Economics Review—Semester 1

Chapter 1:

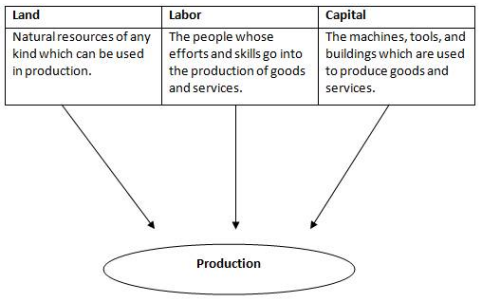
Goods – Tangible items of value.

Services – Intangible items of value.

Consumption - The act of buying and using final goods and services.

Scarcity & Choice – Having limited resources and deciding what to use them for.

The factors of production



Entrepreneurs – "Idea People" who create new enterprises or improve existing ones.

Fundamental Economic Questions:

- WHAT goods and services should be produced?
- HOW should they be produced?
- WHO should receive the goods and services that are produced?

Trade Offs – A trade off occurs when one thing is given up in order to obtain something else.

Opportunity Cost – The thing that is given up in a trade off. (Ex. You decide to go to the movies instead of studying for your eco final, the opp. Cost will be your grade, or lack of one)

Marginalism – The usefulness of adding one more item to the production of a product or a service. (Ex. McDonalds™ decides whether adding one more burger cook will increase productivity enough to offset the cost of his salary.)

Traditional Economy:

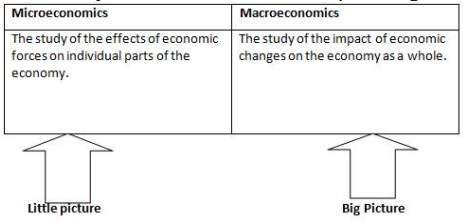
- Found mainly in rural areas of South America, Asia and Africa.
- Self contained communities.
- The chief occupation is usually agricultural like farming, herding or fishing.
- The family is the main organizational unit of life.
- People produce only enough goods for themselves with a slight surplus for sale.
- The fundamental economic questions are answered by tradition and custom.

Command Economy:

- The central power (the government), decides on how to answer the fundamental economic questions.
- Government owns most of the industry.
- Fewer resources were available for production of consumer goods & services.
- Government decides wages and living standards.
- People of value to the government received special treatment.

Market Economy:

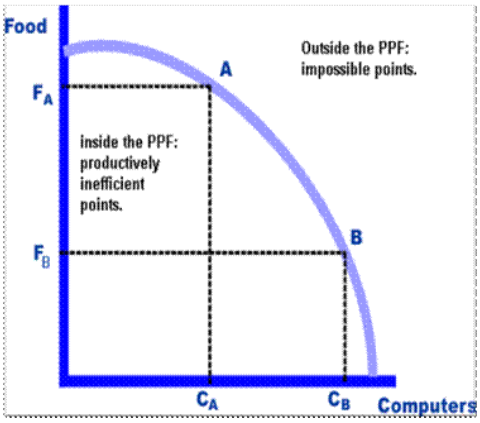
- Fundamental economic questions are answered by the individuals (businessmen).
- Government plays minor role in comparison to command economy.
- The consumers decide what products and services they want businesses to continue producing.



Ceteris Paribus – The assumption that all things remain equal, which is used by economists while studying the economy.

Money – anything which is used as a medium of exchange, a standard of value, or a store of value.

The Production Possibilities Curve



The PPC represents the concepts of Scarcity and Opportunity Cost in graphic form. In the graph above, the economy produces two types of goods, *necessities (food) and Luxuries (computers)*. The blue curved line represents the optimal configurations for a production balance between necessities and luxuries. If this economy is geared more towards luxuries, it will lie somewhere between point B and the bottom of the curve. If the country has a more necessity driven economy, it will lie somewhere between point A and the top of the curve. If the country decides to balance the production of necessities and luxuries, it will lie somewhere on the curve between points A and B. If the country is not producing at its full potential, it will lie on a point somewhere inside the curve meaning it is in a production deficit.

Chapter 2:

Free Enterprise – The freedom for any individual to start or enter any legal business as they see fit. The government does intervene to some extent, to insure the protection of consumers by requiring some professions be licensed.

Private Property – The right for individuals to own property and use it in any legal manner they choose. The government can tax and if it sees fit, use *eminent domain* – which allows the govt. to seize property it intends to use for a public purpose provided it pays a fair price for it.

Profit Motive – The willingness of entrepreneurs to risk loss by organizing business enterprise for the purpose of profit gain.

Consumer Sovereignty – The need to give consumers what they want.

Competition – Is the rivalry among sellers in a particular field for the consumer's dollars.

Specialization – The economic premise that workers provide one specialized task and depend on the skills of other workers to provide them with the things they need.

Evaluation of the Market Economy

Advantages	Disadvantages
· The market system is the most efficient economic system, prices are constantly lowered and quality is constantly raised in an effort to secure consumer dollars. · The market system is very sensitive to consumer demand ensuring fair treatment of consumers.	· The market system does not provide all the goods and services needed by society. (Ex. Roads and schools). · The MS does not provide for all people, people without money cannot buy the goods which are being provided. · The MS is likely to experience periods of expansion and contraction. · The MS cannot account for harmful costs of doing business

Chapter 3:

Demand – the desire to purchase a particular item at a specified price and time, accompanied by the ability and willingness to pay.

Demand Schedule – A chart which shows the change in demand for an item as changes in price occur. For example if you would buy 2 slices of pizza at $2.25 a slice you might buy only one if each slice cost $3.00. However, if each slice cost only .25¢, you might buy a pie for you and your friend(s).

Demand Curve – A line graph which shows the demand schedule in a curve.

As shown above, the Law of demand states that as price decreases, the demand for an item rises and vice versa.

The Principle of Diminishing Marginal Utility – This principle states that each additional purchase of a product or service will be less satisfying than the previous one. For example if you decide to buy pizza, the first two slices may be enjoyable but by the third or fourth slice, you will most likely be "hadged" and not want to buy anymore.

The Elasticity of Demand – The percentage change in demand that follows any given price change.

Elastic vs. Inelastic :

- Elastic – An item is considered elastic when a large raise in the price results in a large drop in demand(Ex. You will buy less pizza if it costs $10 a slice)
- Inelastic – An item is considered inelastic when price changes do not affect the amount of it being purchased by the consumer(Ex. If gas goes up to $8 dollars a gallon we most likely will continue to buy it until alternative fuels are provided)

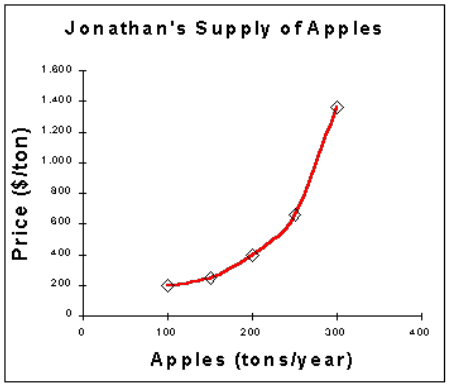
What makes demand Elastic or Inelastic?

- If the item is considered a luxury.
- If the price represents a large portion of the family income.
- If other items can be easily substituted for it.
- If items are durable.

Supply – The quantity of a certain good produced at a given time and price.

The Law of Supply – The quantity of a good varies directly with its price. (Ex. If it costs $1 to make it will be produced more than something that costs $100 dollars to make.)

Supply Schedule – A schedule which shows that producers will offer more of a certain good when they can sell it at a higher price.



Elasticity of Supply – If the price increase of an item causes a large change in supply, it is elastic. If a price increase causes a relatively small change in the supply of an item, it is considered inelastic.

Market Price – The price that consumers are willing to pay for an item at any given time.

How Supply and Demand determine price – When more of an item is available, people will pay less for it. When an item is scarce and more demanded, people will pay more for it.

Chapter 4:

Sole Proprietorship - When you create, own and run a business by yourself.

Advantages	Disadvantages
· Easy to form and run. · You are your own boss. · As the sole owner you do not have to share the profits with anyone.	· Unlimited Liability- meaning there is no ceiling on the amount of losses you can sustain. · Limited Capital- The amount of startup money you can raise is limited. · Limited Life- when you die, the business dies.

Partnership – A business organization formed by two or more people.

Advantages	Disadvantages
· Additional capital to invest in the business. · Two heads are better than one. · Easy to organize.	· Limited Life · Partners may disagree · Difficult to sell or find a replacement. · Limited Capital. · Unlimited Liability.

Corporation – Is a business organization licensed to operate by a state or federal government.

Advantages	Disadvantages

· Limited Liability because the owners and the corp. are separate entities. · Unlimited life because corps. Can go on forever · Ease of transfer because people can easily buy or sell stocks.	· Difficulty and Expense of organizing. · Double taxation, corps. Are taxed twice as much as a sole proprietorship.

S Corporations – Corporations with 75 or fewer stockholders are exempt from double taxation and are taxed as sole proprietorships rather than corporations. Mainly applies to small businesses.

Chapter 5:

Why do people buy stocks?

- Dividends – A portion of the company's profits which it may divide and give to its shareholders.
- Capital Growth – The expectation that a stock will be worth more than one paid for it in the future.

Caveat Emptor - literally translated, it means buyer beware. It is the disclaimer of the SEC to all investors saying it is their responsibility to research stocks before buying them.

Bull Market – In a bull market, the value of stocks are expected to rise in the near future.

Bear Market – A market in which the value of stocks is expected to fall.

Financial Statements – Financial Data which companies are required to make available to their stockholders.

Chapter 7:

Perfect Competition:

- There are many buyers and sellers acting independently. No single buyer or seller is big enough to affect the market price.
- Competing products offered for sale are virtually identical so buyers do not care from whom they buy them.
- Buyers and sellers are fully informed about price, quality, and sources of supply.
- Firms can enter and leave the market at will.

Monopolistic Competition :

- Product Differentiation
- Many sellers who produce similar products that the buyer believes differ in some qualitites.