Unit
1B

# Microeconomics Unit 1: Basic Economic Concepts

## Lesson 2: Scarcity

# Two Definitions of Scarcity

- A situation in which human wants are greater than the capacity of available resources to provide for those wants.
- A situation in which a resource has more that one valuable use.

# Economics

- General economic theory relies on the assumption that resources are limited
- Economics is the social science that studies the choices that individuals, businesses, governments, and entire societies make as they cope with *scarcity,* the *incentives* that influence those choices, and the arrangements that coordinate them.
- Or the study of people producing and exchanging to get the goods and services they want. It is a social science that describes and analyzes how society chooses among scarce resources to satisfy its unlimited wants.

# Three Fundamental Questions

1. What to produce?

   Fruits and vegetables? Sugar cane?

   Manufactured goods?

2. How to produce?

   Machines? Workers?

   Foreign or domestic workers?

3. For whom to produce?

   Affluent societies? Poor? Middle Class?

   Developing World? Developed World?

The cost of choosing one good is giving up another. This is called ***opportunity cost***.

# The Fundamental Economic Problem

- A combination of tradition, command and market solutions is used to deal with this problem.

- Every economic system uses some combination of tradition, command and market solutions to answer the question of:
  - what to produce
  - how to produce
  - and for whom to produce

# How Do We Produce?
# Factors of Production

Resources are the basic elements used to produce goods and services.

1. Natural Resources
2. Human Resources
3. Capital Resources
4. Entrepreneurship

# Natural Resources

- “Gifts of Nature”
- Air, sunlight, forests, earth, water, and minerals are all classified as land, as are all manner of natural forces or opportunities not created by humans.
- Every tangible good is made of natural resources

# Human Resources

- “Labor”
- Taking natural resources and exerting human force to fulfill our wants and needs
- Converting natural resources to human satisfactions

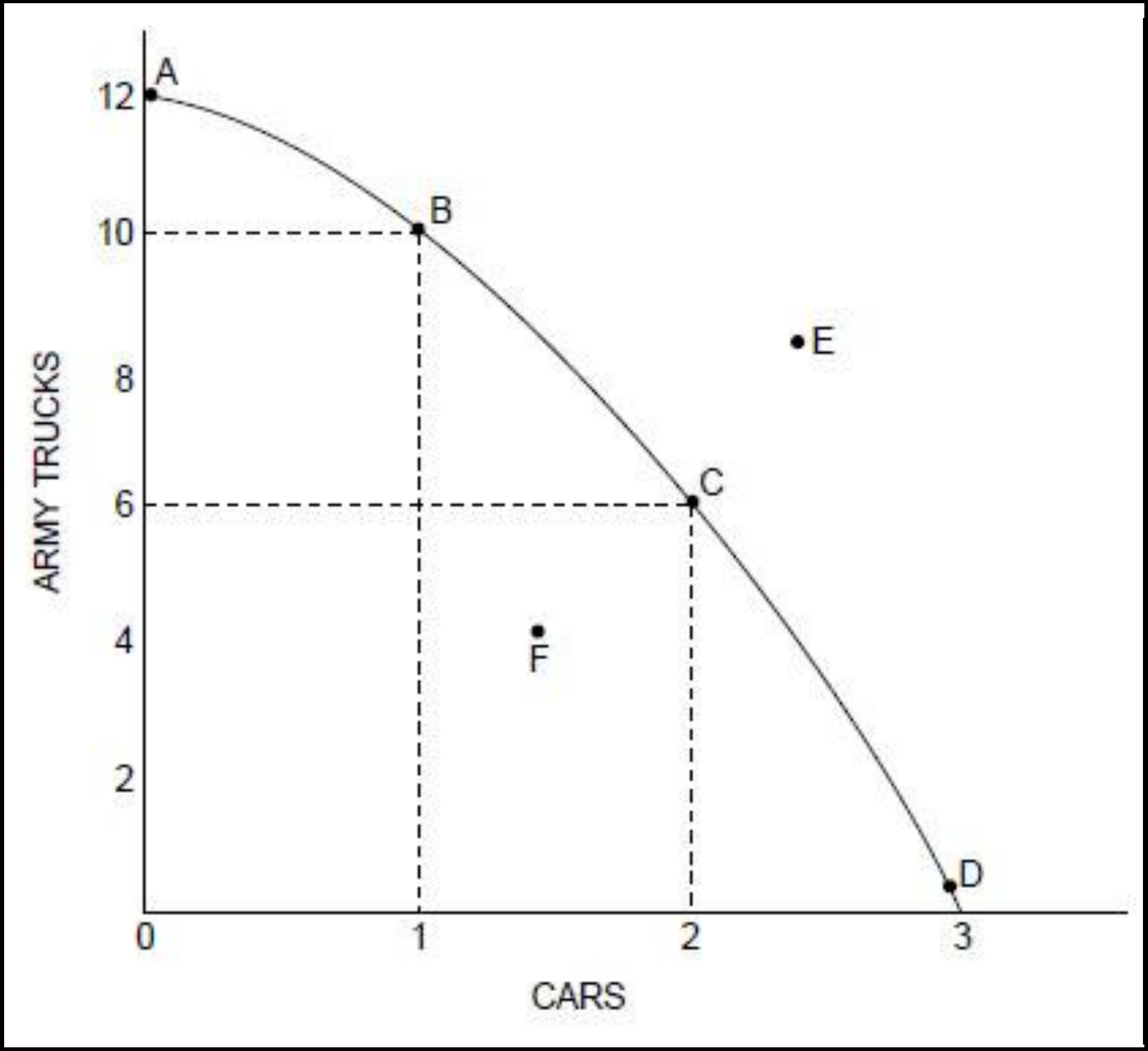
# Capital Resources

- Buildings, tools, and machines people use to produce other goods and services


# Entrepreneurship

- Imaginative thinking, willing to take  risks, and the management and organizational skills needed to operate a business

# Production Possibilities Curve

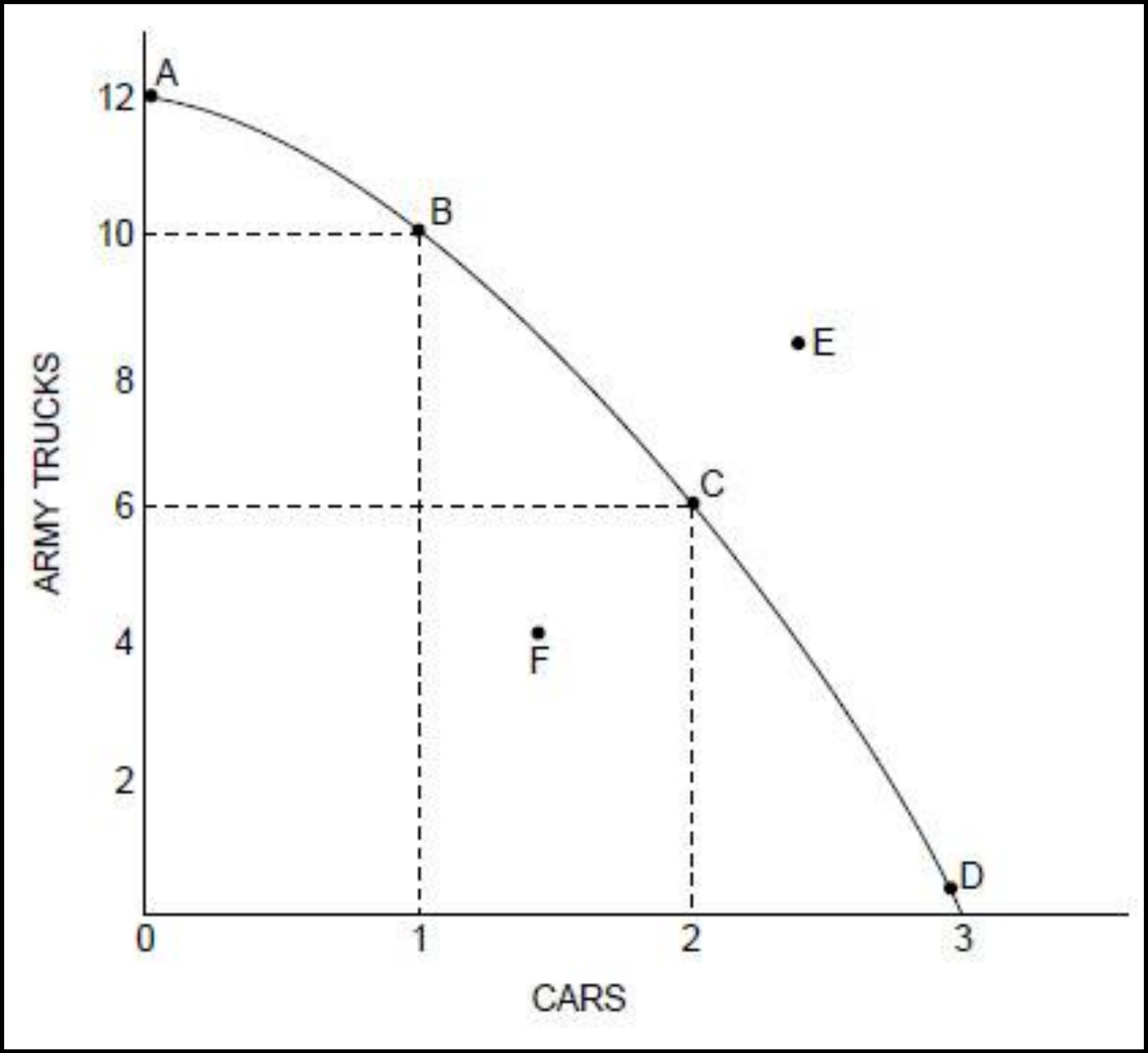



a) What trade-offs are involved?

b) Why is the PPC concave, or bowed out, from the origin?

c) What does a point inside the PPC illustrate?

# Production Possibilities Curve




d) What is an historical example of a point inside the PPC?

e) What is the significance of a point outside the PPC?

f) Under what conditions can a point outside the PPC be reached?

# THE ECONOMIC WAY OF THINKING

## How Much? Choosing at the Margin

- A choice made at the **margin** is a choice made by comparing *all* the relevant alternatives systematically and incrementally.

# THE ECONOMIC WAY OF THINKING

## Marginal Cost

- **Marginal cost** is the opportunity cost of a one-unit increase in an activity.
- The marginal cost of something is what you *must* give up to get *one additional* unit of it.

## Marginal Benefit

- **Marginal benefit** is the what you gain when you get one more unit of something.
- The marginal benefit of something is *measured* by what you *are willing* to give up to get *one additional* unit of it.

# Explicit and Implicit Costs

## Explicit Costs

- Payments by a firm to purchase the services of productive resources.

## Implicit Costs

- The opportunity associated with a firm's use of resources that it owns. These costs do not involve a direct money payment.
- Examples include wage income and interest forgone by the owner of a firm who also provides labor services and equity capital to the firm.

# What Do We Produce?

- We divide the vast array of goods and services produced into:
  - Consumption goods and services
  - Capital goods
  - Government goods and services
  - Export goods and services

# What Do We Produce?

- **Consumption goods and services** are goods and services that are bought by individuals and used to provide personal enjoyment and contribute to a person's standard of living.
  - Examples are movies and Laundromat services.
- **Capital goods** are goods that are bought by businesses to increase their productive resources.
  - Examples are cranes and trucks.

# What Do We Produce?

- **Government goods and services** are goods and services that are bought by governments.
  - Examples are missiles, bridges, and police protection.
- **Export goods and services** are goods and services produced in one country and sold in other countries.
  - Examples are airplanes produced by Boeing and Citicorp banking services sold to China.

# What Do We Produce?

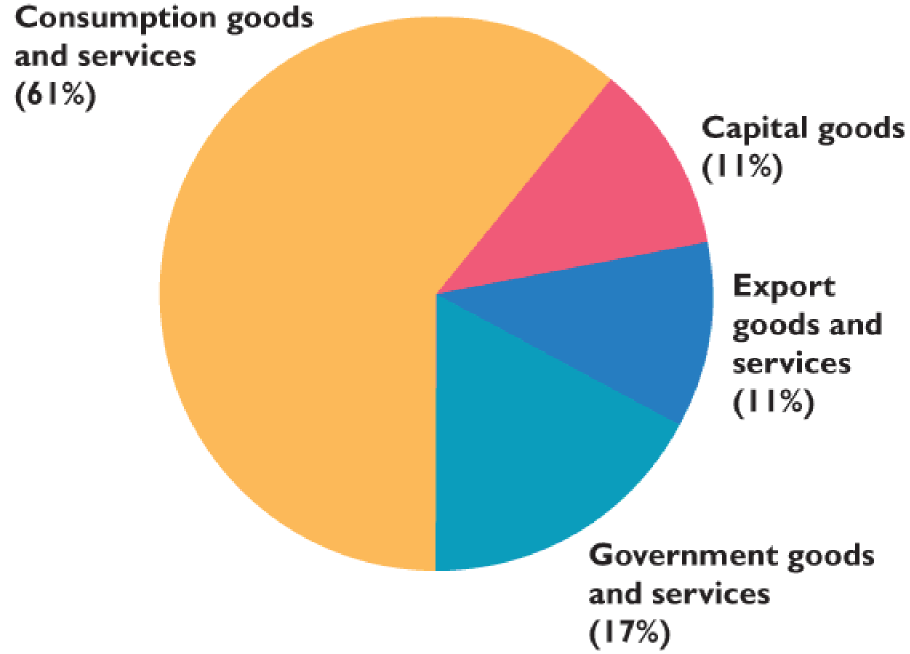
The figure shows the relative magnitudes of the goods and services produced in the United States in 2011:

Consumption 61%

Capital goods  11%

Export goods 11%

Government 17%

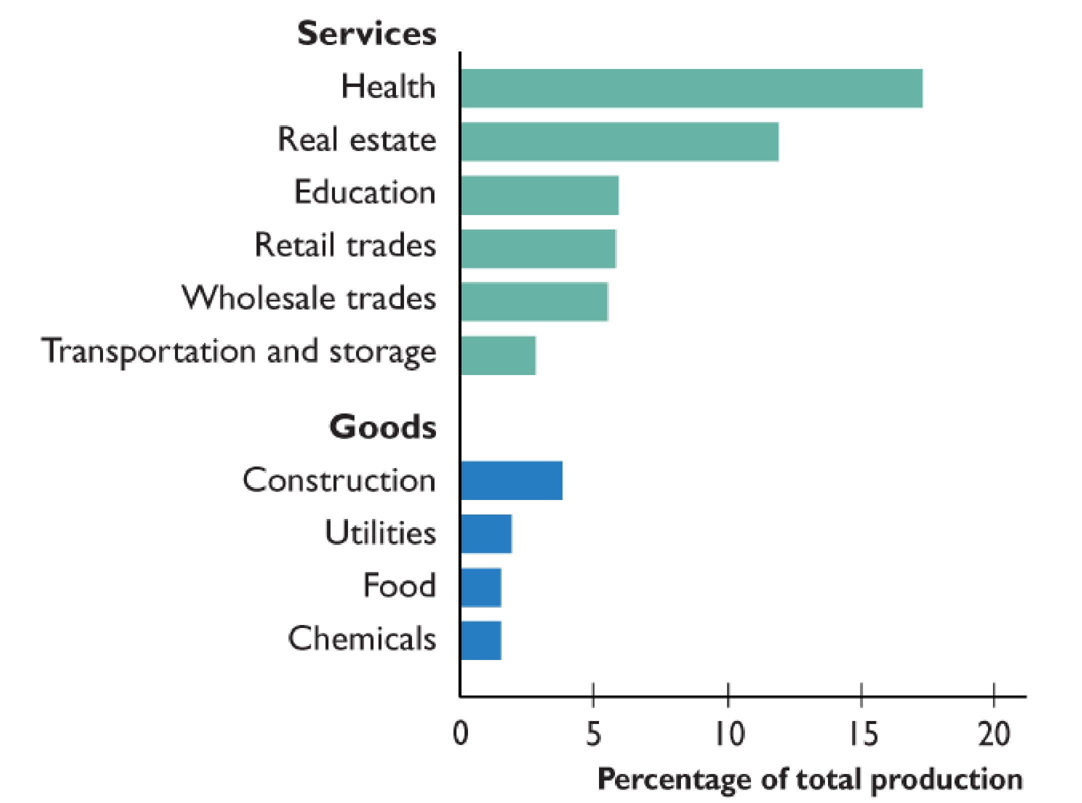



(a) The broad categories

# What Do We Produce?

The figure shows the largest six types of services produced in the United States in 2011 …

and the largest four types of goods produced.




(b) Some of the details

# For Whom Do We Produce?

Factors of production are paid incomes:

Rent  Income paid for the use of land.

Wages  Income paid for the services of labor.

Interest  Income paid for the use of capital.

Profit (or loss)  Income earned by an entrepreneur for running a business.

# THE CIRCULAR FLOWS

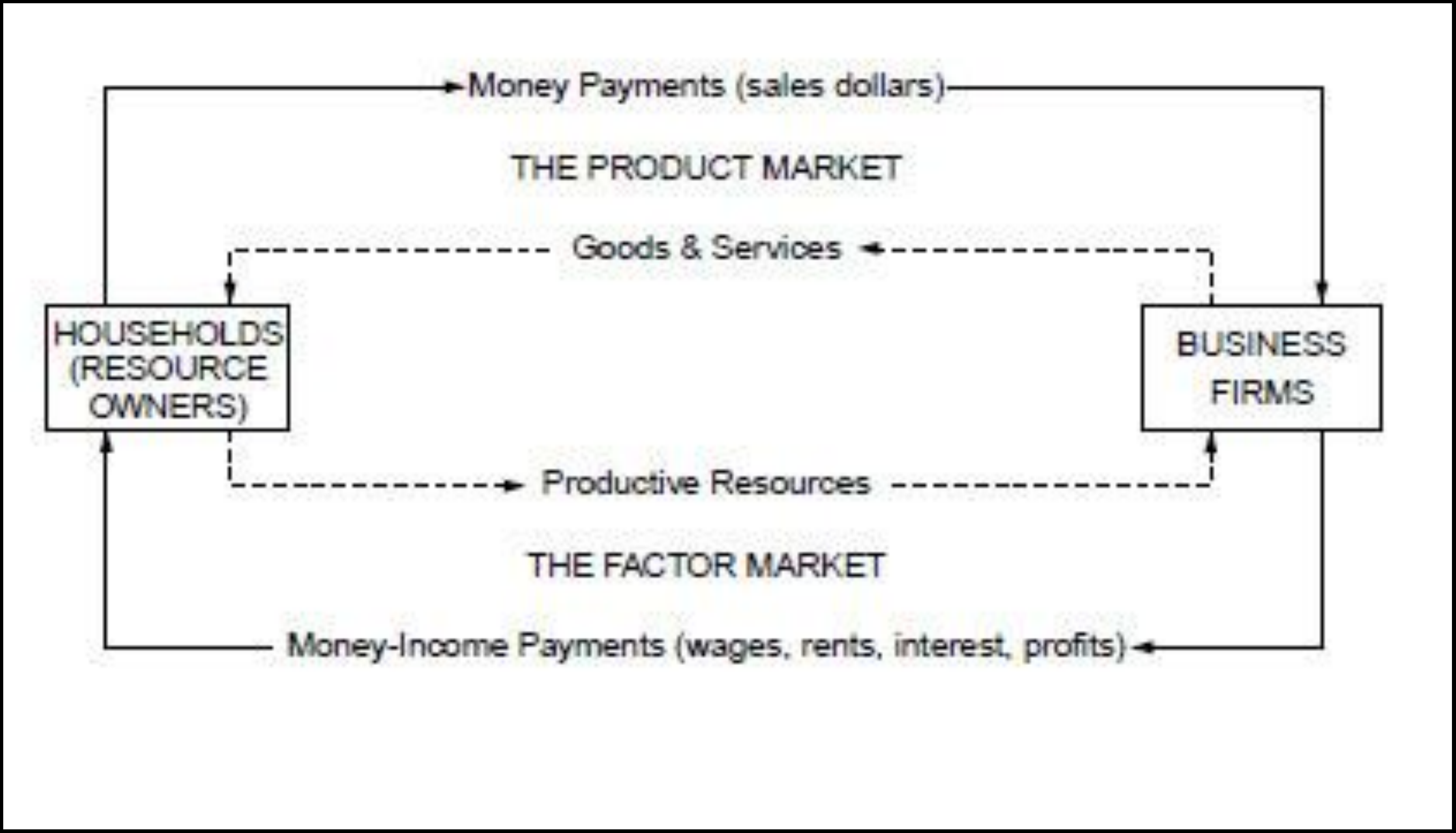
- **Circular flow model** is a model of the economy that shows:
- The circular flow of expenditures and incomes that result from decision makers' choices and
- The way those choices interact in markets to determine what, how, and for whom goods and services are produced.

# THE CIRCULAR FLOWS

## Markets

- A **market** is any arrangement that brings buyers and sellers together and enables them to get information and do business with each other.
- **Goods markets** are markets in which goods and services are bought and sold.
- **Factor markets** are markets in which factors of production are bought and sold.

# Circular Flow of Resources, Goods, Services and Money Payments

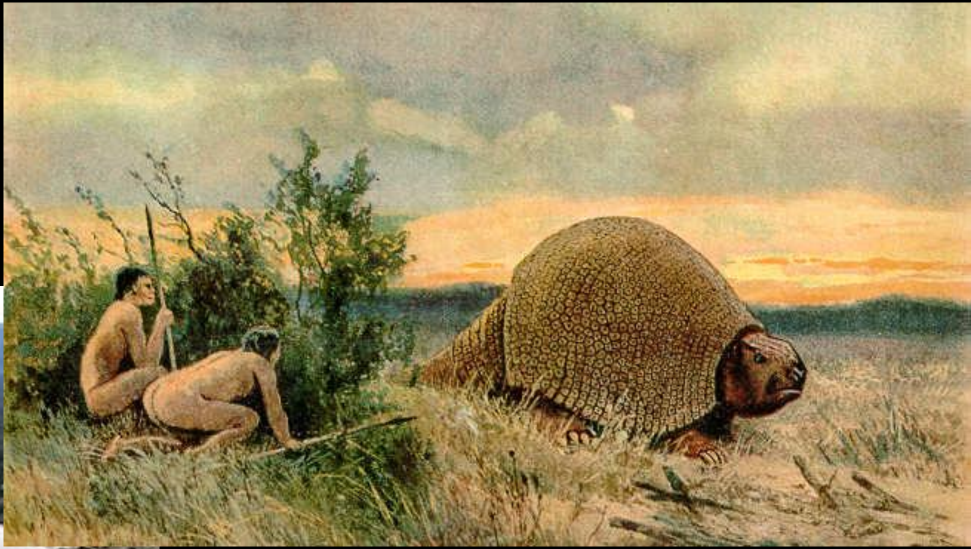


# Lesson 3

# **Absolute Advantage and Comparative Advantage, Specialization and Trade**

# Benefits of Trade

- What would life be like if every person had to be totally self-sufficient and could not specialize and trade.



# Who Trades?

- Remember, that ***individuals, NOT nations***, trade.
- However, specialization and trade can be accomplished both domestically and internationally.
- The more we trade, the better off we all are.

# Absolute Advantage and Comparative Advantage

## Absolute Advantage

- One nation can produce more output with the same resources as the other.

## Comparative Advantage

- One nation can produce a good at a lower opportunity cost than the other.

## Examples of Comparative Advantage

- Lawyer and secretary
- Doctor and nurse

# Determining Comparative Advantage (Output Method)

| | **CDs** | **Pounds of Beef** |
|---|---|---|
| Japan | 4 | 2 |
| Canada | 4 | 6 |

1. Which nation has an absolute advantage in producing CDs?

2. Which nation has an absolute advantage in producing beef?

# Determining Comparative Advantage (Output Method)

| | CDs | Pounds of Beef |
|---|---|---|
| Japan | 4 | 2 |
| Canada | 4 | 6 |

3. Which nation has a comparative advantage in producing CDs?

4. Which nation has a comparative advantage in producing beef?

# Determining Comparative Advantage (Output Method)

| | CDs | Pounds of Beef |
|---|---|---|
| Japan | 4 | 2 |
| Canada | 4 | 6 |

5. Should Japan specialize in CDs or beef?

6. Should Canada specialize in CDs or beef?