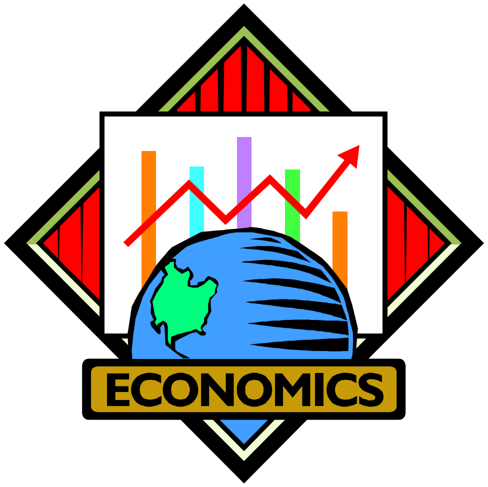
CHAPTER 1

What is Economics?



THE FUNDAMENTAL ECONOMIC PROBLEM

- **Scarcity is the condition where unlimited human wants face limited resources.**
- **Economics is the study of how people satisfy wants with scarce resources.**
- **Needs are required for survival; wants are desired for satisfaction.**
- **Someone has to pay for production costs, so There Is No Such Thing As A Free Lunch (TINSTAAFL).**

THREE BASIC QUESTIONS

- **What must we produce? Society must choose based on its needs.**

- **How should we produce it? Society must choose based on its resources.**
- **For whom should we produce? Society must choose based on its population and other available markets.**

THE FACTORS OF PRODUCTION

- **Factors of production are resources necessary to produce what people want or need.**
- **Land is the society’s limited natural resources-landforms, minerals, vegetation, animal life, and climate.**
- **Capital is the means by which something is produced such as money, tools, equipment, machinery, and factories.**

THE FACTORS OF PRODUCTION (continued)

- **Labor is the workers who apply their efforts, abilities, and skills to production.**
- **Entrepreneurs are risk-takers who combine the land, labor, and capital into new products.**

- **Production is creating goods and services – the result of land, capital, labor, and entrepreneurs.**

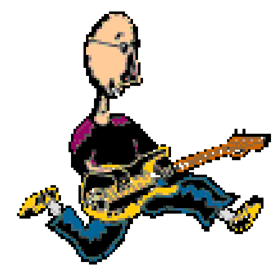
THE SCOPE OF ECONOMICS

- **Economics deals with the description of economic activity – Gross Domestic Product, unemployment rate, government spending, tax rates, etc.**

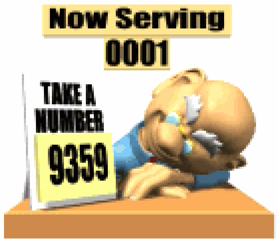
- **Analysis looks at the "why" and "how" of economic activity – why prices go up and down, for example, or how taxes affect savings.**

THE SCOPE OF ECONOMICS (continued)

- **Explanation refers to how economists communicate knowledge of the economy and its activities to the society’s population.**



- **Prediction refers to how yesterday’s and today’s economic activities advise us of potential future activity.**



GOODS, SERVICES, AND CONSUMERS

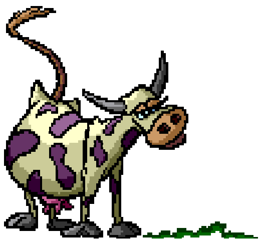
- Goods are items that are economically useful or satisfy an economic want. They are tangible and can be classified as consumer/capital and durable/nondurable.
- Services are work performed for someone and are intangible.
- Consumers use goods and services to satisfy wants and needs.

VALUE, UTILITY, AND WEALTH

- **Value is worth expressed in dollars and cents. Scarcity by itself is not enough to create value. For something to have value, it must also have utility.**
- **Utility is a good's or service's capacity to provide satisfaction, which varies with the needs and wants of each person.**
- **Wealth is the accumulation of goods that are tangible, scarce, useful, and transferable to another person. Wealth does not include services.**

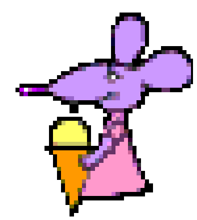
THE CIRCULAR FLOW OF ECONOMIC ACTIVITY

- **Markets are locations/mechanisms for buyers and sellers to trade. They are classified as local, regional, national, global, and cyberspace.**
- **A factor market is where people earn their incomes. Factor markets center on the four factors of production: land, capital, labor, and entrepreneurs.**
- **A product market is where people use their income to buy from producers. Product markets center on goods and services.**



PRODUCTIVITY AND ECONOMIC GROWTH

- **Productivity is a measure of the amount of output produced by the amount of inputs within a certain time. Productivity increases with efficient use of scarce resources.**
- **Specialization and division of labor may improve productivity because they lead to more proficiency (and greater economic interdependence).**



PRODUCTIVITY AND ECONOMIC GROWTH (continued)

- **Investing in human capital improves productivity because when people's skills, abilities, health, and motivation advance, productivity increases.**
- **Economic growth depends on high productivity. Yet, an economy's productivity may be affected by its interdependence – reliance on others and their reliance on us to provide goods and services.**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TRADE-OFFS AND OPPORTUNITY COST

- **Trade-offs are the alternative choices people face in making an economic decision. A decision-making grid lists the advantages and disadvantages of each choice.**
- **Opportunity cost is the cost of the next best alternative among a person's choices. The opportunity cost is the money, time, or resources a person gives up, or sacrifices, to make his final choice.**

PRODUCTION POSSIBILITIES

- **The production possibilities frontier diagram illustrates the concept of opportunity cost. It shows the combinations of goods and/or services that can be produced when all productive resources are used. The line on the graph represents the full potential – the frontier – when the economy employs all of these productive resources.**

PRODUCTION POSSIBILITIES

(continued)

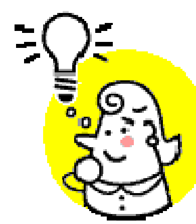
- **Identifying possible alternatives allows an economy to examine how it can best put its limited resources into production.**

- **Considering different ways to fully employ its resources allows an economy to analyze the combination of goods and services that leads to maximum output.**

PRODUCTION POSSIBILITIES (continued)

- **An economy pays a high cost if any of its resources are idle. It cannot produce on its frontier and it will fail to reach its full production potential.**

- **Economic growth made possible by more resources, a larger labor force, or increased productivity causes a new frontier for the economy.**



THINKING LIKE AN ECONOMIST

- **Building simple models helps economists analyze or describe actual economic situations.**
- **Cost-benefit analysis helps economists evaluate alternatives by looking at each choice's cost and benefit.**
- **Taking small, incremental steps in implementing an economic decision helps economists test whether the estimated cost of the decision was correct.**