Unit 1 Notes

Incentives

- Economics has been defined as the study of how people respond to incentives.
- An incentive is a factor that motivates someone to behave in a certain way.

Incentives

- Positive incentives make people better off.
  - The more cars a salesman sells, the more he gets paid.
- Negative incentives make people worse off.
  - If you get caught speeding, you will have to pay a fine.
- Incentives can have unintended consequences.
  - A tariff on cars imported from Japan might hurt our farmers.
    - The tariff is intended to make American cars cheaper, helping Ford and GM.
    - However, Japan might retaliate by putting a tariff on food imported from the U.S., hurting our farmers.

Incentives - Assignment

In groups of three or four students, identify a problem at school. Develop a plan that uses financial incentives to solve that problem. Your plan can use positive incentives, negative incentives, or both. List any unintended consequences that might result from your solution.

Factors of Production

- Land
- Labor
- Capital
- Entrepreneurship

Land

- Natural Resources present without human intervention
- Land and water
- Animals
- Trees and Plants
- Oil, minerals, etc.

Labor

- The "human resource"
- Anyone who works to provide goods and services

Capital

- Manufactured goods used to make other goods and services
- For example:
  - A car is a capital good of a taxi company
  - A car is not a capital good of Ford

Entrepreneurship

- The ability of individuals to:
  - Start new businesses
  - Develop new products
  - Improve management techniques

Scarcity

- People do not have enough resources to satisfy their every want.
- Scarcity forces people to make economic choices.
  - "How can I use my resources to obtain the wants/needs that are most important to me?"

Trade-offs

- Anything you give up to do or get something else.
- Scarcity of resources force all of us to make economic decisions (trade-offs).

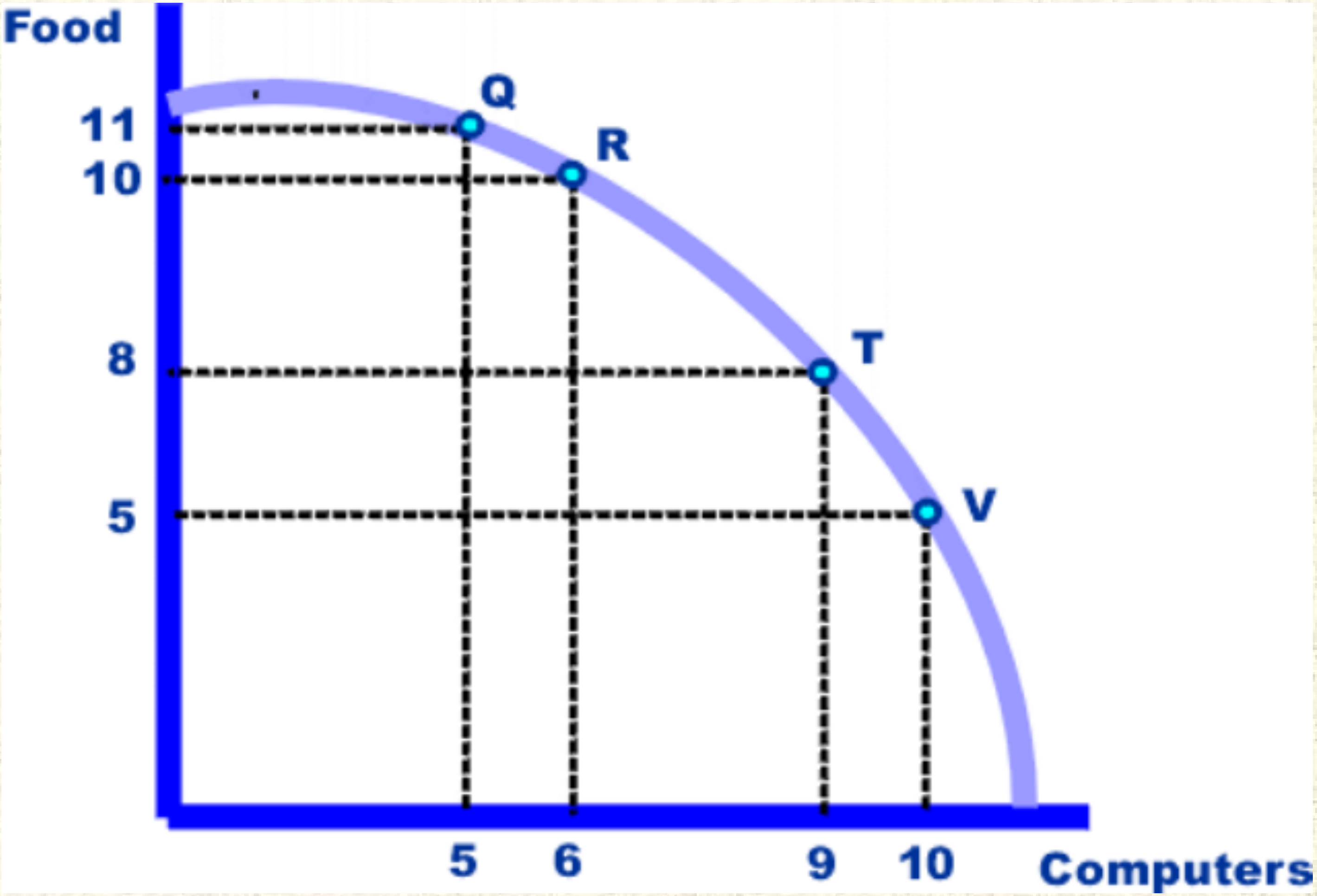
Opportunity Cost

- The value of the **next best alternative** that has to be given up when an economic decision is made.
- Note: It is not *everything* you give up when you make a decision, it is just the value of the next best alternative

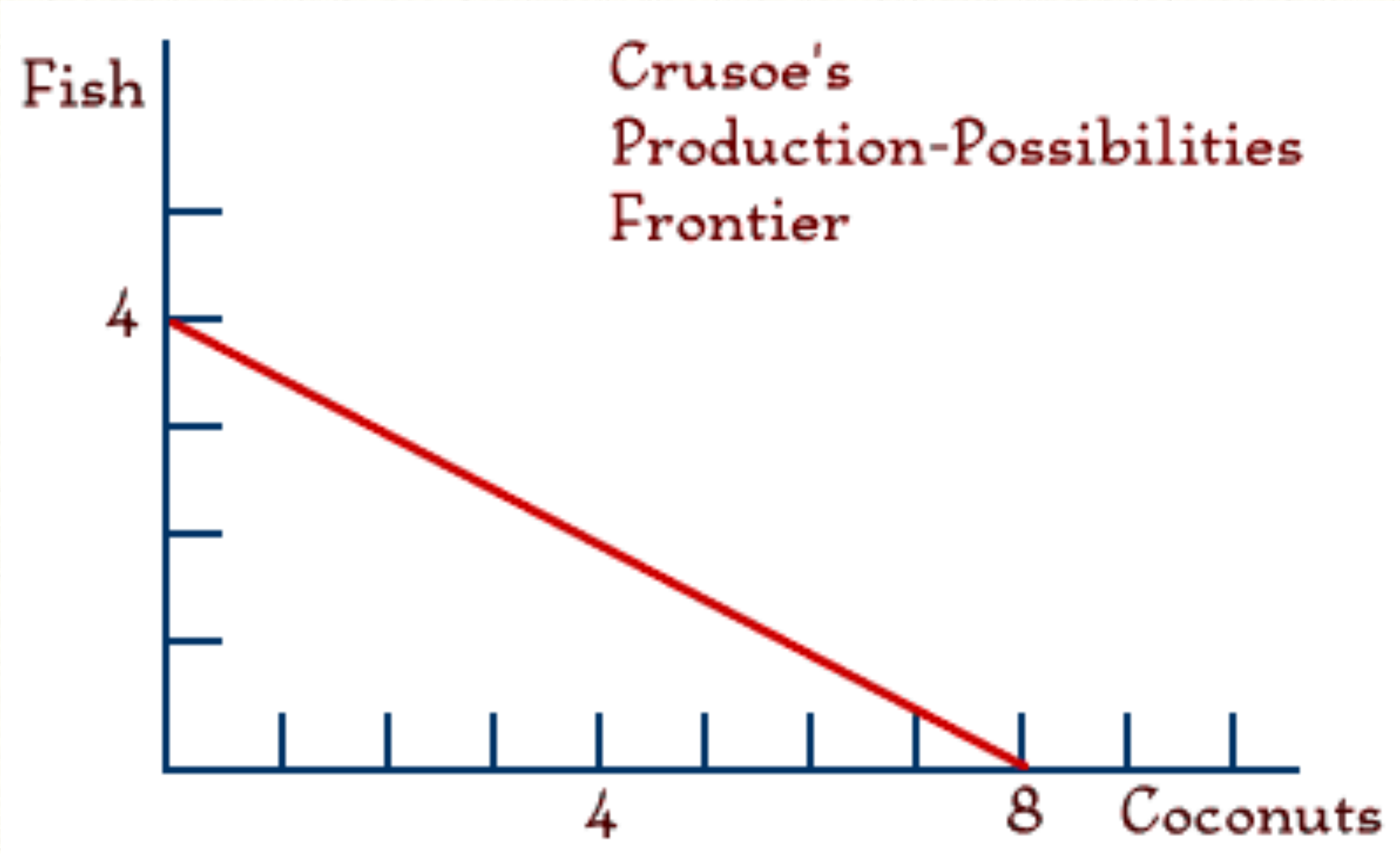
Production Possibilities Curve

- An economic model designed to show all of the different combinations of two goods that can be produced from a fixed set of resources.
- 2 assumptions:
  - Only <u>two</u> types of goods can be made.
  - Amount of resources available is <u>fixed</u>.

Production Possibilities Curve



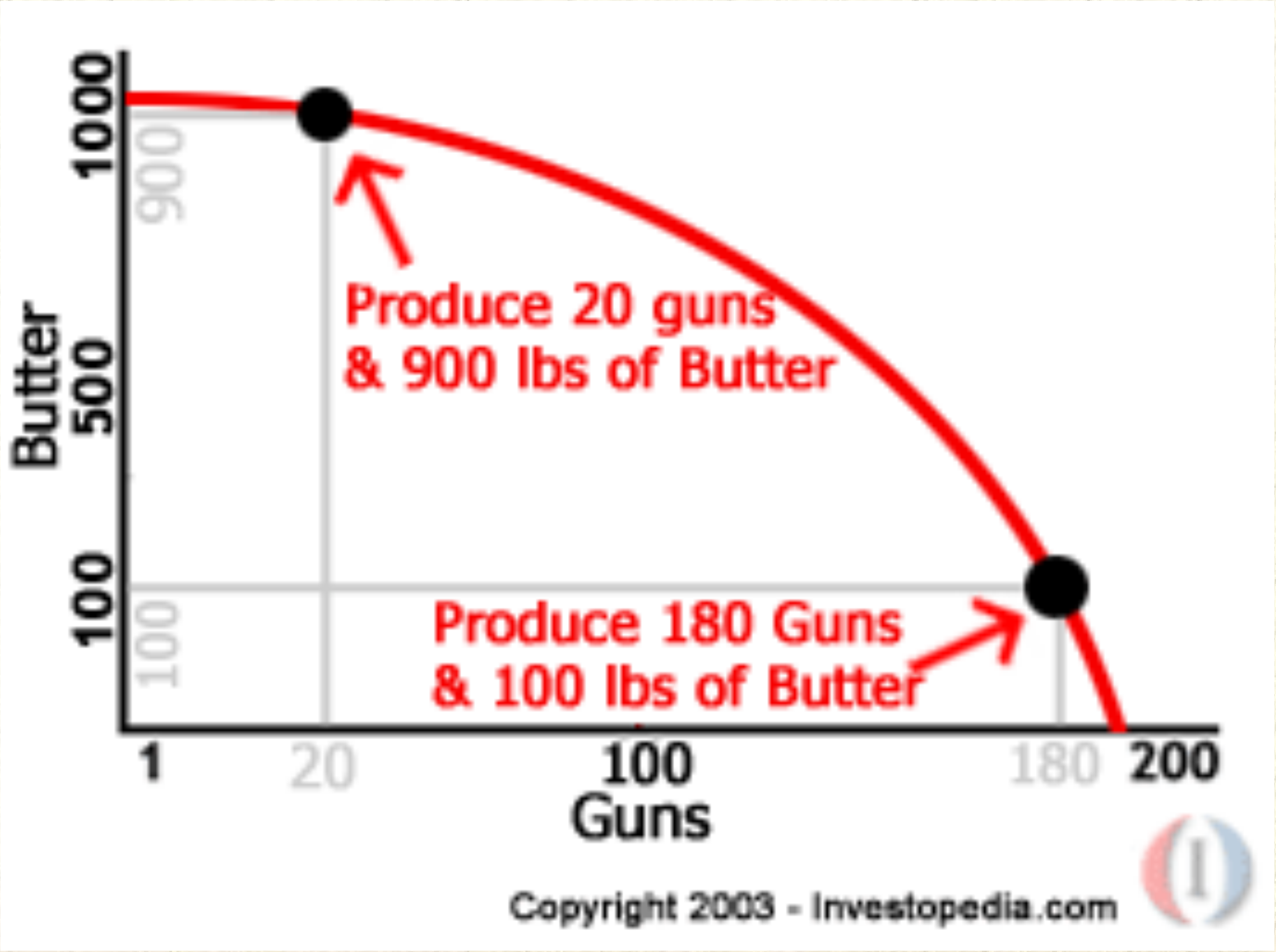
Production Possibilities Curve



Guns vs. Butter

- “The classic example” of a production possibilities curve
- Shows an economic choice every government must make
  - Military spending (guns) vs. civilian spending (butter)

Guns vs. Butter



Three Basic Economic Questions

- What should be produced?
- How should it be produced?
- For whom should it be produced?
- - All economic systems must answer these questions.

Four Types of Economic Systems

- Traditional Economy
- Command Economy
- Market Economy
- Mixed Economy

Traditional Economy

- Things are done the way they have always been done
- Advantage: Expectations are clear
- Disadvantage: Change is discouraged, production is inefficient
- Example: Aborigines of Australia

Command Economy

- Government, not individuals, has control over how economic questions are answered
- Government owns resources and distributes goods and services
- Advantage: Poor are taken care of
- Disadvantage: Lack of worker incentives
- Example: China, North Korea, Cuba

Market Economy

- <u>Market</u>: Exchange of goods and services by buyers and sellers
- Also called capitalism
- Economic decisions made by individuals, not government
- Advantage: Freedoms, wide array of goods to buy, efficient production
- Disadvantage: Weak can get left behind

Mixed Economy

- Combination of a market economy and command economy
- Individuals own factors of production
- Government regulates business to protect individuals
- Example: United States, Western Europe, Australia

Voluntary Exchange

When consumers make purchases, they do so willingly.

- Consumers will only spend money when they value the good or service more than the money it would cost to buy it.

When sellers make sales, they do so willingly.

- Sellers will only sell their product when they value the amount of money more than they value the product.

These actions demonstrate the concept of voluntary exchange.

Broad Goals of Economic Policy

- Freedom
- Efficiency
- Equity
- Security
- Growth
- Price Stability
- Full Employment

Note: These goals are of different importance in capitalist and socialist economic systems

Freedom

- Goal: To allow each member of society to make choices.
  - Spend or save
  - Where to work
- Freedom is valued much more highly in capitalist economies than in socialist economies

Efficiency

- Goal: Allocate scarce resources to produce goods and services people want and need.
- Why? Resources are scarce.
- Capitalist economies have proven to be much more efficient than socialist ones.

Equity

- Goal: Fairness.
- Equity in a capitalist economy means that every citizen has an equal opportunity to better themselves.
  - We have laws to ensure equal pay, fairness in hiring practices, etc.
- Equity in a socialist economy means that the government provides for everyone equally.

Security

- Goal: Protection against risks beyond our control.
- Government provides such security through social programs.
    - Welfare, health insurance, etc.
- Capitalist economies provide less security than socialist ones.

Growth

- Goal: Increase the amount of goods produced over the long term.
- Our population is expanding; the country’s economy must grow to meet the additional wants and needs.

Price Stability

- Goal: Maintain the currency's purchasing power by controlling inflation
- In a capitalist economy, the government can use policy to affect the unemployment rate.
- In a socialist economy, the government has more control over the economy and often sets prices.

Full Employment

- Goal: Maintain an unemployment rate at an acceptable level.
- In a capitalist economy, the government can use policy to affect the unemployment rate.
- In a socialist economy, the government guarantees employment to citizens by providing jobs.

Adam Smith

- Wrote *The Wealth of Nations* - 1776
  - Individuals left on their own will work for their own self-interest, benefiting society as a whole
    - Government's role should be limited
  - "Invisible hand" guides them to use resources efficiently
  - Capitalism/Free Enterprise
    - "laissez faire" - let people do as they choose
    - From 1880s on, the role of government has increased in our economy

Karl Marx

- Wrote *The Communist Manifesto*, 1848
- Viewed history as a struggle between different classes of society
- Said workers (proletariat) would rise up and overthrow business owners (bourgeoisie)
- Communism would emerge in the place of capitalism
  - Communism is an idealized system with no need for government
  - Private property doesn’t exist
    - Says people will share resources with one another based on need

Property

Private Property - Property owned by individuals and businesses.
Examples: House, car, factory

Public Property - Property owned by the government.
Examples: National Park, Library

Communal Property - Property that is not owned by citizens but is used by citizens.

In a capitalist economy, most of the property is private property.

Communal Property

"What is common to many is taken least care of, for all men have greater regard for what is their own than for what they possess in common with others."

—Aristotle

In your notes, restate Aristotle's quote in your own words.

Intellectual Property

Intellectual Property - Intangible property created by an individual, business, or other organization

Example: pharma drug, song lyrics, company logo

In a capitalist economy, intellectual property rights are protected by:

patent: exclusive right to profit from an invention for 20 years

copyright: exclusive right to profit from a creative work for a period of time.