Unit 1: Fundamentals of Economics Notes

Name: ________________________________ Date: __________________ Block: ________

<u>Economics: Problem of Scarcity</u>

<u>Economics</u> – study of how people & societies choose to use **limited resources** to satisfy their needs & **unlimited wants**

- #1 ongoing problem that all economists face is SCARCITY!!!!!!!!!!!

- **Needs** are the basic survival necessities such as water, food, shelter, & clothing

- **Wants** are UNLIMITED desires that can be satisfied by consuming or purchasing a good or service

- People will **always want more**, but the resources available to satisfy them are **limited** which causes SCARCITY!

- In order to be considered scarce, a good or service must be:

  - **limited**, (not everyone can get it or afford it)
  - **desirable**, (people want it!)
  - **have a cost** (you have to pay for it)

- Scarcity affects which goods are made and which services are provided

- **Goods** are physical objects that can be purchased
  - Ex: food, clothing, furniture, electronics, etc.

- **Services** are work that one person performs for another for payment
  - Ex: sales clerk, tech support, teachers, doctors, lawyers, lawn care, etc.

- Scarcity affects the choices of both the **<u>consumer</u>** (person who buys goods & services for personal use) & the **<u>producer</u>** (person who makes goods or provides services

<u>Productive Resources</u>

<u>Productive Resources</u> – economic resources needed to produce goods and services (**Factors of Production)**
Acronym if it helps: **CELL**

1) **<u>Land</u>** – includes all the **natural resources** found on or under the ground that are used to produce goods and services
   - water, forests, wildlife, minerals, oil

2) **<u>Labor</u>** – all the human time, effort & talent that go into the making of products
   - workforce

Unit 1: Fundamentals of Economics Notes

Name: _______________________________ Date: _________________ Block: ________

3) **<u>Capital</u>** – all the resources made and used by people to produce & distribute goods and services

   - **Physical capital** includes: tools, machinery, factories, roads, airplanes, offices, warehouses

   - **Human capital** – knowledge, education, training, skills & specialized talents of people

   - **Financial capital** - money, used by entrepreneurs & businesses to buy what they need to produce their goods or services

4) **<u>Entrepreneurship</u>** – combination of vision, skill, ingenuity & **willingness to take risks** that is needed to create & run new businesses
   - innovators, inventors, investors, risk takers
   - Encouragement of entrepreneurship brings about several positive things:
     - changes in production of goods and services
     - new products/ production methods
     - people seeking patents to inventions
     - new businesses cropping up

<u>Choices and Opportunity Cost</u>

- **<u>Incentives</u>** – benefits offered to encourage people to act in certain ways (rewards or punishments)
  - Ex: grades in school, wages paid to workers, trophies in sports, speeding tickets, etc.

- **<u>Utility</u>** – benefits or satisfaction gained from the use of a good or service (happiness)

- People make decisions according to what they believe is the best combination of **costs & benefits**

"THERE IS NO SUCH THING AS A FREE LUNCH!" (**TINSTAAFL**)
There's ALWAYS a COST!

- <u>Every</u> choice involves costs
  - Ex: Studying for a test or hanging out with friends; eating a salad or a cheeseburger; going to college or getting a job out of high school

Unit 1: Fundamentals of Economics Notes

Name: ________________________________ Date: __________________ Block: ________

- The alternative that you give up when you make an economic choice is called a **<u>trade-off</u>**

  - Individuals and Trade-Offs – studying one subject vs. another, college or work, watching TV or working out, etc.
  - Business Trade-Offs – producing one item vs. another

  - Society and Trade-Offs – “guns or butter”, capital or consumer goods

  - **<u>OPPORTUNITY COST</u>** of an economic decision is the **value of the next-best alternative** that you give up in order to do something else
    - #1 Trade-off

<u>Marginal Costs and Benefits</u>

- The practice of examining the costs and the expected benefits of a choice as an aid to decision making is called **<u>cost-benefit analysis</u>**

- **<u>Marginal cost</u>** is the **cost** of using **one more unit** of a good or service

- **<u>Marginal benefit</u>** refers to the **benefit or satisfaction** received from using **one more unit** of a good or service

- Analysis of marginal costs & benefits helps explain the decisions consumers, producers, & governments make as they **try to meet their unlimited wants with limited resources**

- <u>Thinking at the margin </u>– analyzing the costs and benefits of **incremental** (small) decisions
  - If **MB > MC** then do it!

- If **MB < MC** then it’s probably not the best choice to make

- **<u>Law of Diminishing Marginal Utility</u>** states that the **marginal benefit** from using **each additional unit** of a good or service during a given time-period **tends to decline** as each is used

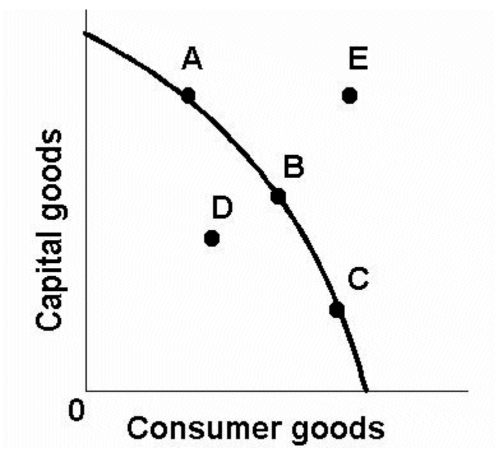
Unit 1: Fundamentals of Economics Notes

Name: _________________________________ Date: __________________ Block: ________

<u>Production Possibilities Curve (PPC)</u> graph used to illustrate the **impact of scarcity** on an economy by showing the maximum number of goods or services that can be **produced** using **limited resources**

❖ <u>PPC is based on 4 assumptions</u>:

1. Resources are fixed
2. All resources are fully employed (economy is at full production)
3. Only 2 things can be produced (you would never have enough resources to make an infinite number of products)
4. Technology is fixed



❖ PPC shows that:
- ➢ **nothing is free** <u>&</u>
- ➢ **everything has an opportunity cost**
- ➢ If society wants more of one thing it must give up something in return

❖ **<u>Efficiency</u>** – condition in which economic resources are being used to produce the maximum amount of goods & services (on the curve – Full Employment)

❖ **<u>Inefficiency</u>** – condition in which economic resources (F.O.P) aren't being used to their full potential (underutilization)
- ➢ Point **D** represents inefficient production because it's inside the curve: **Recession**

❖ **<u>Unattainable</u>** – condition in which society cannot produce at current levels for prolonged periods of time with given resources

Name: ________________________________ Date: __________________ Block: ________

- Point **E** is unattainable for long periods of time because it's outside the curve and represents an economy experiencing an **Inflationary Gap**

❖ **<u>Law of increasing opportunity costs</u>** states that as production switches from one product to another, increasingly more resources are needed to increase the production of the second product, which causes opportunity cost to rise

- Points **A, B, C** are all efficient, operating **at Full Employment** (on the line)

- Point **D** is inefficient, showing the economy is in a **Recession** (inside line)

- Point **E** is unattainable for long periods of time (outside the line) and represents an economy experiencing an **inflationary gap**

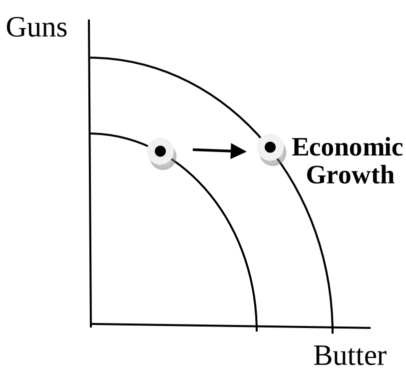
<u>PPC "Shifters" (economic growth)</u>

1. Increase productive resources/ change in quantity or quality of productive resources (F.O.P: land, labor, capital)

2. New technology = increased efficiency & productivity

3. International Trade* - does not allow a nation to produce more but does allow it to consume more

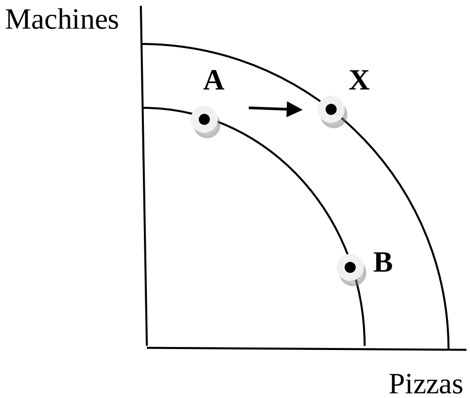
✓ **Outward shift shows long run economic growth**



Countries that produce more capital goods will have more growth in the future because capital goods (RESOURCE) produce other goods while consumer goods are made to increase individual's utility (satisfaction)

Unit 1: Fundamentals of Economics Notes

Name: ________________________________ Date: __________________ Block: ________



Point A would be more beneficial for this society to experience economic growth in the long-run and extend the PPC to **Point X** because its producing more machines (**capital goods**) and less pizzas (consumer goods).

<u>Adam Smith and Capitalism</u>

❖ **Adam Smith** challenged <u>mercantilism</u> (economic system where the government-controlled trade & favored economic independence) & promoted the concept of **free trade** in his book *<u>The Wealth of Nations</u>* (1776)

❖ ***<u>Laissez-faire</u>*** – economic policy of allowing owners of industry to dictate their prices and working conditions **without governmental interference** (*"allow to do")*

<u>Smith's 3 natural laws of economics:</u>

1. **<u>Law of self-interest</u>** – people work for their own good

2. **<u>Law of competition</u>** – competition forces people to make a better product for lower price

3. **<u>Law of supply and demand</u>** – enough goods would be produced at the lowest price to meet the demand in a market economy

- ***Invisible Hand*** establishes the price and quantity of goods & services produced without gov't interference

<u>Capitalism</u> – economic system in which the **factors of production are privately owned** and money is invested in business ventures **to make a profit**

<u>Fundamentals of Market Economies</u>

1) **<u>Specialization</u>** – people **concentrate their efforts** in the areas in which they **have an advantage**; allowing people to trade with the most efficiency

Unit 1: Fundamentals of Economics Notes

Name: ________________________________ Date: __________________ Block: ________

2) **<u>Division of Labor</u>** – **separation of tasks** so workers perform fewer tasks in order to **operate more efficiently**
3) **<u>Productivity</u>** – increased amount of output (good or service) per unit of labor input
   - Increased productivity due to technology advancements leads to economic growth
   - Capital investments allow increased efficiency

4) **<u>Voluntary Exchange</u>** – act of **buyers & sellers** willingly & **freely engaging in market transaction** where **both parties benefit**

- **<u>Economic System –</u>** method used by society to allocate/distribute the scarce resources in order to bring goods and services to the people

- All economic systems must answer the 3 basic questions:
  - **1) What** to produce?
  - **2) How** to produce?
  - **3) For whom** to produce?

1) **<u>Traditional economy</u>** – relies on habit, custom, or ritual to decide the 3 economic questions
   - Developing Countries who are **poverty-stricken** countries based on subsistence agriculture
   - EX: African Mbuti, Australian Aborigines, $ Canadian Inuits

2) **<u>Market economy</u>** – economic decisions are made by buyers & sellers trading freely
   - **CAPITALISM**…$$$$!

- <u>Advantages</u>
  a. Ability to adjust to change based on consumer demand & producer supply
  b. Ability to have a voice in the economy ("vote with our dollars")
  c. High degree of individual freedom
  d. Limited gov't involvement
  e. **Variety** of goods & services created
  f. High degree of consumer satisfaction

- <u>Disadvantages</u>
  a. Inability of the market to meet every person's basic needs
  b. Inadequate job of providing some highly valued services like justice, education, infrastructure, & health care (needed public goods)
  c. Citizens may face a level of uncertainty & the prospect of economic risk, loss, & failure

Name: ________________________________ Date: __________________ Block: ________

3) **Command Economies** – in a centrally planned economy, the central government decides how to answer the three economic questions
   - SOCIALISM & COMMUNISM…uh oh!

Socialism – political & economic system in which the gov't controls the means of production to distribute among the community as a whole to prevent economic & social suffering

Communism – absolute socialism advocating **class warfare** & leading to a society in which **all property is publicly owned** and each person works & is paid according to their abilities & needs (**MARXISM**)

Karl Marx is considered the father of the radical version of socialism known as Communism after publishing his ideas in the *Communist Manifesto* (1848)

- Advantages (of Communism)
  a. Ability to drastically change direction in a relatively short period of time
  b. Little uncertainty for its citizens because workers are forced into state sponsored labor

- Disadvantages
  a. Citizen needs may not be met: starvation, poor healthcare, lower standard of living, etc.
  b. Consumer wants aren't met since consumer goods aren't produced
  c. Hard work isn't rewarded/no worker incentives
  d. Individual initiative goes unrewarded (no incentives to produce)
  e. Citizens have very few rights, liberty, & freedoms
  f. Bureaucracy delays decisions that need to be made
  g. Little flexibility to deal with day-to-day problems

4) **Mixed Economies** – market-based economy in which government plays a role in the market to help with poverty, unemployment, public safety, health care, education, etc.
   - Most modern economies are mixed economies (U.S., Japan, England)

- Advantages
  a. People make their own decisions
  b. Gov't is still limited in scope
  c. Provides freedoms & benefits: Free Enterprise/Business Ownership, Social Welfare, Profit Earnings, & Political Freedoms

d. Gov't is active in economy & provides support & direction

- Disadvantages
  a. It all depends on how "mixed" the economy is
  b. Big Gov't policies (taxes, regulations, etc.) stifles economic growth & becomes SOCIALISM in the end

5 Advantages of a Free Enterprise System

1) **Private Enterprise/Economic Freedom** – business or industry that is managed by independent companies or private individuals rather than by the state (private ownership)

❖ **Patents** - set of exclusive rights granted by the gov't to an inventor for a limited period of time in exchange for detailed public disclosure of an invention

2) **Private Property Rights** – Individuals & businesses own property; have the right to buy and sell as much property as they want

3) **Competition** – efforts among sellers/producers to attract consumers at various prices

4) **Profit Motive** – encourages people & organizations to improve their material well-being

❖ Many people in our society are driven by the **desire to make money**, which **ultimately benefits the market**

❖ People in the U.S. are **rewarded for innovations & efficiency via cash INCENTIVES**

5) **Consumer sovereignty** – desires & needs of consumers control the output of producers

❖ Consumers are like "Kings" in a market economy

Gov't's Role in a Market Economy

Government acts an **informer**, **protector**, **provider**, and **regulator**

- Government has the responsibility to **protect property rights**, **inform the public** and **oversee business activities**

Unit 1: Fundamentals of Economics Notes

Name: ________________________________ Date: __________________ Block: ________

1) Gov't as Informer
   - Make sure producers provide consumers with full disclosure
   - Consumers use gov't information to protect themselves from dangerous products & fraudulent claims

2) Gov't as Protector
   - Federal government acts to preserve competition, regulates airlines, communications, banking, stock markets etc.
   - Gov't doesn't control it, but it does impose various restrictions on the private market

3) Gov't as Provider
   - **Public sector –** part of the economy that involves the goods provided by the government

   - **Private sector** – part of the economy that involves the goods provided by private firms

   - **Public Good/Service** – shared good or service for which it would be impractical to make consumers pay individually and to exclude nonpayers (gov't provided)
     - Ex: Roads, Bridges, Public Education, Military, National Park, Snow Removal, Police, etc.

   - **Redistribution of Income** is when the **gov't takes** from one group & **reallocates** to another group

   - **Transfer payments** – transfers of income from one person or group to another even though the receiver does not provide any goods or services in return
     - **Examples:** Welfare, Social Security, Unemployment, Food Stamps, etc.

   - **Safety net** – gov't programs designed to protect people from economic hardships

Externality – side effect of a transaction that affects someone other than the producer or buyer

❖ **Negative Externality** – negative effects experienced by people that had no part in the consumption of a good or service
   ➢ Ex: Cigarette smoker, chemical waste dumping, foreclosures & property values, etc.

Unit 1: Fundamentals of Economics Notes

Name: ________________________________ Date: __________________ Block: ________

- **Positive Externality** – Goods/services that generate benefits to many people, not just those who pay for the goods
  - Ex: Education, better technology, medicine, **infrastructure**, etc.
  - **Subsidy** – gov't payment that helps cover the cost of an economic activity that's considered to be in the public's best interest

4) Gov't as Regulator
   - Gov't regulation has **negative effects** on businesses & consumers
   - Gov't regulations **increase the cost of business & reduce the incentives to produce**

7 Economic Goals of a Market Economy

1) **Economic Freedom** – freedom to buy or sell what we want, make choices with little interference by the government

2) **Economic Efficiency/Innovation** – making the most of scarce resources, using your resources wisely and productively by improving upon existing technology

3) **Economic Growth** – improving the economy from year to year, improving people's standard of living

4) **Full Employment** – highest amount of the labor force that could be employed within an economy at any given time (95% employment rate or better)

5) **Economic Security** – government will provide a safety net in times of economic downturns

6) **Price Stability** – knowing that goods & services will consistently be available at stable prices

7) **Economic Equity** – Equal pay for equal work (fairness); being paid according to your skill level and not discriminating based on age, gender, race/ethnicity, religion, etc.