and should specialize in the production of something he is good at.

Frame 2 shows that Og has planted some seeds and is watering them to help them grow.

In frame 3 the plants have matured and have produced fruits.

Frame 4 suggests Og has produced more fruit that he needs or wants.

In frame 5 he exchanges his surplus fruit for a spear.

Frame 6 shows a happy Og because he now has good collection of pots and spears. By specializing in fruit growing and producing surpluses Og has been able to engage in trade with producers of other items he needs and wants but is unable to produce efficiently himself.

Activity 3.2 Ye olde swap shop

1. There must be a double coincidence of wants for exchange to take place, i.e. the ruler-maker must want to exchange rulers for pencils. The exchange rate between pencils and rulers – i.e. how many pencils are needed to obtain one ruler – must also be agreed.

2. If the pencil-maker does not want erasers then the eraser-maker must persuade the ruler-maker to exchange some of the pencils it has acquired in the first trade in return for erasers. Again, there must be a double coincidence of wants between the ruler-maker and the eraser-maker and they must agree a rate of exchange between pencils and erasers.

3. Milk, cheese and eggs are perishable items. They will go off – i.e. lose their value – if people are unable to trade them.

Activity 3.3 Funny money

1. Due to hyperinflation the Brazilian currency, the cruzeiro, failed as a good store of value. People lost confidence in the currency and so it had to be replaced with a new currency, the Real.

2. The cruzeiro was failing to perform all three functions before it was replaced. Because the rate of inflation was so high the currency lost value rapidly so people did not want to accept it as medium of exchange. Because the purchasing power of the currency was being eroded so quickly by rapid inflation it also failed to provide a stable measure of value. The article states that a product priced at $1 one day had risen to $2 a month later, and to $1,000 by the end of the year.
Activity 3.4 What is a ‘good’ money?
Mountains are scarce but too big to be a good money. They are not portable.
Cheese is perishable and will not be a very good store of value.
Cigarettes are portable, relatively scarce and durable unless they are consumed. However, they may be easily damaged and unlikely to be generally acceptable to all.
Gold is scarce, durable, divisible, a good measure of value and store of value. Gold rings and pieces are likely to be generally acceptable mediums of exchange.

Activity 3.5 Mrs Mint’s money
1 Notes, coins and instant access savings.
2 Long-term savings, savings bonds, jewellery.

Activity 3.6 Why do we need banks?
1 If there were no banks Digital Dreams would need to use a generally acceptable medium of exchange or exchange goods or services of equal value to make payments.
2 In a safe of its own. Bank accounts provide a much safer way to store money.
3 Borrowing money from friends, relatives or other people. The business is unlikely to raise very much from these sources. The money supply in the economy will be far more limited. This is because banks create deposit money from their lending activities.
4 Because Digital Dreams would have to organize making payments to all its employees and suppliers and would have to collect cash or other acceptable forms of payments from all its customers, its running costs would be much higher. There would be no credit or debit cards to make online payments.

Activity 3.7 You can bank on it!

<table>
<thead>
<tr>
<th></th>
<th>Central bank</th>
<th>Commercial bank</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Main functions</strong></td>
<td>To maintain the stability of the national currency and the money supply</td>
<td>The provision of financial services to individuals and businesses</td>
</tr>
<tr>
<td><strong>Services</strong></td>
<td>issuing notes and coins</td>
<td>• accepting deposits of money and savings</td>
</tr>
<tr>
<td></td>
<td>managing payments to and from the government’s account</td>
<td>• helping customers make and receive payments</td>
</tr>
<tr>
<td></td>
<td>managing the national debt</td>
<td>• making personal and commercial loans</td>
</tr>
<tr>
<td></td>
<td>supervising and regulating the banking system</td>
<td>• buying and selling shares for their customers</td>
</tr>
<tr>
<td></td>
<td>acting as lender of last resort to the banking system</td>
<td>• providing insurance</td>
</tr>
<tr>
<td></td>
<td>managing the nation’s gold and foreign currency reserves</td>
<td>• operating pension funds</td>
</tr>
<tr>
<td></td>
<td>operating monetary policy</td>
<td>• financial and tax planning advice</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• exchanging foreign currencies</td>
</tr>
<tr>
<td><strong>Organization, control and finance</strong></td>
<td>In most countries, the central bank is owned by the government and run by a public corporation</td>
<td>These banks are usually limited companies owned and financed by their shareholders</td>
</tr>
<tr>
<td><strong>Relationships with other organizations</strong></td>
<td>The central bank in a country supervises the banking system, regulates the conduct of banks, holds their deposits and transfers funds between them</td>
<td>Commercial banks are regulated by the central bank; they lend money to other businesses and to government</td>
</tr>
</tbody>
</table>
Unit 3 The individual as producer, consumer and borrower

Activity 3.8 Floating away

1 A stock market is a global market for the buying and selling of new and second-hand government stocks and company shares. It therefore consists of all those individuals and organizations willing and able to buy stocks and shares and all those individuals and organizations willing and able to sell them.

2 Public limited companies are able to issue new shares for sale publicly on the Saudi Stock Exchange to raise finance. Existing shares in companies can also be bought and sold on the Saudi Stock Exchange as it brings together holders of shares who wish to sell them and investors who wish to buy them.

3 The company can sell many more shares publicly to Saudi nationals and Saudi-registered financial firms and therefore raise more finance than if it had to issues shares for a private sale.

4 The company plans to issues 12.75 million at a price of $12.80 each. If it sells all its shares at this price it will raise $163.2 million.

5 If demand for the new shares exceeds their supply the market price of the shares at which they are exchanged on the stock market will rise above the face value of the shares.

Activity 3.9 Share your success

This activity requires you to track the stock market prices of shares in different companies and to forecast what might happen to their market prices as market conditions change. For example, if analysts forecast the profits of a particular company are likely to rise in future demand for its shares may rise. If economists expect worsening economic conditions due to falling demand, this could result in lower profits for all companies and a general fall in stock market prices.

Activity 3.10 Just the job

1 Wages and salary levels will depend on the labour demand supply conditions for each job. Some jobs require people with high levels of skills and qualifications. However, the supply of labour with specific skills and qualifications may be relatively low compared to the supply of unskilled labour. So, for example, jobs for economists may offer high wages or salaries to attract a supply of suitably qualified labour. Similarly, jobs that require people to work long and unsociable hours or involve dangerous work may need to offer attractive wages to encourage a supply of labour willing to work in these jobs.

2 The job advertised for an economist is likely to offer the higher salary because the supply of skilled economists may be limited. This is because good economists may have studied for many years at university to obtain the qualifications they need. In contrast, general labouring may offer the lowest wages because there is a ready supply of semi-skilled and unskilled labour willing to undertake the work.

3 The economist job is likely to attract the least number of applicants. This is because economist skills are in short supply. The cost of long periods of study at college and the opportunity cost of foregone earnings during these periods will restrict the number of people wishing to become economists.

4 Your choice of job will depend not just on your skills and interests but also the net advantages of the positions, including the wage or salary, hours of work, the cost and time it takes to travel to and from your workplace, promotion prospects and many other factors.
This task requires you to investigate different jobs and the monetary and non-monetary benefits they offer.

Activity 3.11 The rise and fall of labour

<table>
<thead>
<tr>
<th>What has changed</th>
<th>Impact on labour demand</th>
<th>Impact on labour supply</th>
<th>Impact on market wage rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Nurses are offered new contracts with shorter working weeks</td>
<td>Increase in the demand for factory workers to make flat-screen televisions</td>
<td>Increase in the supply of nurses</td>
<td>Fall</td>
</tr>
<tr>
<td>• Consumer spending on flat-screen televisions increases significantly</td>
<td></td>
<td>Increase in the supply of people seeking public sector jobs</td>
<td>Rise</td>
</tr>
<tr>
<td>• The government raises the retirement age of public sector workers</td>
<td></td>
<td>Fall in the supply of air industry workers</td>
<td>Rise</td>
</tr>
<tr>
<td>• Overtime payments for airline employees are to be scrapped</td>
<td></td>
<td>Fall in the supply of airline industry workers</td>
<td>Rise</td>
</tr>
<tr>
<td>• Computerized assembly lines boost labour productivity in car plants</td>
<td>Increase in the demand for car assembly line workers</td>
<td>Increase in the supply of retail workers</td>
<td>Rise</td>
</tr>
<tr>
<td>• A major retail chain announces it will remain open 24 hours each day</td>
<td></td>
<td>Fall in the supply of police</td>
<td>Rise</td>
</tr>
<tr>
<td>• Assaults on police increase</td>
<td></td>
<td>Fall in the supply of restaurant and hotel staff from next April</td>
<td>Rise</td>
</tr>
<tr>
<td>• The government announces it will tax tips received by restaurant and hotel staff from next April</td>
<td>Increase in the supply of part-time workers and others seeking more flexible working arrangements</td>
<td>Increase in the supply of female labour</td>
<td>Fall</td>
</tr>
<tr>
<td>• A survey finds more people are working part-time and flexible hours</td>
<td>Fall in the demand for female workers</td>
<td>Increase in the supply of labour to office-based occupations</td>
<td>Fall</td>
</tr>
<tr>
<td>• Statutory maternity leave and pay are to be increased</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• New technology allows more office workers to work from home</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Activity 3.12 How’s your differential?

1 Labour demand and supply conditions for different occupations will explain differentials in earnings and between males and females. For example, managerial and professional occupations, such as lawyers and doctors, tend to pay higher salaries than less skilled occupations because the supply of professional and managerial skills is more limited. Average female earnings in the same occupations tend to be lower than average male earnings because many women may take career breaks to raise families and may work reduced hours. However, it is also possible that workplace discrimination may hold back the pay and career prospects of some females.

2 This task requires you to find examples of jobs in different occupational groups in your country, state whether their wage rates or earnings follow the same pattern given in the bar chart in the activity based on the UK, and use your knowledge of factors that may affect labour market conditions to explain the pattern of wage of earnings differentials.
Activity 3.13: The minimum wage debate

1. Arguments for a minimum wage: to lift people on low incomes out of poverty; to boost productivity.

Arguments against a minimum wage: it raises employment costs and will reduce the demand for labour.

If the minimum wage (MW) for an occupation is set below the market wage rate (W) it will have no effect. If the minimum wage (MW) is set above the market wage rate (W) there will be an excess supply of labour, equal to n1 to n2 in the diagram below. Employment will fall from N to n1.

2. By observing changes in employment and levels of productivity in low wage occupations.

3. a. There is an excess supply of labour at W1
   b. W2 is below the equilibrium wage rate and will therefore have no effect

4. Wage elasticity of demand for teenage labour = % change in quantity of labour demanded / % change in wage. Therefore the elasticity of demand is 0.3. This suggests labour demand is relatively wage inelastic.

Activity 3.14 Why I’m part of the union!

1. Negotiating wages and other non-wage benefits with employers; defending employees’ rights and jobs; improving working conditions, such as better hours of work and health and safety; improving pay and other benefits, including holiday entitlement, sick pay and pensions; encouraging firms to increase workers’ participation in business decision making; supporting members who have been dismissed or who are taking industrial action; developing the skills of union members, by providing training and education courses; providing social and recreational amenities for their members; influencing government policy and employment legislation.

2. Benefits might include time savings associated with negotiating with union representatives rather than many individual workers; unions will maintain the skill levels of their members through on- and off-the-job training; unions can participate in business decision making and discuss ways to improve productivity. Problems might include increased bargaining power of unions in negotiations over pay and working conditions, especially if there is a closed shop or single union agreement negotiations; unions may restrict the supply of labour to put upward pressure on wages.

3. See answer to question 1 for possible benefits of union membership. There are costs associated with union membership including membership fees but also foregone wages if the union requires its members to take strike action.
Activity 3.15 A tough negotiation

This activity requires you to write a report and take part in a role-play exercise. The outcome of the exercise will depend on your skills in negotiation.

The team playing the union will need to address the following questions in its report.

- What is your pay claim? A 5% increase in the wage rate. However, you might also seek improvements in overtime pay and performance-related payments. You might be willing to accept changes in these to reduce your demand for a 5% pay increase.

- Why have you made this pay claim? Because your members will be required to operate new machinery. The new equipment will increase productivity and reduce costs. As a result, profits are likely to rise so the union wants to secure a share of these by raising its members’ wages but also wants to protect the jobs of its members.

- What has been the management response? Managers have not rejected the demand outright but have stated that they are to avoid any increase in wage costs that may make them uncompetitive. This means they might be willing to improve pay if there are improvements in labour productivity.

- What forms of action could the union take if necessary? Initially the union could ask its members to work to rule and reject overtime working. Ultimately, the union could organize a strike.

- Why are both you and the management keen to avoid a strike? Union members will lose wages while on strike and the union does not want to jeopardize a big customer order that will help to keep its members in jobs. Managers similarly do not want to lose output and put the new customer order at risk. The strike may lose the company custom it cannot recover and ultimately may force it to close down.

The team playing the managers will need to address the following questions in their report.

- What wage claim has the union made? A 5% increase in the wage rate. However, the union may also seek improvements in overtime pay and performance-related payments. The union might be willing to accept changes in these to reduce its demand for a 5% pay increase.

- What are the implications of accepting or rejecting this claim? If the union demand is rejected its members may take strike action but the union will know this might place the new order and future of the business, and therefore the jobs of their members, at risk. Accepting the demand without any improvements in labour productivity will increase production costs and may make the business uncompetitive.

- Why you are keen to avoid a strike? It will mean lost output and revenue during the strike because the company will not be able to meet customers’ orders. The reputation of the company as a reliable supplier will also be damaged and it may continue to lose customers even when the dispute is resolved.

- What will be discussed with the union? The likely impact of any disruption on the company and therefore the jobs of union members; reducing their immediate pay demands; linking improved pay to improvements in productivity; how best to minimize redundancies following the introduction of the new equipment, for example by offering generous early redundancy packages.
**Activity 3.16 Spending patterns**

1. Households with the highest incomes spent proportionally more of their total weekly expenditure on restaurants and hotels, recreation and cultural activities and transport than low-income households. In contrast, low-income households spent a larger proportion of their weekly expenditure on food and non-alcoholic drinks, housing, fuel and power, and alcohol and tobacco, than high-income households.

2. All households will have to spend money on essential products such as food, housing and power, but these costs will account for a far greater proportion of the weekly budget of a low-income household than a household with a much larger income. High-income households can afford to spend more on satisfying their wants and the purchase of luxury items, hence the larger proportion of their total expenditure they spend on recreation and culture, eating out at restaurants and travel.

**Activity 3.17 Shop ’til they drop**

<table>
<thead>
<tr>
<th>Consumer trends</th>
<th>Reasons</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rising sales of new cars</td>
<td>Increase in real disposable incomes and availability of motor vehicles in many developed and rapidly developing economies; increase in availability of credit to buy cars; increase in demand for travel and leisure activities as incomes have increased and tastes have changed; growing pressure to reduce vehicle use to cut harmful emissions and increasing taxes on petrol may reduce demand for cars and vans and travel in future. However, new low-emissions and electric vehicles are being developed and becoming more affordable as their scale of production is increased</td>
</tr>
<tr>
<td>Increased consumption of fruit and vegetables; reduced consumption of meats, potatoes, sugars and preserves</td>
<td>Increasing health conscious diets; increased availability of different fruits and vegetables from overseas; demand is likely to rise further as concerns about diet and obesity grow</td>
</tr>
<tr>
<td>Increasing household ownership of consumer durables</td>
<td>Rise in real household disposable incomes; increased availability and falling prices of many consumer durables; changes in lifestyles have increased demand for labour-saving products such as washing machines and microwaves; many products have reached saturation point so demand is likely to fall, requiring manufacturers to develop extension strategies and new technologies and products</td>
</tr>
<tr>
<td>Increase in mobile telephone and broadband subscriptions; falling fixed telephone line subscriptions</td>
<td>Increasing demand for fast Internet access and communications while on the move; increasing competition between broadband service providers has reduced charges; falling cost of mobile communications relative to cost of fixed lines and likely to see continuation of these trends; also cheaper for phone companies to supply mobile telecommunications instead of investing in the fixed-line network and physically having to visit buildings to connect telephones to the network</td>
</tr>
<tr>
<td>Fall in proportion of adults smoking</td>
<td>Increased taxation of tobacco products and increasing awareness of negative impact of smoking on health has reduced consumption. This trend is likely to continue</td>
</tr>
<tr>
<td>Increase in Internet usage</td>
<td>Rapid increase in usage as access to computers increases, in part due to falling prices of computers and growing competition between Internet service providers; This is also linked to population growth. The trend is likely to continue especially in developing economies, with increasing demand for mobile Internet access via Wi-Fi and on mobile telephones</td>
</tr>
<tr>
<td>Expanding global health and wellness tourism market</td>
<td>Due to rising incomes and ageing populations in many developed economies in particular, people have more leisure time and income to spend on health care and leisure activities such as spa treatments and massage. This trend is likely to continue as incomes and number of older people increase</td>
</tr>
</tbody>
</table>
Activity 3.18: ‘If I owe you a pound, I have a problem; but if I owe you a million, the problem is yours’

1. Increased household wealth due to a boom in stock market and low interest rates. Both factors have increased borrowing and therefore consumer debt.

2. Many Koreans have total debts exceeding their annual income. Many loans are short term and have variable interest rates. An increase in interest rates will therefore increase the cost of interest charges on loans and will therefore take a larger proportion of household income. This will reduce disposable income available for spending on consumer goods and services and, if significant, could create an economic downturn and reduce economic growth.

3. A government could reduce consumer demand for borrowing by increasing interest rates and by increasing taxation.

4. A young, unmarried university graduate will have a relatively low income and is likely to spend most of his or her income on food and rented accommodation, but also on fashionable clothes, music and going out with friends.

   A married couple with a young family will spend a larger proportion of their income on housing costs, for example paying off a mortgage, and on household goods and services for their home. Children’s clothes and education costs are also likely to account for a significant proportion of total expenditure.

   A retired couple are likely to have a relatively stable income from a pension. They will tend to spend a larger proportion of their income on heating their homes during winter, medical care and recreational activities because they are not working.

5. As debt rises, loan repayments and interest charges will take a larger percentage of total income. Households will have less to spend on other goods and services. If consumer spending falls, firms may be forced to cut back output and employment. They may also delay plans to invest in new plant and equipment that could expand their productive potential.