

Unit 1- Introduction

Let's get our brains thinking.... make groups of 4 or 5!

1. Why are newspapers, but not soft drinks, sold in vending machines that allow customers to take more units than they paid for?

2. Why does a 10% increase in the price of insulin have a different change in demand compared to a 10% increase in the price of apples?

3. We have recently been through a global economic crisis (2008-2009). What are some characteristics of this stage of the business cycle?

4. Currently the Canadian dollar sits around 20% lower than the U.S. dollar. Is this a good thing or a bad thing?

Scarcity

Scarcity occurs because people want many things, but resources available for producing the things that people want are limited.

When faced with scarcity, people and societies must make choices. People decide how a resource should be used and/or who should get something that is available.

- Water- drink, transportation, electricity, bathing
- Trees- building, paper, heating, cooking, tools, oxygen
- tax\$- health care, insurance, schools, snow removal, police

Definitions of Economics



“Economics is the study of human activity involved in using scarce resources to satisfy wants.” (Theoton)

“A social science concerned chiefly with description and analysis of the production, distribution, and consumption of goods and services.” (Webster’s Dictionary)

"Economics is the study of people in the ordinary business of life." (Alfred Marshall)

"Economics is the science which studies human behavior as a relationship between given ends and scarce means which have alternative uses." (Lionel Robbins)

Economics is the "study of how societies use scarce resources to produce valuable commodities and distribute them among different people." (Paul A. Samuelson)

Economics is the study of how individual and societies choose to use the scarce resources that nature and previous generations have passed to them. (Econ Guru)

Factors of Production

The productive resources that are available to an economy, categorized as land, labor, capital and enterprise.

- Land is defined as anything natural, such as fertile soil, deep harbors, good climate or minerals in the ground.
- Labor refers to a broad spectrum of human effort, ranging from that of a skilled surgeon to that of a construction laborer.
- Capital is made up of tools, equipment, factories and buildings used in the production process.
- Enterprise is that very special talent that is able to put abstract ideas into practical application, Ex: CEO

Each of the factors of production receives different forms of payment.

- **Wages** are the payments made and the income received for the use of labor
- **Interest** is the payment made and the income received for the use of capital
- **Rent** is the payment made and the income received for the use of land
- **Profit** is the income received from the activity of enterprise

Goods and Services are produced when a variety of resources are combined together in a specific way. Since goods and services are combinations of scarce resources, they themselves are scarce.

Reading- Economic Problem

-Answer questions at end of reading

Microeconomics: is the study of the choices that individuals and businesses make, the way these choices interact in markets, and the influence of governments

Macroeconomics: is the study of the performance of the national economy and global economy.

Micro	Macro
A family's decisions on how much income to save for retirement	Government's decision to raise corporate taxes
Firm's decision to hire more workers	Evening news states the minimum wage will rise 2%

Three Fundamental Questions of Economics

Economics is about what gets produced, how it is produced and who gets it.

1. What to Produce?

Any society has only a fixed amount of resources at its disposal, and therefore must have a system in place to make millions of decisions about production. For example, should the 50 new military helicopters be produced, or should the limited resources available be used to produce 10 new hospitals? Should we continue to exploit natural resources to allow for growth and jobs or should we conserve the resources for the future? Economics does not have the right answers however, it gives us the tools to identify and measure both the benefits and costs of each of the choices so that informed decisions can be made.

2. How to Produce?

This questions looks at how to produce *what* we have chosen to produce. What is the most appropriate technology to use? In this case technology means the best combination of the factors of production (labor, capital, land etc.). For example a highway could be constructed using an extremely labor intensive method and very little capital. On the other extreme a very capital intensive method could be used and very little labor.

3. For Whom?

How should the total output of a society's economy be shared among its people? Should it involve an equal share for everyone, or should it be based on individual needs? Alternatively, should it be based on the contribution of each member of society?

Efficiency vs. Equity

- Ex.: Handicapped-designated parking spaces in a busy parking lot.

A conflict between:

Equity - making life "fairer" for handicapped people

Efficiency - making sure that all opportunities that make people better off have been fully exploited by never letting parking spaces go unused

How far should some policy-makers go in promoting equity over efficiency?

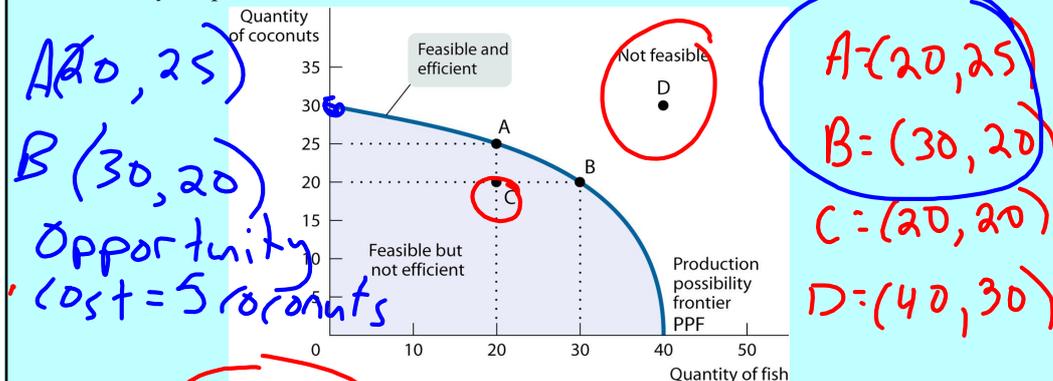
Production Possibilities Curve



The quantities of goods and services that we produce in our economy are limited by:

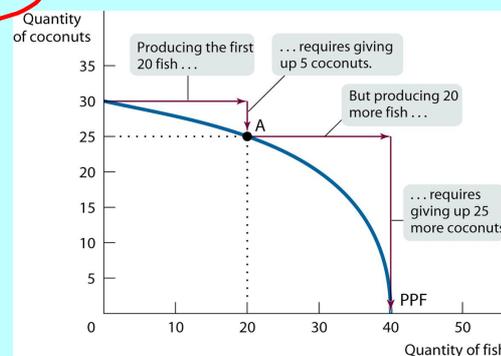
- Our available resources
- Technology

The **Production Possibilities Frontier** illustrates *scarcity* because we cannot attain the points outside the frontier. They are points that describe wants that can't be satisfied.



We achieve *production efficiency* if we cannot produce more of Good A without producing less of Good B. When production is efficient, we are at a point on the PPF. If we are at a point inside the PPF, production is inefficient because we have some unused resources or we have some misallocated resources or both.

If we want to increase the production of one thing, with no new resources or technology, we must decrease the production of something else. We *face tradeoffs!* Tradeoffs arise in every imaginable real world situation. At any given point in time, we have a fixed amount of labor, land, capital and entrepreneurship. By using our available technologies, we can employ these resources to produce goods and services. Every choice along the PPF involves a tradeoff - we must give up something to get something else. All tradeoffs involve a cost - an opportunity cost.



The opportunity cost of an action is the highest valued alternative forgone. Along the PPF, there are only 2 goods, so there is only one alternative forgone: some quantity of the other good. In our example of fish and coconuts, the opportunity cost of producing additional fish is the number of coconuts we must forgo.

Examples:

- The opportunity cost of going to school
- The opportunity cost of buying a cup of coffee at Tim Horton's
- The opportunity cost of going to the movies
- The opportunity cost of the government spending tax dollars on education

Opportunity Cost

The value of the next best alternative. For example, the opportunity cost of studying on Friday night might be missing your high school team's football game.

Question:

Why did LeBron James chose not to attend college and play college basketball?

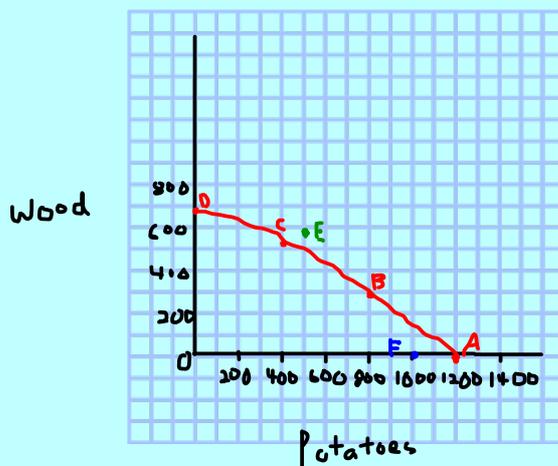
Answer:

An economist would answer this question by stating that the opportunity cost of college (making millions in the NBA) was too high for James.

Sample Problem:

Gallacher Island produces potatoes and wood. The following table shows different combinations of potatoes and wood.

Maximum annual output options	Potatoes (pounds)	Wood (logs)
A	1,200	0
B	800	300
C	400	550
D	0	700



Are each of the following production combinations feasible but inefficient or not feasible?

- E. 500 pounds of potatoes, 600 wood logs Not feasible
- F. 1,000 pounds of potatoes, 10 wood logs Feasible but inefficient

What is the opportunity cost of producing:

- G. 550 wood logs to zero wood logs?
 $(400, 550)$ $(1200, 0)$ The opportunity cost is 550 wood logs, but we gain 800 potatoes

- H. 800 pounds of potatoes to 400 potatoes?
 $(800, 300)$ $(400, 550)$ The opportunity cost is 400 potatoes, but we gain 150 wood logs

What is the opportunity cost of producing:

- I. 550 wood logs instead of zero wood logs?
 $(1200, 0)$ $(400, 550)$ The opportunity cost is 800 potatoes, but we gain 550 wood logs

- J. 800 pounds of potatoes instead of 400 potatoes?
 $(400, 550)$ $(800, 300)$ The opportunity cost is 250 logs, but we gain 400 wood logs

Why is the PPF not a constant slope?

Opportunity cost grows! We need to give up more one good to produce the other. It's not a constant trade off.

	Computers	Cars
A	50	0
B	45	2
C	35	4
D	20	6
E	0	8

1. What is the opportunity cost of computers in terms of cars when the economy goes from point A to B?

2. What is the opportunity cost of cars to computers from point E to C?

Worksheet:

Problems and exercises

Hong Kong reading

- Quiz Thursday
 - Definitions
 - PPF, opportunity cost

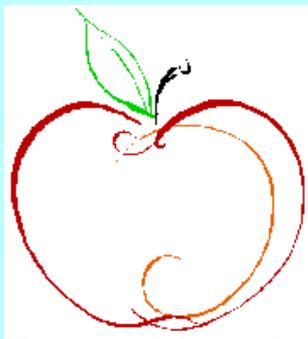
How do we get to a point outside the production possibilities frontier?

We said that the quantity of goods and service that we can produce depend on our resources as well as our technological capabilities. Therefore, in order to push the PPF outwards we must see technological change and/or capital/labor/entrepreneurial accumulation.

Technological change and resource accumulation allow the PPF to expand. By how much and in what direction depends on where the new technology and resources is used.

Where does the technological change and resource accumulation come from? The answer to this question is that to have growth tomorrow we must lower production today. This is the opportunity cost of economic growth. We must give up some production today so that new technology can be invented, new machines can be made and humans can become more educated. In the field of economics this concept is explained by the statement “ There is no free lunch”. A free lunch is never free, because the provision of any meal involves the use of resources which could have been put to some other use. Also, the expansion of the PPF curve is not a cure for scarcity and tradeoff. These still exist on the new PPF.

There is no such thing as a free lunch



"There is no such thing as a free lunch" because we have to continually choose among goods and services, given that we cannot have all those we want. We are giving up one thing upon choosing another. Sometimes certain goods are mistakenly thought of as free in that they involve no apparent cost to access. Imagine that you receive free subscription cards falling out of magazines, and you get an additional season of copies. Producing the cards and offering the free copies, however, absorbs scarce resources that are drawn away from competing uses (unnecessary trees torn down).

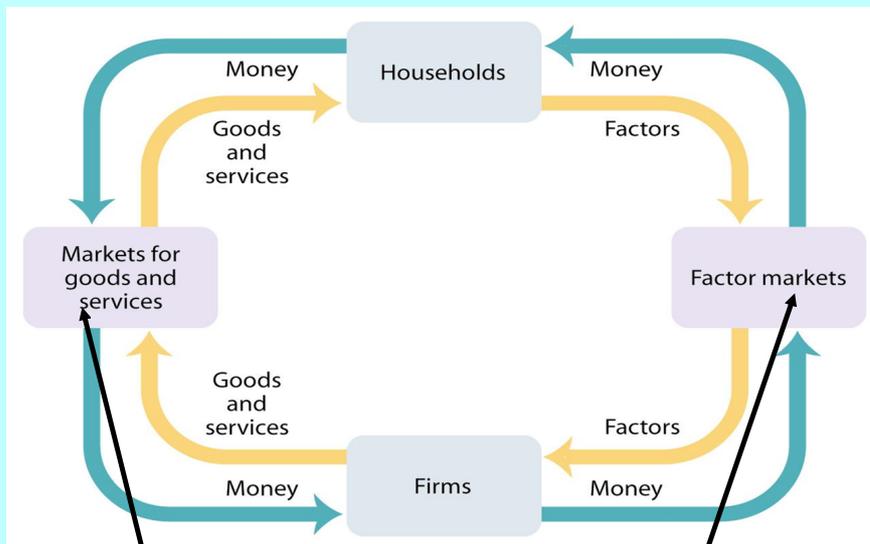
A Morning with Mr. Peabody

Unit Assessment on
Wednesday, February 21

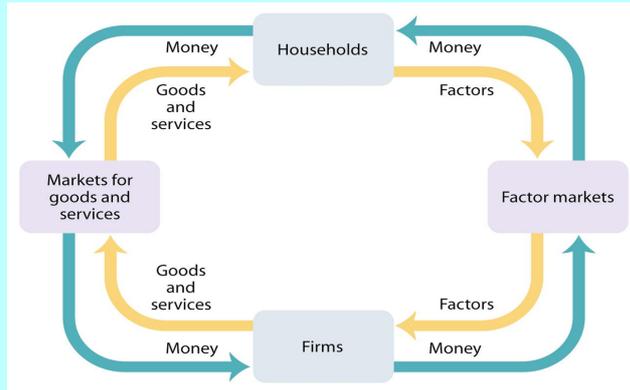
Circular Flow Diagram

The economy consists of millions of people engaged in many activities - buying, selling, working, hiring, manufacturing and so on. The circular flow diagram is a model that explains, in general terms, how the economy is organized.

- Two types of decision makers - households and firms
 - Firms produce goods and services using various inputs, such as labor, land, capital (buildings and machines), and enterprise. These inputs are called the factors of production or resources. Households own the factors of production and consume all the goods and services that firms produce.
- Households and firms interact in two types of markets
 - In the markets for goods and services, households are the buyers and firms are the sellers. In the market for factors of production, households are the sellers and firms are the buyers.



In the model, firms and households interact with one another in both the product market (market for goods and services) and the factors of production market (or factors market). The **product market**, as mentioned in the name, is where all products made by businesses/firms are exchanged. The **factors of production market** is where inputs such as land, labor, capital, and other resources are exchanged. Households earn money by selling their “resources” (most often labor) to businesses in the factor market. In return, households receive income. The price of the resources the businesses purchase (labor from households) are the “costs.” From the resources provided by households, businesses produce goods, which are then sold in the product market. Households use their incomes to purchase these goods in the product market. In return for the goods, businesses bring in revenue.



A. Using the circular flow diagram place the statements below in the appropriate columns.

- Buy and consume goods and services
- Hire and use factors of production
- Own and sell factors of production
- Produce and sell goods and services

Households	Firms

B. How would you classify each statement's role in the circular flow diagram?

1. You are graduating from high school and recently purchased a BHS grad ring from a local jewelry store.

2. You recently inherited a building that you intend to convert into an apartment building where you will have 4 tenants paying rent.

In-Class Assignment

Chapter 2 Lecture.ppt