

## Unit 1: Basic Economic Concepts

### What is Economics?

**Economics** is the study of **scarcity** and **choice**

**Scarcity** means that there is a finite amount of a good or service (Basically they are limited). Because something is limited, we need to make decisions regarding how we use and allocate our resources.

So studying economics helps use to better make decisions regarding how to deal with the condition of scarcity.

Before we begin, there are few more definitions we should learn. In addition to scarcity you should know that:

**Goods** are tangible items, or products, such as Pop Tarts, automobiles and I Phones.

**Services** are intangible items such as a haircut, mowing a lawn, and a dentist visit.

Also, you should know the difference between scarcity and shortage. **Shortage** is a short term condition of a limited amount of a resource. For example, if there is a frost in Florida and the orange crop is destroyed, the supply of oranges will be limited, but only for that growing season.

One of the most important aspects of choice in Economics is the idea that every choice has trade-off-what didn't you choose. This is related to the concept of opportunity cost.

**Opportunity Cost** is your second choice-what you give up when you make a decision. For example, if you choose to go to college, you give up the salary you could have earned if you go directly into the work force. The salary you would give-up is the opportunity cost of going to college. Remember that Economics is the study of scarcity and choice. The concept of opportunity cost is an important element in economic choices.

### The Factors of Production

In order to better understand how we make decisions regarding scarcity and choice, it is important to understand how goods and services are produced. This is where the concept of the **factors of production** comes in:

**The Factors of Production** are classifications of what goes into the making of a good or service. They include:

**\*Land or Natural Resources** which are products used in the production of goods and services, come from the earth. Examples could include lumber or oil.

Natural resources can be characterized as either:

**Renewable resources** are resources that can be replenished, such as trees that can be replanted.

**Nonrenewable resources** are resources that cannot be replaced such as coal.

**\*Labor or Human Resources** is the work that goes into the production of a good or service. When looking at this factor, we usually look at the number of workers and the workers' skills.

**\*Capital** is the term used for the items that are used to create a good or service. Examples of this may include the building where a good is produced, or the tools utilized to create a good or provide a service.

**\*Entrepreneurship** is the putting together of land labor and capital to create a good or provide a service. This is basically the ideas that go into the process of creating a good or providing a service.

## **Basic Economic Questions**

Societies need to determine how to put all of the factors of production together to best deal with the issue of scarcity. To do this they need to address these **Basic Economic Questions:**

**What goods and services should be produced?** What goods and services does the society need? What goods and should the society produce? Should the society specialize in particular products and trade for others?

**How should goods and services be produced?** How should the factors of production be combined? What resources should be used? How should we utilize our labor and capital?

**Who should receive the goods and services?** How should goods and services be distributed? Should everyone receive them? If not how does society decide who gets particular goods and services and who might not?

## **Types of Economic Systems**

There are **Three Economic Systems** that societies have developed to address these questions. They include:

**A Traditional Economy** that deals with these questions by relying on customs and traditions. This type of economy is usually associated with cultures that practice subsistence agriculture, with customs and economic roles being passed down from generation to generation. An example of this might be some tribal societies found in the Amazon River Basin.

**A Command Economy** answers these questions by having the government make (or command) decisions pertaining to what is produced, how much is produced, and how goods produced and services are provided. An example of this would be the economic system developed in communist countries such as the old Soviet Union.

**A Market Economy** answers these questions by allowing the buyers and the producers of goods and services to come to an agreement regarding what is provided and bought in a society and what the price of a good or service should be. In its purest form, this is

the opposite of a command economy. In this system decisions are made by individuals, not by the government.

In reality, it is probably impossible to find any society that in some way does not mix these systems. So it is important that you understand that most societies would be classified as having a **Mixed Economic System**.

**A Mixed Economy** utilizes aspects of different systems. For example, the United States economic system, at its base, would be classified as a market economy. Businesses are privately owned and consumers have the ability to make economic decisions. However, the government does play a prominent role in regulated businesses, and by providing services.

## **The Nation's Economic goals**

In the United States, most people would agree that our system should try to strive for the following economic goals.

**Freedom:** Individuals have the right to save their money, buy what they want, and to work at the jobs they choose. Businesses have the ability to create what they want, make profits and own the means of production.

**Efficiency:** This goal reflects the ideal of using the country's factors of production to their fullest extent.

**Equity:** While there may be disagreements regarding the ideal degree of economic equality in our society, most agree that opportunities for economic advancement should be available to all.

**Security:** Our market oriented system can leave some individuals behind. Because of this, our government has created a **safety net**. This includes programs such as Social Security, Medicare, Medicaid, unemployment insurance, and welfare programs.

**Growth:** Increased production of goods and services creates economic growth which provides increased income and less unemployment.

**Price Stability:** One of the major goals of the nation's economic institutions is to prevent extreme fluctuations in prices. Both rapid increases in price level (inflation), and decreases in price level (deflation) can cause economic problems. So government institutions should do their best to moderate the changes in price level.

**Full Employment:** Allowing the economy to provide a sufficient number of jobs is crucial to maintain a healthy economy and society.

## How Do You Study Economics?

Now that we have covered the basics of Economics, we can now discuss how students of economics study economic topics:

First you should understand how the discipline is organized: In general, Economics is separated into two areas:

**Microeconomics:** Which basically analyzes individual business situations or sectors of the economy. For this course the topics we will study will include Supply and Demand, Elasticity (the degree to which prices impact behavior), and Market Structures (the level of competition in a particular industry).

**Macroeconomics:** Which analyzes the broad aspects of a country's economy. In this area we will study GDP, unemployment, inflation and the government's tools to deal with economic circumstances. Also, included in this topic will be topics pertaining international trade.

One important thing to know about Economics is the fact that opinions are intertwined with facts, and economists are influenced by their political leanings. Because of this, it is very important to separate factual statements from statements containing opinions. Statements of fact (**Positive Statements**) would be statements such as "the unemployment rate has decreased by 1%". Statements including opinion (**Normative Statements**) are usually prescriptive. An example of this would be "The government should decrease taxes to improve the economy". Understanding the differences between these types of statements will help you to better analyze economic positions.

So how do economists analyze the economy?

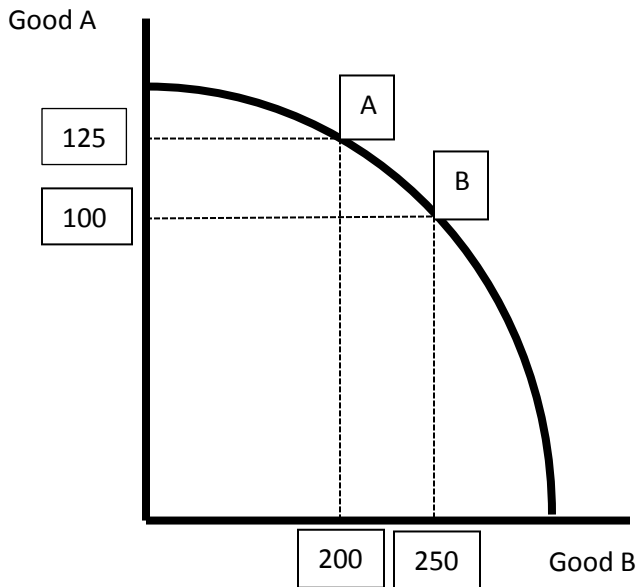
First it is important to understand that Economics is a **Social Science**. Because of this there can be many variables that can impact a particular outcome. So economists need to utilize the concept of **Ceteris Paribus**, which means all else being equal. What this means is that economic analysis minimizes the number of variables considered. The reason for this is that limiting variables helps to provide a simplified model to explain certain economic circumstances.

Here are a couple of models to show you how this works.

The first model is the **Production Possibilities Curve** or the **PPC**.

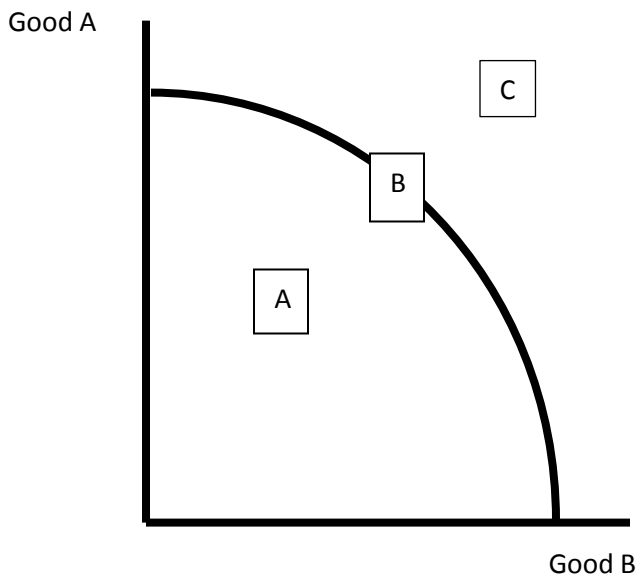
The Production Possibilities Curve can demonstrate the idea that decisions have trade-offs and opportunity costs. The PPC is a graphic representation of an economic trade-off which can demonstrate the opportunity cost of a decision.

Below is a PPC:



This model simplifies the choices in an economy. This economy can choose between 2 goods. Good A and Good B. The curved line represents the maximum amount of production that can be achieved considering all possible combinations of Good A and Good B. At point A the country can produce 125 units of good A, and 200 units of good B. If the country then chooses to produce 250 units of good B (point B), the country must give up 25 units of good A: moving from 125 units to 100 units. So the opportunity cost of producing 50 more units of good B (200-250) is 25 units of good A. Hopefully this shows you how a simplified model can demonstrate the concept of opportunity cost.

The PPC can also demonstrate the level of efficiency an economy is operating at. Here is another PPC:

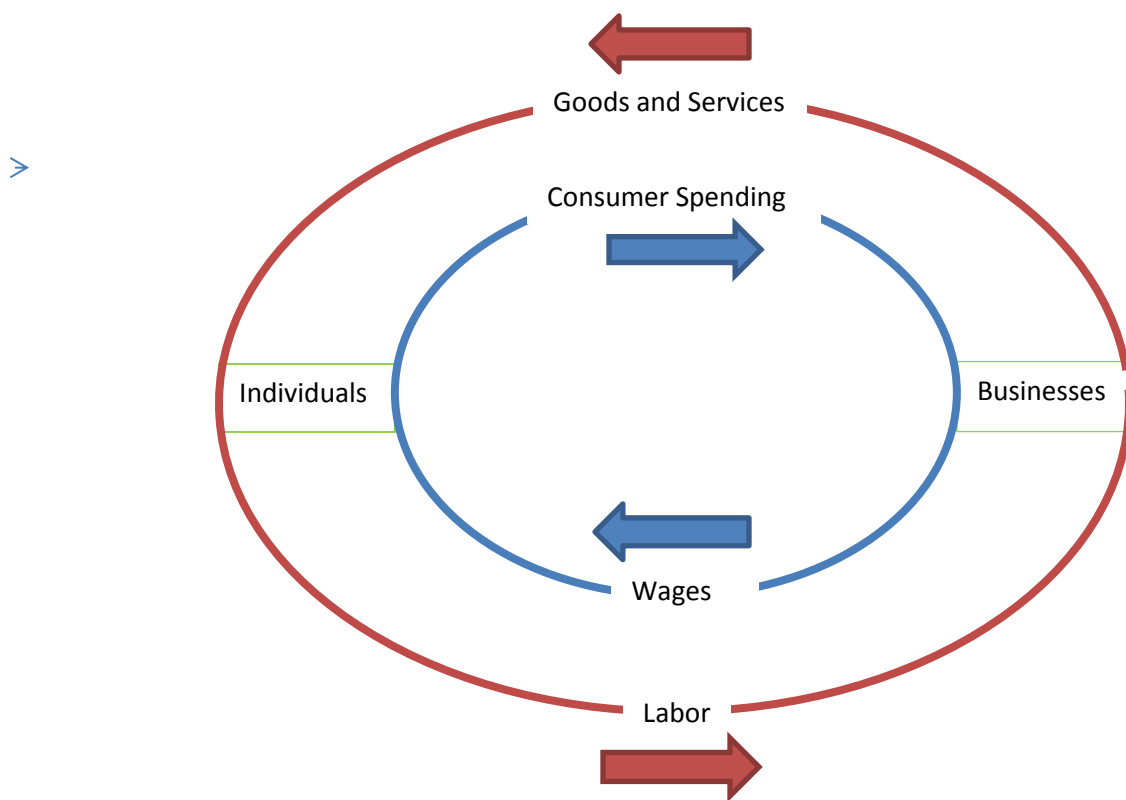


Remember the curved line represents the maximum production of all possible combinations of good A and good B. Point B (on the line) is a location that is **efficient**: meaning that all the factors of production in an economy are being fully utilized. Point A is **inefficient**: meaning that the factors of production are not being fully utilized. Point A also represents a recession because the country is producing less than it is capable of. In addition, Point A represents an economic situation with less than full-employment. Point C is unobtainable given the current factors of production because it is beyond the maximum amount of production of both goods A and B.

So there is our first model, the PPC. It simplified an economy by only looking at two goods, but this simplification allows for a clear analysis of opportunity cost. It also provides a graphic representation of both efficient and inefficient allocation of resources, and unobtainable production given the current factors of production.

Our next model is **The Circular Flow Diagram**

**The Circular Flow Diagram** is a simplified model that demonstrates how money and goods and services move through the economy.



This diagram represents the economic interaction between individuals and businesses. The top of the diagram represents the **Market for Goods and Services**. In this market, individuals spend their money (consumer spending) and in return they receive goods and services. The bottom of the diagram represents the **Factor Market**. In this market, individuals provide labor (a factor of production). In return, individuals receive payment (wages). The model also demonstrates the flow of money. The blue

inner circle shows how money flows from consumers to businesses and from businesses back to individuals in return for their productive services. The red outer circle shows how goods and services flow through the economy. Individuals provide services (labor) to the businesses and businesses provide goods and services to individuals.

This simplified model of the economy will be important to understanding economic interactions and later the course will help students in their understanding of how Gross Domestic Product (GDP) is calculated.

## **Recap: What is Economics All About?**

Economics is the study of scarcity and choice. Making decisions regarding scarcity we need to understand the factors of production and the three economic questions. In dealing with these economic questions, different economic systems have been developed. In the U.S. market system, we strive to meet the nation's economic goals. To better meet our economic goals, economists have developed simplified models to provide a deeper understanding of economic circumstances.

## **Unit 1**

### **Videos and Quizzes:**

[Scarcity](#)

[Opportunity Cost](#)

[Productive Resources](#)

[Technology](#)

[Economic Systems](#)

### **Extension Assignments**

Watch the 2 videos below and complete the opportunity cost assignment sheet

[Opportunity Costs Outputs](#)

[Opportunity Costs Inputs](#)

[Opp Cost Worksheet](#)

### **Unit 1 Quiz**

[Unit One Quiz](#)