

TRADITIONAL INTRO TO ECONOMICS

Economics is a way of thinking

-it is always concerned with alternatives and how the “pieces” fit together

economics: the study of the allocation of *scarce* resources among competing uses

scarcity: there is never enough of a good to satisfy both the needs and wants of society for it

-*relative scarcity exists*

-*competing uses exist for goods so alternatives exist*
(to use something one way is *not* to use it for something else)

opportunity cost: the cost of something is what you have to give up to get it, or the value of something in its *next best* use

-cost can exist *even if* no money changes hands

COST: can be either explicit or implicit

explicit cost: when money is directly involved

implicit cost: the cost of an owned resource (such as your own time) - no money changes hands

price - is an *explicit* cost

-it is not necessarily to total cost of something

some goods have a low explicit cost and a high implicit cost

ex: IBM - compatible computers

-inexpensive to buy (explicit cost) but take much time to learn how to use (large implicit cost)

-by not taking implicit cost into account in the early 1980s, many companies made bad decisions as the “payback” from the computer investments was less than anticipated

others have low implicit cost and high explicit cost

ex: Macintosh computers

-easy to learn (implicit cost) but expensive to buy

true cost of a good = explicit + implicit cost

the actual cost difference between goods is thus smaller than you think

-large discount store prices vs local store prices

-cost of driving to Providence from Kingston

-costs for owner of a small firm

-cost of retained earnings by firms

Economic System:

-refers to the way inputs and production are organized to satisfy the needs *and* wants of society

every economic system has:

Resource endowment: inputs and resources available

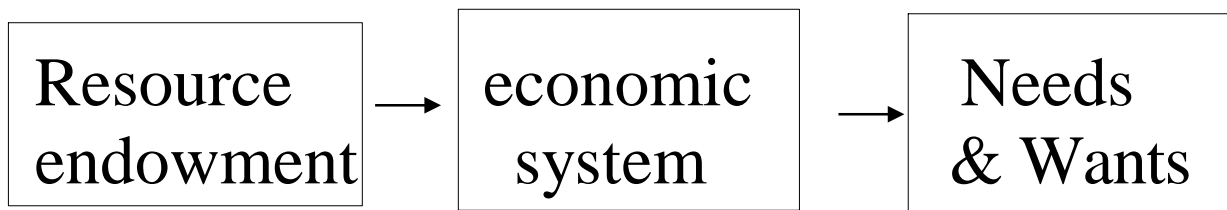
-economies differ in which inputs are abundant

(ex: LDC's - plentiful labor, scarce capital

DC's - plentiful capital, relatively scarce labor)

-this affects input costs and organization of production

Needs and wants of its people



Way to organize production and transform inputs into goods and services for needs and wants of society

INPUTS: FACTORS OF PRODUCTION

-Four input categories

LAND - land and resources on/in land

LABOR

CAPITAL - physical capital (machinery/equip)

ENTREPRENEURSHIP - ownership/management

Any economic system must answer three questions
What to Produce - the specific goods and services and quantities for each of these (as decide what to produce, also decide what *not* to produce)

a *market economy* (like ours) is geared to consumer goods and what can be produced and sold profitably
command economy (like communism) focuses more on collective consumption (public goods) and less on consumer goods

- their long lines generate large implicit costs that offset the low (subsidized) explicit costs
- these “queues” are inefficient - waste productive time
- often they have severe *shortages* of critical goods

How To Produce - deals with the organization of production and “efficiency”

- market economy* - incentive to cut costs and to use less labor (LAYOFFS AND UNEMPLOYMENT)
- seek to produce at lower costs to raise profits
- command economy* - there is no unemployment or use of layoffs to cut costs
- use more labor than is efficient (**redundant labor**)
 - generate less output than firms in market economies

The demise of communism was caused by its inability to feed its populations and to produce enough goods and services

-their move to capitalism and market economies introduced them to unemployment and rising prices

For Whom to Produce - with relative scarcity there is never enough goods to satisfy the needs and wants of society

-**exclusion mechanism** is needed to determine who gets the goods produced (and who does not)

market economy - uses **effective demand** for this
-to get a good, must be willing *and* able to pay the market price (all others excluded)

-ability to pay - real income - critical to this

-price serves as a **rationing device**

- if price is not used, an alternative form of rationing, such as government rationing, is needed

government rationing - the government decides who gets the goods and how much they get

-often results in problems with quantity and quality

Every economic system faces tradeoffs. The most critical of these is:

EQUITY vs EFFICIENCY

- as make the economic system more fair (equitable) often cause it to be less efficient (produce less)

Universal Medical Coverage - excellent example

equity: everyone should have access to medical care

efficiency: this is very expensive - to provide this:

-it is necessary to reduce some of the other goods and services society provides AND

-medical services some now get might be reduced

-there is also a question of the *quality* of medical care

-if doctors are made to earn less per patient, they might “cut corners” and give less quality (ex: less time per patient)

Society must evaluate these tradeoffs

in a *command economy*, there is subsidized medical care and often government rationing which can result in “black markets”