

Reading: *Chapter 1.1, 1.2, & 1.3 Macroeconomics/Ragan - 14<sup>th</sup> edition*

# Chapter 1: Economic Issues and Concepts

- Objectives:*
- *To view the market economy as a self-organizing entity in which order emerges from a large number of decentralized decisions.*
  - *The importance of scarcity, choice, and opportunity cost, and how all three concepts are illustrated by the production possibilities boundary.*
  - *About the circular flow of income and expenditure.*
  - *Types of economic systems*

## 1. The Complexity of the Modern Economy

**Economy** is a system in which *scarce* resources are allocated among *competing* uses.

*Q: What is considered as a scarce resource in an economy?*

*A:*

## The Nature of Market Economies

*Q: What coordinates a complex set of dealings organized in an economy?*

*A:*

Early economists noticed that the interaction of *self-interested* people creates a spontaneous social order -- the economy is *self-organizing*. Self-interest, not benevolence, is the *foundation* of economic order.

## **Efficient Organization**

Loosely speaking, efficiency refers to organizing *available* resources to produce the output that people most value, using the \_\_\_\_\_ possible resources to do so.

## **Main Characteristics of Market Economies**

1. **Self-interest & Incentives:**

2. **Prices and quantities:**

3. **Institutions:**

Main characteristics of market economies above produce a spontaneous self-organization.

## **2. Scarcity, Choice, and Opportunity Cost**

**Economics** is the study of the use of *scarce or limited* resources to satisfy \_\_\_\_\_ human wants.

## Economic Resources

A society's resources are usually divided into as follows;

**1. Labour:**

**2. Land and Natural mineral:**

**3. Capital:**

Economists refer to resources as *factors of production*, and outputs are \_\_\_\_\_ (tangibles) or \_\_\_\_\_ (intangibles).

## Scarcity and Choice

Resources can produce only a fraction of the goods and services desired by people.

Scarcity implies the need for \_\_\_\_\_, associated with *opportunity costs*.

**Opportunity cost** is the costs of using resources for a certain purpose, measured by the *benefit* \_\_\_\_\_ by not using them in their *best* alternative use.

Ex. Suppose your scarce resource is *time* given today.

	Your current activity	Alternative activity
Benefits		
Costs or Benefits given up		

Therefore, all times, we make a choice based on opportunity costs associated with two \_\_\_\_\_ activities, with a given amount of resources.

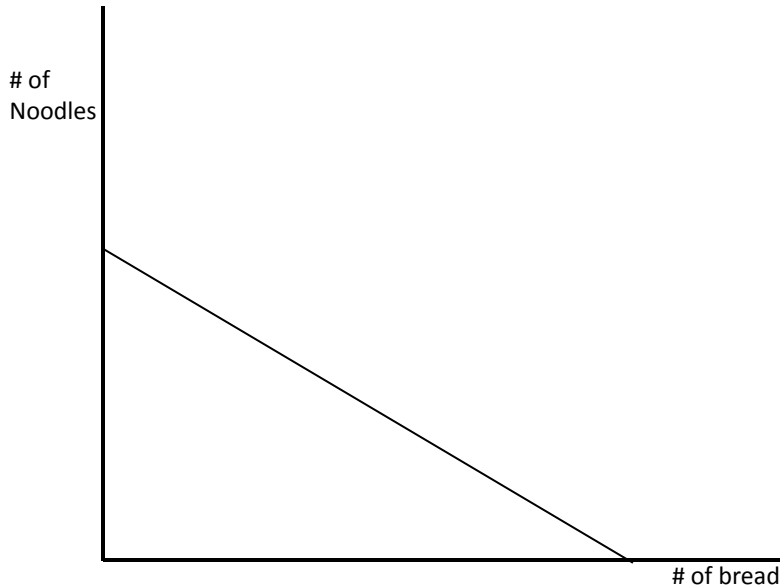
*Q: What would be the opportunity cost of completing a university degree?*

A:

**Production Possibilities Boundary (PPB)**

The PPB curve shows which alternative combinations of commodities can just be attained if all available resources are used *efficiently*.

Suppose you have 100 kg of wheat (as a raw material). Using current technology and productivity, you can produce a noodle using 0.5 kg of wheat, and a loaf of bread using 0.25kg of wheat.



*Q: What is meant by each area inside and outside the PPB, respectively?*

*A: Area inside: an **attainable** set of current production*

*Area outside: an **unattainable** set of current production*

*Q: What does the slope of the PPB represent?*

*A:*

*Q: Determine opportunity costs of producing a unit of bread and noodle, respectively.*

*A:*

*Q: How can the PPB be expanded outward (called "long run economic growth")?*

*A:*

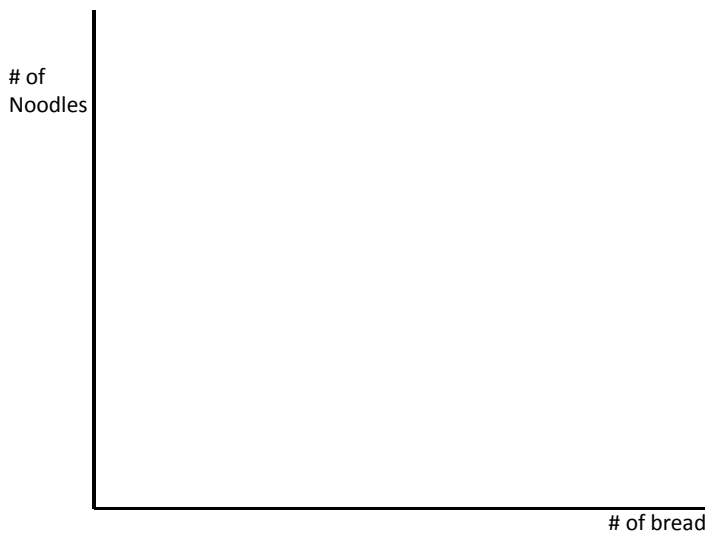
### *Summary*

The production possibilities boundary illustrates: \_\_\_\_\_,  
\_\_\_\_\_, and \_\_\_\_\_.

### **The PPB with an increasing opportunity cost**

*Q: Is it likely that all combinations of **efficient production** would have the **same** opportunity costs?*

*A: No. opp. cost of the particular good is rising as more resources are devoted to producing it.*

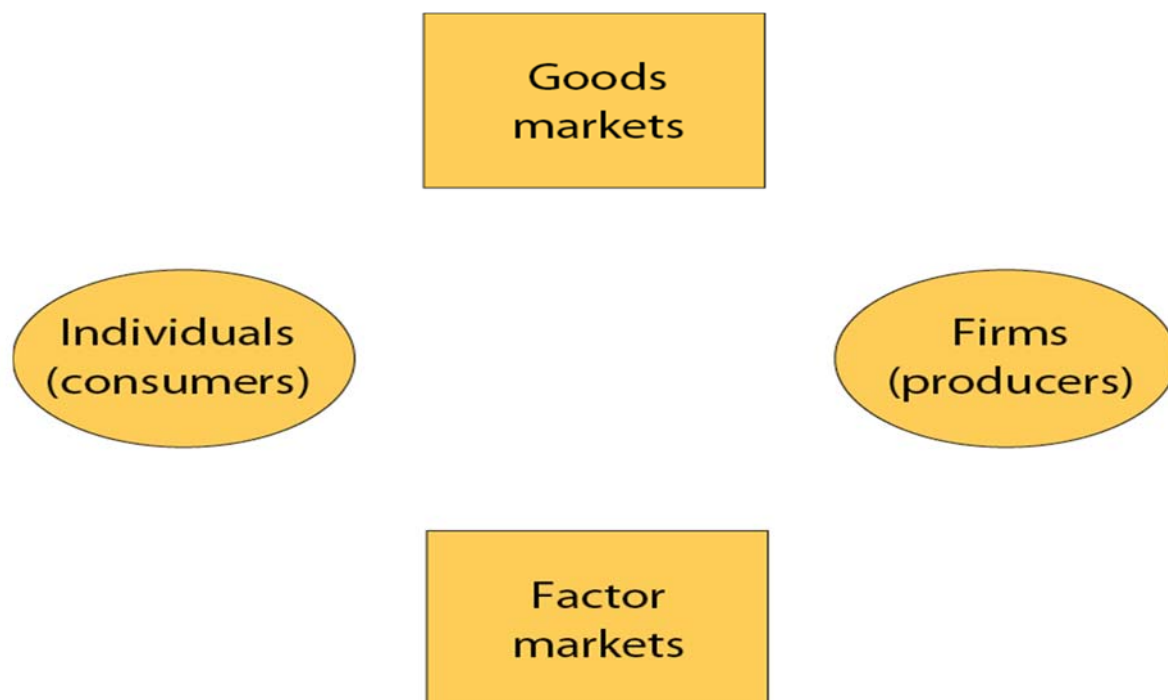


The shape of a PPB, referred to as concave to the origin, represents **increasing** opportunity cost with increased output of a good.

### 3. The Decision Makers and Their Choices

#### The Flow of Income and Expenditure

Individuals own factors of production. They sell the services of these factors to producers in factor markets and receive payment in return.



#### Production and Trade

Production usually displays two characteristics noted long ago by Adam Smith: *specialization* and *division of labour* ( that **must** be accompanied by trade.)

## Money and Trade

Money eliminates the cumbersome *system of barter* by separating the transactions involved in the exchange of products, thereby facilitating specialization and trade.

## Globalization

Underlying modern globalization is the rapid *reduction of transportation and communication costs* in the last half of the 20th century.

### 3. Is There an Alternative to the Market Economy?

#### Pure Types of Economic Systems

Three economic systems below differ depending on how economic decisions are coordinated.

*Traditional economy*: economic behavior is based primarily on \_\_\_\_\_, \_\_\_\_\_, and \_\_\_\_\_.

*Command economy*: economic behavior is determined by some central \_\_\_\_\_, usually the government.

*Free-Market economy*: most economic decisions are made by private \_\_\_\_\_ and \_\_\_\_\_.

In practice, every economy is a *mixed economy*, in the sense that it combines significant elements of all three systems above.