INTRODUCTION TO ECONOMICS

Choices, Choices, Choices, . . .

Part 1: The Basics

WHAT IS ECONOMICS???

- Economics – the study of how individuals and societies make decisions about ways to use scarce resources to fulfill wants and needs.
- What does THAT mean?!!??!!

The Study of Economics

- Macroeconomics
  - The big picture: growth, employment, etc.
  - Choices made by large groups (like countries)

- Microeconomics
  - How do individuals make economic decisions

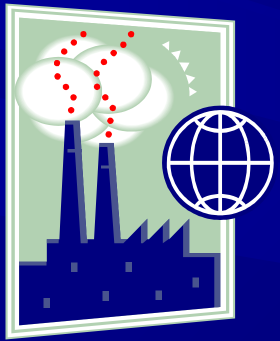
ECONOMICS: 5 Economic Questions

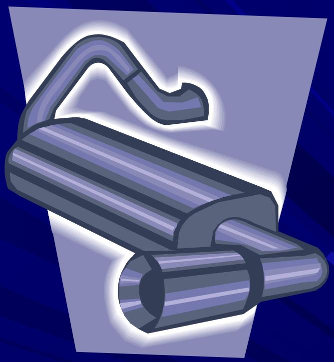
Society (we) must figure out

- WHAT to produce (make)
- HOW MUCH to produce (quantity)
- HOW to Produce it (manufacture)
- FOR WHOM to Produce (who gets what)
- WHO gets to make these decisions?

What are resources?

- Definition: The things used to make other goods





BUT, there’s a Fundamental Problem:

SCARCITY: unlimited wants and needs but limited resources

Choices, Choices

- Because ALL resources, goods, and services are limited – WE MUST MAKE CHOICES!!!!

Why Choices?

We make choices about how we spend our money, time, and energy so we can fulfill our NEEDS and WANTS.

What are NEEDS and WANTS?

Wants and Needs,
Needs and Wants

- NEEDS – “stuff” we must have to survive, generally: food, shelter, clothing

- WANTS – “stuff” we would really like to have (Fancy food, shelter, clothing, big screen TVs, jewelry, conveniences . . . Also known as LUXURIES

VS.

TRADE-OFFS

You can't have it all (SCARCITY – remember?) so you have to choose how to spend your money, time, and energy. These decisions involve picking one thing over all the other possibilities – a TRADE-OFF!

Trade-Offs, cont.

- IN YOUR JOURNAL: What COULD you have done instead of come to school today?

- These are all Trade-Offs! Thanks for being here!

A special kind of Trade-Off is an

OPPORTUNITY COST =

The Value of the Next Best Choice

(Ex: Sleeping is the opportunity cost of studying for a test)

Opportunity Costs

- This is really IMPORTANT – when you choose to do ONE thing, its value (how much it is worth) is measured by the value of the NEXT BEST CHOICE.
  - This can be in time, energy, or even MONEY

If I buy a pizza…

Then I can't afford the movies…

Q: What is the opportunity cost of buying pizza?

Production

- So how do we get all this “stuff” that we have to decide about?

  Decisions, decisions …

PRODUCTION, cont.

- Production is how much stuff an individual, business, country, even the WORLD makes.
- But what is "STUFF"?

- STUFF – Goods and Services.
- Goods – tangible (you can touch it) products we can buy
- Services – work that is performed for others

Factors of Production

- So, what do we need to make all of this Stuff?

4 Factors of Production

- LAND – Natural Resources
  - Water, natural gas, oil, trees (all the stuff we find on, in, and under the land)
- LABOR – Physical and Intellectual
  - Labor is manpower
- CAPITAL - Tools, Machinery, Factories
  - The things we use to make things
  - Human capital is brainpower, ideas, innovation
- ENTREPRENEURSHIP – Investment $$$
  - Investing time, natural resources, labor and capital are all risks associated with production

Which Factor of Production?

Which Factor of Production?

Which Factor of Production?

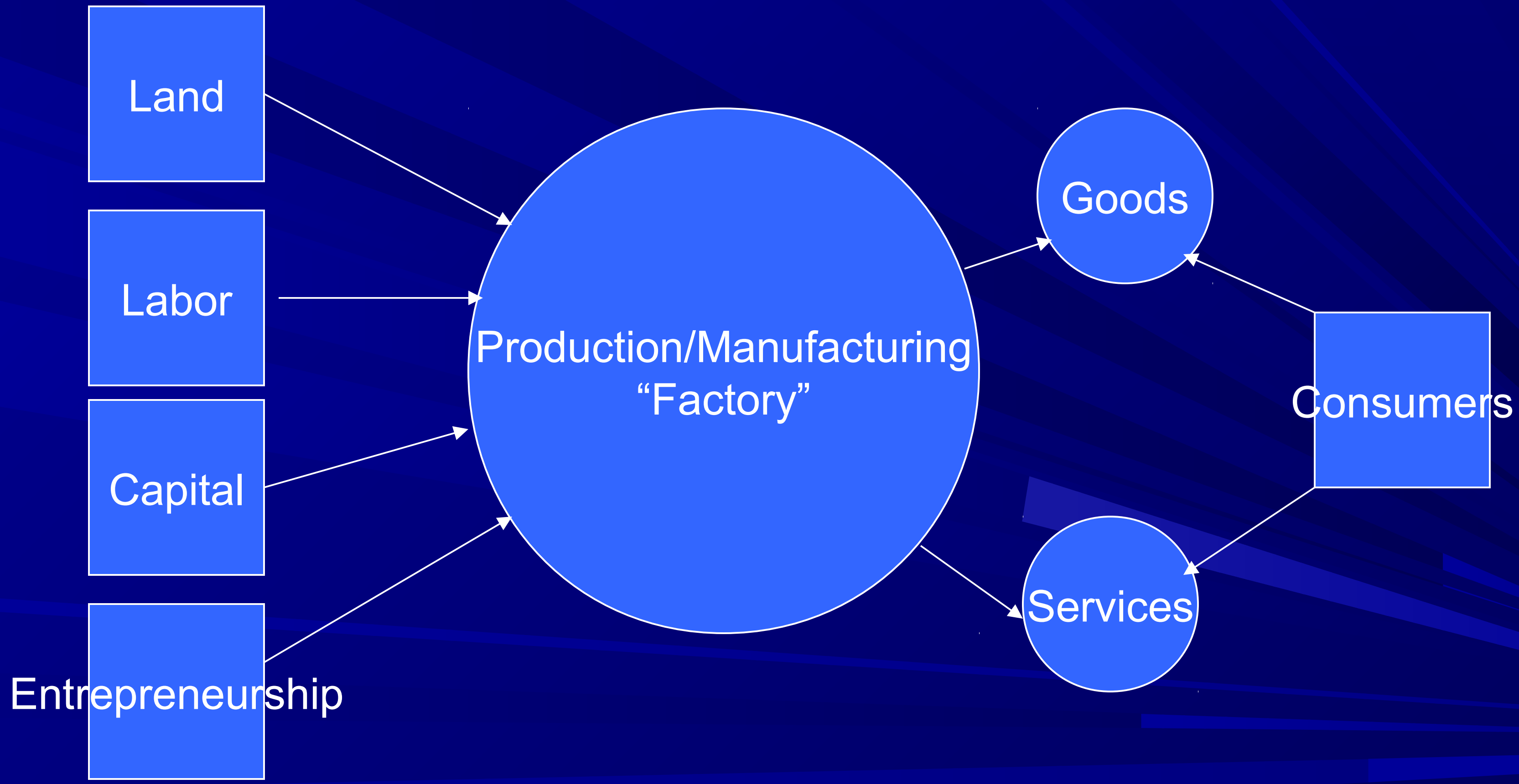
Which Factor of production?

THREE parts to the Production Process

- Factors of Production – what we need to make goods and services
- Producer – company that makes goods and/or delivers services
- Consumer – people who buy goods and services (formerly known as “stuff”)

Which Came First?

Production Process



Capital Goods and Consumer Goods

- Capital Goods: are used to make other goods

- Consumer Goods: final products that are purchased directly by the consumer

CHANGES IN PRODUCTION

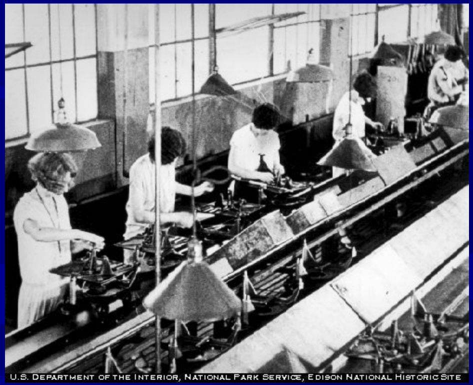
- Specialization – dividing up production so that Goods are produced efficiently

Hardee's makes hamburgers, not shoes!!

Nike makes shoes, not hamburgers

CHANGES IN PRODUCTION

- Division of Labor – different people perform different jobs to achieve greater efficiency (assembly line).



CHANGES IN PRODUCTION

- <u>Consumption</u> – how much we buy (Consumer Sovereignty)

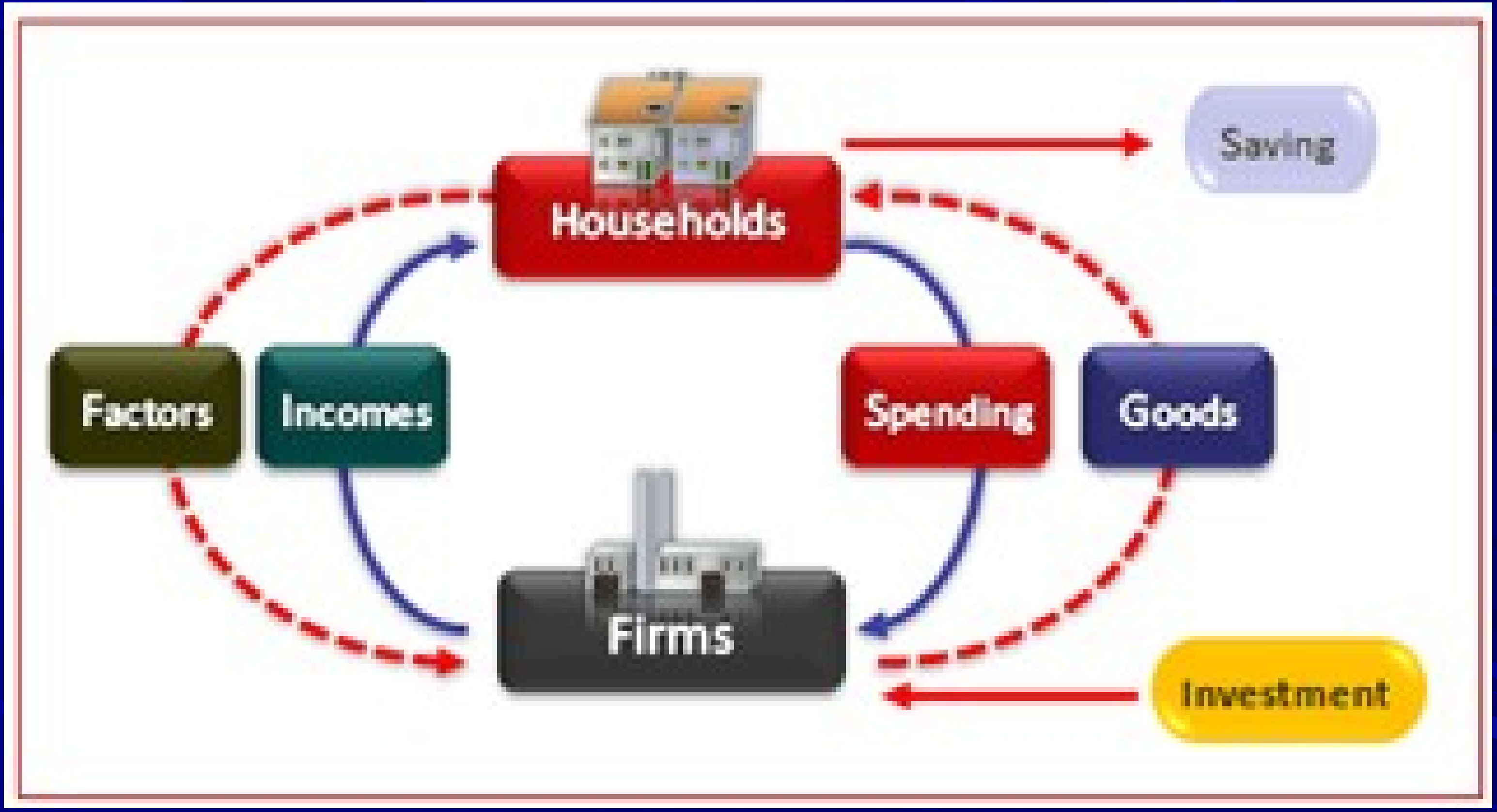
The DELL store is empty because….

Everyone is at the APPLE STORE!!!

CHANGES IN PRODUCTION

- If we INCREASE land, labor, capital we INCREASE production
  - Many entrepreneurs invest profit back into production
- If we DECREASE land, labor, capital we DECREASE production
- BUT WHY would we ever DECREASE production?

The Circular Flow Model



PRODUCTION, cont. again

- A measure of the production of an entire country in one year is

GDP

The total peso value of ALL final Goods and Services

produced in a country in a year.

(GROSS DOMESTIC PRODUCT)

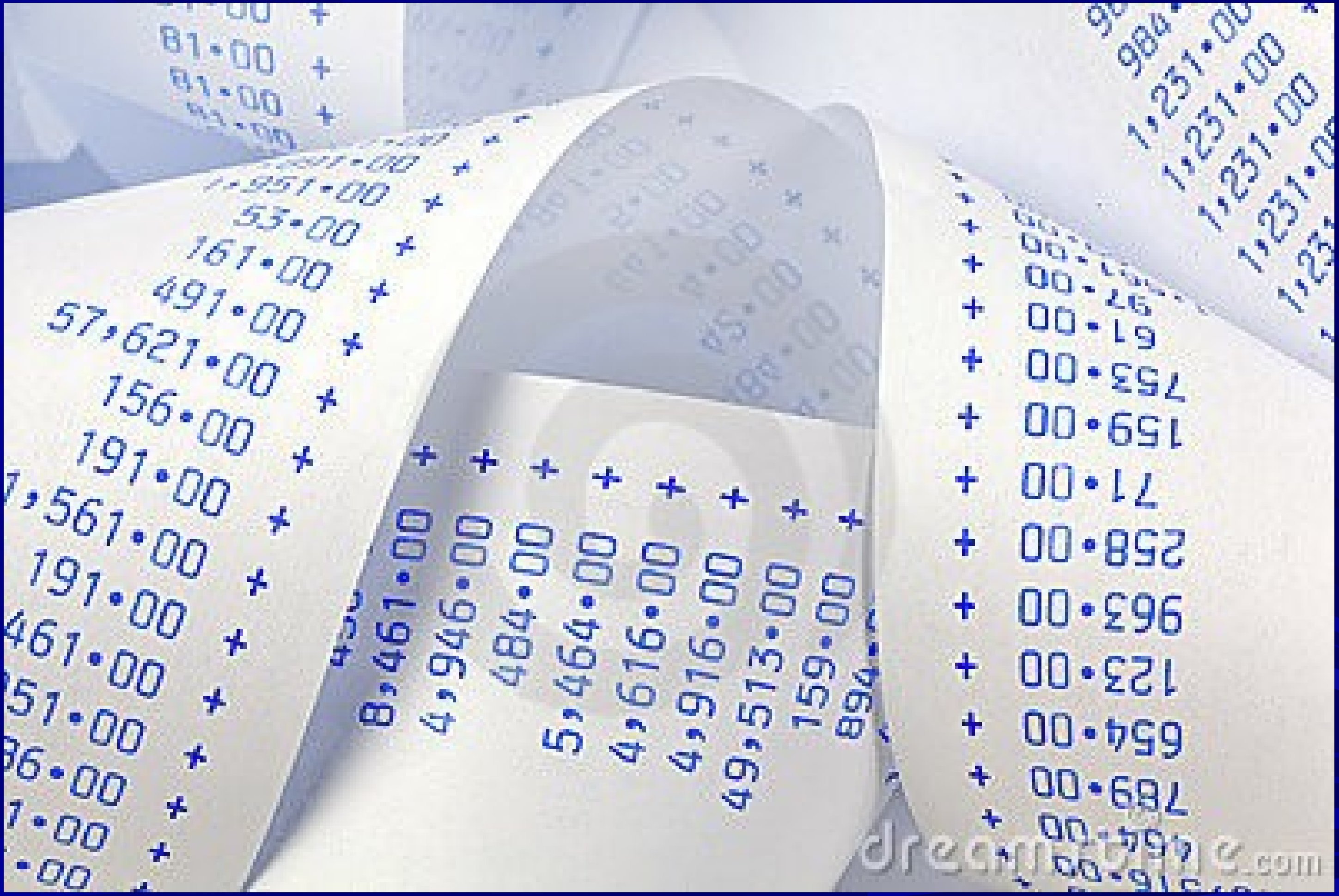
World GDP

- **Total GDP 2005**

(millions of US dollars)

- 1 United States 12,455,068
- 2 Japan 4,505,912
- 3 Germany 2,781,900
- 4 China 2,228,862
- 5 United Kingdom 2,192,553
- 6 France 2,110,185 a
- 7 Italy 1,723,044
- 8 Spain 1,123,691
- 9 Canada 1,115,192
- 10 Brazil 794,098
- 11 Korea, Rep. 787,624
- 12 India 785,468
- 13 Mexico 768,438
- 14 Russian Federation 763,720
- 15 Australia 700,672
- 16 Netherlands 594,755
- 17 Switzerland 365,937
- 18 Belgium 364,735
- 19 Turkey 363,300
- 20 Sweden 354,115
- 21 Saudi Arabia 309,778

Part 2: Costs and Revenues



Costs and Revenues

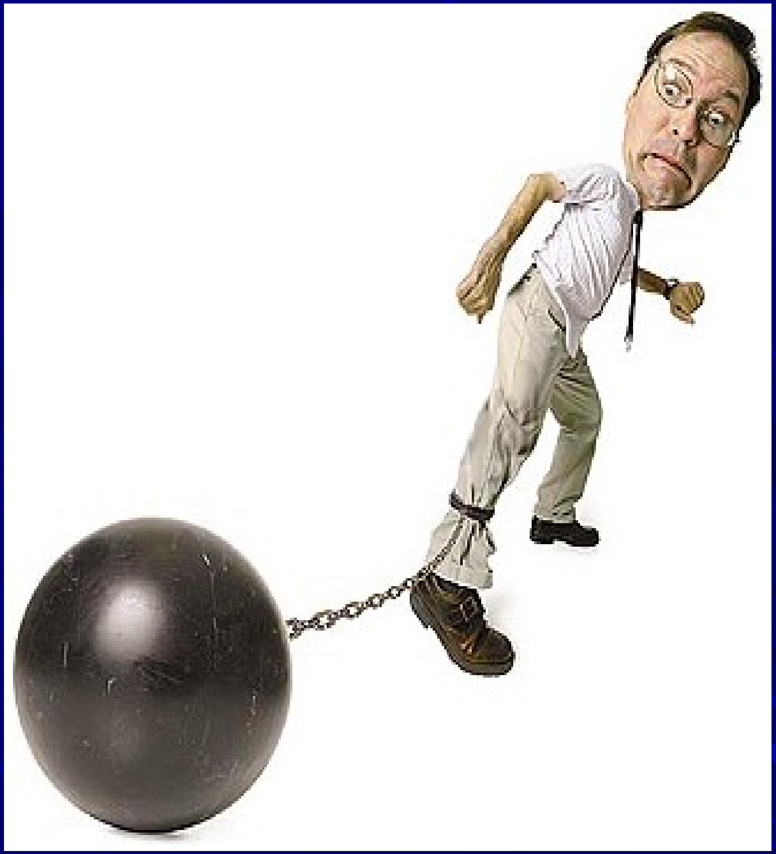
- Cost – the total amount of money it takes to produce an item (to pay for ALL Factors of Production).

Costs and Revenues

- Revenues – the total amount of peso a company or the government takes in.

Costs and Revenues

- <u>Fixed Costs</u> – the amount of money a business MUST pay each month or year (like rent and Capital expenses).



Costs and Revenues

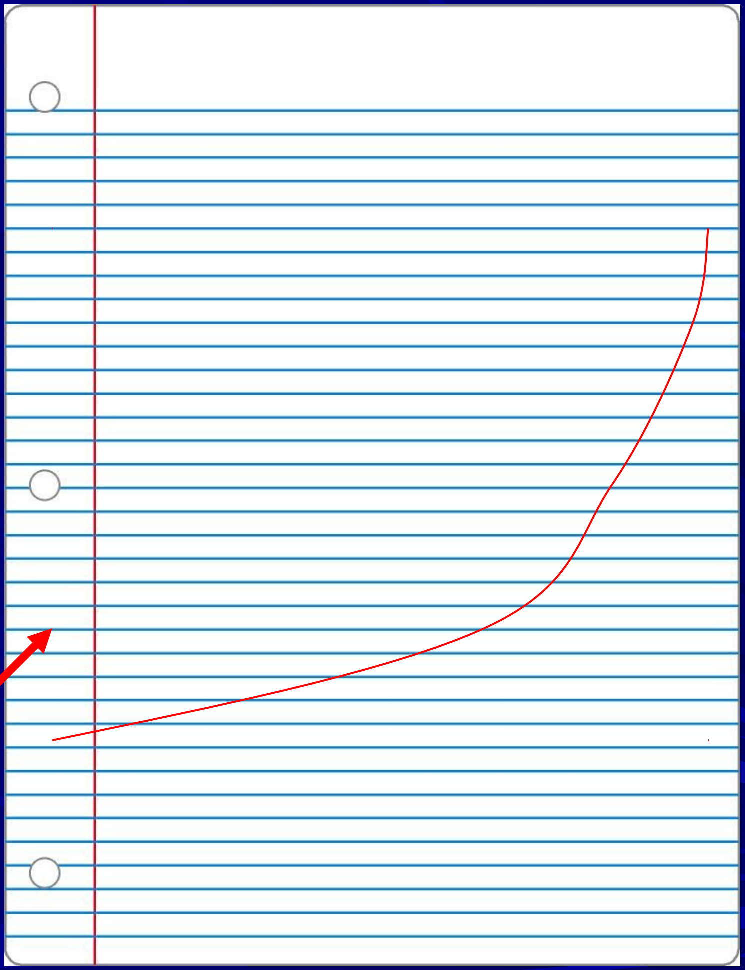
- Variable Costs – the amount of money a business pays that changes over time (Labor and Raw Materials).

Costs and Revenues

- <u>Total Costs</u> = Fixed + Variable Costs.

Costs and Revenues - Chart

- <u>Marginal Costs</u> – the additional Cost of the NEXT UNIT produced.



Margin=Extra Space

Costs and Revenues

- Profit – the difference between Total Costs and Revenues. This is WHY you're in BUSINESS (Profit Motive!)
  - Profit=Revenues-Total cost
  - Profit Motive=why you are in business---to make MONEY
    - (principles of Capitalism)

Costs and Revenues

- Cost Benefit Analysis – weighing the Marginal Costs vs. the Marginal Benefits of producing an item or making any economic decision. If the Benefit is GREATER than the Cost, then business does it.

Cost-Benefit Analysis

- Immediate or short term satisfaction can lead to missing the long-term benefits.#7

For Example

- Immediate spending on cheap stuff instead of long-term savings will lead to lower economic prosperity.

Part 3: Comparative Economics

Traditional Economies

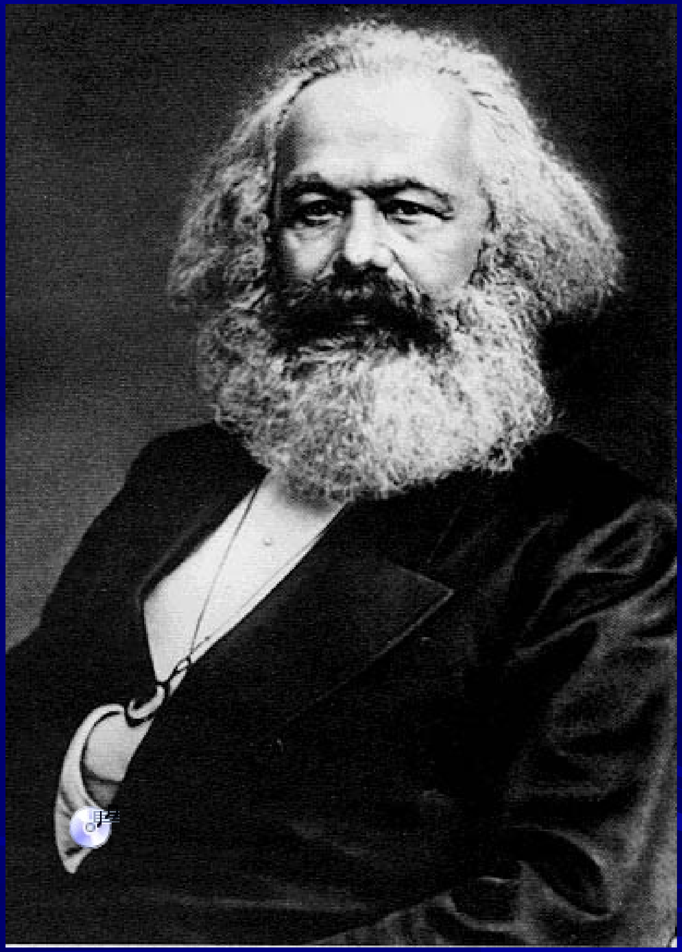
- Def: Economic Questions answered by custom
- Predominately Agricultural
- Developing or “3rd World”
- Trade and barter oriented
- Low GDP & PCI (per capita income = avg. inc.)

Command Economies

- Def: Economic questions answered by the government
- Very little economic choice
- No private ownership
- Communism
- Old Soviet Union, old Communist China, Cuba and North Korea

Karl Marx

- 19th century German economist
- Author of “Communist Manifesto” and “ Das Kapital”
  - Government should control economy and distribute goods and services to the people
- Founder of revolutionary socialism and communism



Communism Falls

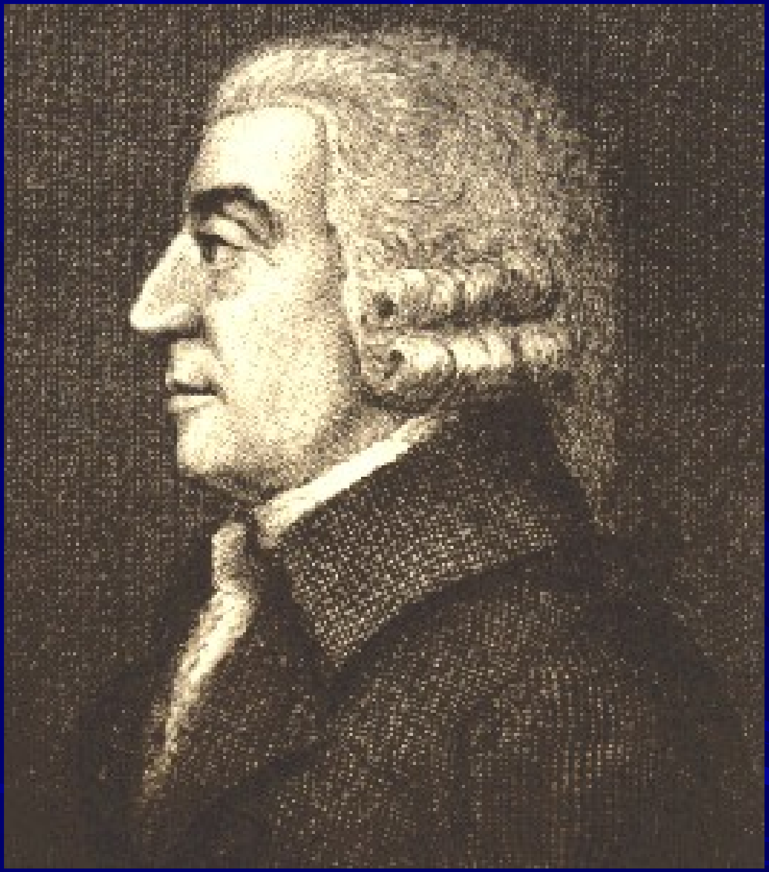
- Market reforms in China in the mid 1970s.
- Fall of the Berlin Wall in 1989.
- Collapse of the Soviet Union 1991.
- Free Market Capitalism (w/ some Mixed Economies) the only show in town.

Free Market (Capitalist) Economies

- Economic questions answered by producers and consumers
- Limited government involvement
- Private property rights
- Wide variety of choices and products
- U.S., Japan

Adam Smith

- 18th century Scottish economist
- Published “The Wealth of Nations” in 1776
- Explained the workings of the free market within capitalist economies
- Invisible hand of the market



Adam Smith (cont.)

- Laissez-faire - Government stays out of business practices “hands off” to let the market place determine production, consumption and distribution.

- Individual freedom and choice emphasized.

Principles of Capitalism

- Competition – more businesses means lower prices and higher quality products for consumers (US!) to buy.

Principles of Capitalism

- Voluntary Exchange – businesses and consumers MUST be free to buy or sell what and when they want.

Principles of Capitalism

Private Property – Individuals and businesses MUST be able to get the benefits of owning their OWN property. Government doesn't control it.

Principles of Capitalism

- Consumer Sovereignty – consumers get to make free choices about what to buy and this helps drive production (Demand drives Supply).

Principles of Capitalism

- Profit Motive – people want to make or save $$$$. Their “Self Interest” motivates Capitalism.

Principles of Capitalism

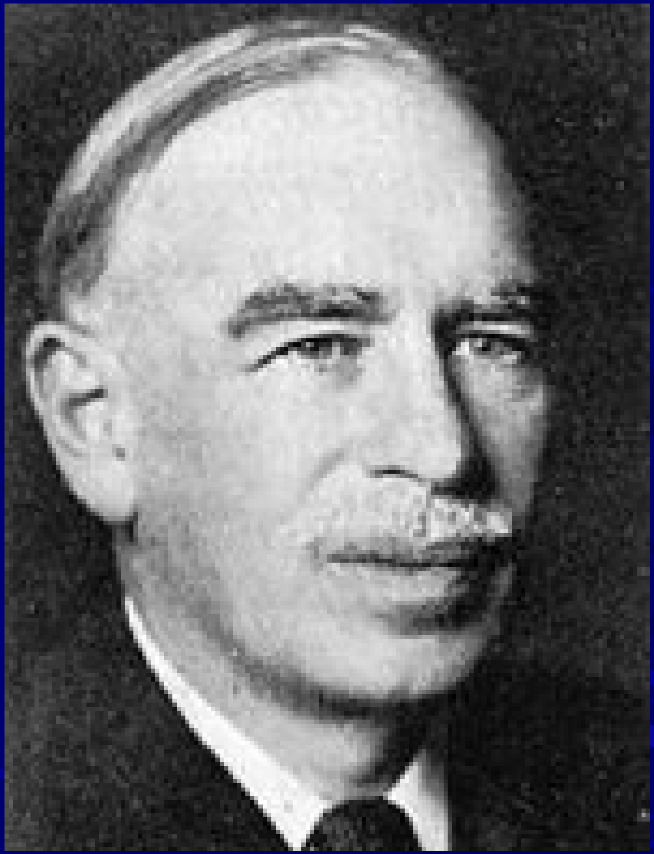
- Social Safety Net – "Mixed Economy" idea that says the government should NOT allow people to suffer in economic crisis (natural part of Capitalism's "Business Cycle"), but provide security instead – Social Security, Unemployment Insurance, etc.

Mixed Economy/Socialism

- Government involvement and ownership and control of property, of decision making, and companies.
- Government control of business
- Social “safety net” for people
- Socialism
- Common in Europe, Latin America, and Africa

John Maynard Keynes

- The Invisible Hand doesn't always work.
- "The long run is a misleading guide to current affairs. In the long run we are all dead." or . . . the trouble is people eat in the short run.



Keynesian Economics (cont.)

- Government should <u>intervene</u> in economic emergencies through tax and spending (Fiscal Policy) and changing the money supply (Monetary Policy).
- This is done to smooth out the business cycle (expansion and recession) and keep <u>inflation</u> low.

Part 4: Labor Issues

LABOR

- Wages – what companies pay employees for their labor (usually based upon an hourly rate).
- Blue Collar
- Manufacturing, work with hands
- Usually the ‘labor’ in production

- Salary – the amount of pay a person gets over a year (especially for “professional” jobs).
- White Collar
- ‘Office’ jobs
- Usually control production

When Production Decreases

- Downsizing – laying off employees to save costs.
- Outsourcing – sending jobs and manufacturing overseas or contracting to outside companies to save money.
- Bankruptcy – government allows business to restructure it's debt, but now all profits go to paying off debt rather than to the owners/investors.
- Out of Business – lose all your business, money, and profits.
- The current trend in the U.S. is that manufacturing jobs are declining

How does 'Labor' protect itself?

- Labor Unions: organization of workers who have banded together to achieve common goals
  - Wage protection
  - Workplace safety
  - Benefits
  - Job protection

Collective Bargaining and Strikes

- Collective Bargaining
  - Representatives of the Union and the company negotiate a contract for the workers; usually they rely on compromise
- Strikes
  - When an agreement can't be reached, workers stop working to try to force the hand of the company