Unit 1 – Economic Systems

What is Economics?

- Economics is the study of how people choose to use resources. How society organizes the production, consumption and distribution of goods and services**.**

- Why we Study Economics-

- It relates to every aspect of our lives, from the decisions we make as individuals or families to the structures created by governments and firms.

-Who Makes Economic Decisions-

Either as a consumer or producer **INDIVIDUALS** make decisions:

- **Consumers**: those who buy & use Goods/Services
- **Producers**: those who provide Goods/Services

a) Goods: physical objects used:

1) capital goods: equipment used in the production of other goods.

2) consumer goods: the finished products

b) Services: activities a person performs for another that consumers can buy.

-The Study of economics begins with the concept, we can't have everything:

- Need is to survive
- Want is to live in comfort

-Resources is defined as anything used to produce goods or services; manmade, or all natural.

-Factors of Production-

- Factors of production describe the inputs that are used in the production of goods or services:
  - **Land** items provided by nature.
  - **Labor** any paid human time and effort used in production.
  - **Capital** manmade equipment used to produce goods.
  - **Entrepreneurs** use land, labor, and capital to make goods and services**.** The people who assume the risk involved in creating a new product or business.

-Scarcity-

- **Scarcity** – Human wants and needs exceeds limited. **Resources** available. (sooner or later a limit will be reached)
- This forces producers to make decisions of what to make or Allocate (to distribute) and consumers what to buy or use.

- **Tradeoffs**- the decision to sacrifice one thing for another thing (**What to give up**).
- **Opportunity Cost** - the cost/value of what you passed up to obtain something else (**Value of what you sacrifice**) Entrepreneurs have an opportunity cost when they choose to make one product over another.
- **Cost-benefit analysis –** weighing the benefits of an action against its costs: time, money, effort

-Production Possibility Curve-

- A graph used to illustrate the impact of scarcity on an economy by showing the maximum number of goods or services that can be produced using limited resources. It increases a company's efficiency.
- It shows the opportunity costs of each production decision.
- The curve on a PPC represents the border or Frontier. Left of the curve is inefficient because the economy is not using all of its resources to produce the maximum amount of goods. This is called underutilization
- Any point along the PPC border curve itself is efficient because the economy is using all of its resources to produce the maximum amount of goods.
- Right of the curve, the level of production is impossible, its exceeding productive resource capacity. To achieve that point, the economy would have to expand in terms of new resources, new technology, or both.

An **economic system** is the way societies provide goods and services to meet the wants and needs of its citizens.

Economic Systems

- Three Economic Questions -

To address scarcity, societies must answer three questions:

1. **What to Produce-**
   - Societies decide what is most important to satisfy its wants and needs.
   - What resources (land, labor, & capital) are available?
   - What are the opportunity costs of those decisions?
2. **How to Produce it-**
   - How do we use our available resources?
   - Is there a more efficient way to use them?
   - What combinations of land, labor & capital are needed to produce?
3. **For whom to Produce-**
   - What is the market for it?
   - Who will use the product?
   - Who has the greatest need?
   - Who can afford the products?

-Economic Systems-

- The answers to these questions shape the economic system a society has. There are 4 types of systems that production in different ways….

1) Traditional Economy

- Economic system in which families, clans, or tribes make economic decisions based of habit, custom, and ritual.
- Relatively small communities , Strong families & religious beliefs
- Generally agricultural economies
- Low standard of living and Little room for innovation
- Most often no money used, Goods and services are bartered, or traded.

2) Command Economy

- Relies on government or central planning committee to make economic decisions
- Individuals have little or no say in economic planning and freedom of choice.
- The government has control or owns resources.
- **Concentration of Production**: can focus all of their production on one particular industry as necessary.

➢ **Socialism -**Not a pure Command System.

- A system in which the gov't owns basic resources; the rest are privately owned.
- The government owns the basic industries, but other industries are privately owned.
- Central Planners{members of the central gov't} make decisions for government-owned industries.
- Socialism can exist in a democracy

  Ex: Canada, and Sweden

➢ **Communism** - A Pure Command and a more extreme form of socialism.

- There is no private ownership of property and little or no political freedom.
- All economic and political decisions are made by the Government
- It requires absolute obedience to authority.
- It prevents individuals from making profits, which is against the Communist principle that wealth should be shared

  Ex: Cuba, North Korea, former Soviet Union and China

-Karl Marx-

- Karl Marx (1818-1883) had said that industrialisation had made the middle classes rich and powerful but had made the workers slaves.
- 1848 - Wrote the book "Communist Manifesto", Introducing his form of socialism called Communism
- Russia will be one of the first to adopt Marx's ideals.

Market Economy

3) <u>Market Economy</u>

- A market system allows people to buy the goods they want and producers to make the goods they feel people will buy.
- Promotes free-enterprise or capitalism
- Capitalism - name often given to describe this freedom to buy and sell goods of one's choice and the right to own private property.
- Individuals answer economic questions.
- Individuals & businesses use the market to exchange goods & money.
- Individuals & private businesses own & control resources.

-<u>The Circular Flow Model</u> -

- The circular flow model shows the movement of resources and money through the economy.
- The model represents the two key economic decision makers —households, which are made up of individuals like you, and businesses
- Industries are a number of firms that do the same thing
- Specialization leads to economic efficiency
- Encourages more innovative & higher technology
- The market is driven by self-interest.
- Strong sense of competition- rivalry between companies.
- Incentives encourage individuals & businesses to behave in a certain way.
- Businesses are motivated by profits/financial gain

Ex- America, Japan and Germany

<u>-Adam Smith-</u>

- A Scottish economist in the 1700s - promoted free market economy
- <u>Wealth of Nations</u> - written in 1776 describes how a <u>Market system</u> can flourish.
- Called for economic <u>laissez faire-</u> restricted government involvement.
- The <u>Invisible Hand</u> - Self-interest can drive the market, ultimately society benefits.

4) <u>Mixed Economy-</u>

- Combines the elements of Traditional, Command, and Market economies.
- The government has varying degrees of involvement:
  a) regulates business
  b) provides a safety net for those in need
- All economies are actually mixed: Most tend to lean heavy towards one system

- **<u>JOHN NASH</u>** - a modern day mathematician ~ won the Nobel Prize in 1994
  ~ subject of ***A Beautiful Mind***

- **Wrote the "Nash Equilibrium" - "Game Theory"**
- Smith's Invisible Hand theory was incomplete
- In an economy, we practice ***Game Theory:*** **"The Science of Strategy"** individuals will plan & act based on what we believe other people will do.
- The **"Nash Equilibrium" states:** individuals will act for their own self-interest **&** for the benefit of the group
- The outcome may not be the "best", but you will be able to "stay in the game