

## Basic Economic Definitions

**Economics:** Economics is the study of the choices that people make, all of the choices, and the personal and social consequences of those choices. Economics is the study the production and distribution of goods and services; it is the study of human efforts to satisfy unlimited wants with limited resources.

**Wants - Simply the desires of citizens:** Wants are different from needs as we will see below. Wants are a means of expressing a perceived need. Wants are broader than needs.

**Needs:** These are basic requirements for survival like food and water and shelter. In recent years we have seen a perceived shift of certain items from wants to needs, for example: telephone service--to many, is a need.

**Scarcity** - Scarcity is simply the concept that human wants (not human needs) exceed the resources available that are necessary to produce the goods used to satisfy those wants. Scarcity is the fundamental economic problem facing ALL societies. Essentially it is how to satisfy unlimited wants with limited resources. This is the issue that plagues all government and peoples. How do we conquer the issue of scarcity? Many people have thought they had the answer (see Marx, Smith, Keynes, etc.) but the issue of scarcity still exists.

*A good is considered scarce if the amount people demand of the good (quantity demanded) exceeds the amount that is supplied (quantity supplied), when the price of the good equals zero.*

*A good is considered free if the quantity demanded either equals or is less than the quantity supplied, when the price of the good equals zero.*

**Factors of Production/Resources** - these are those elements that a nation has at its disposal to deal with the issue of scarcity. How efficiently these are used determines the measure of success a nation has. They are

- Land - natural resources, etc.
- Capital - investment monies.
- Labor - the work force; size, education, quality, work ethic.
- Entrepreneurs - inventive and risk taking spirit. This is a rather new addition to a traditional list.

### Basic Economic Choices/Questions

The "Three Basic Economic Questions" - these are the questions all nations must ask when dealing with scarcity and efficiently allocating their resources.

1. What to produce?
2. How to produce?
3. For whom to produce?

1. **WHAT** goods will be produced?

Initially society must decide what goods, specifically, they wish to produce.

2. **HOW** will resources be used in the production process?

Once it has been decided exactly what goods will be produced, the next question that must be addressed is exactly how these goods will be produced. This question focuses on issues such as the type of technology to be used, whether the production process should be labor intensive or capital intensive, and so forth. The most important focus for economists is on the issue of producing output with the fewest resources or the lowest costs.

### 3. **WHO** will receive the goods?

Once the goods have been produced, the next crucial question that remains deals with who, specifically, will get these goods. In a market economy, which relies upon money for many transactions, this question is essentially one of determining the distribution of income. Higher income, in a market economy, translates into the ability to purchase more goods and services. Thus, this question focuses on issues of taxation and subsidies.

**Opportunity Cost** - the cost of an economic decision. The classic example is "guns or butter." What should a nation produce; butter, a need, or guns, a want? What is the cost of either decision? If we choose the guns-the cost is the butter. If we choose butter-the cost is the guns. Nations must always deal with the questions faced by opportunity cost. It is a matter of choices. Resources are limited thus we cannot meet every need or want.

An opportunity cost equals the value of the next-best foregone alternative whenever a choice is made. *Only indirect costs are considered opportunity costs. For example, lost wages refer to the wages that a student loses because s/he chooses to attend college. Any resource can have an indirect cost associated with it, not just labor. For example, a person could have \$10,000 that she uses to finance the direct payments for college. However, she could have used this money as an investment, which would have yielded interest payments. The interest that she loses as a result of this decision is also a cost of attending college, albeit an opportunity cost.*

**Free Products:** Air and sunshine are so plentiful no one could own them.

Economists are interested in "economic products" - goods and services that are useful, relatively scarce and transferable.

**Good:** tangible commodity. These are bought, sold, traded and produced.

**Consumer Goods:** Goods that are intended for final use by the consumer.

**Capital Goods:** Items used in the creation of other goods: factory, machinery, trucks, etc.

**Durable Goods:** Any good that lasts more than three years when used on a regular basis.

**Non Durable Goods:** Any item that lasts less than 3 years when used on a regular basis.

**Services:** Work that is performed for someone. Service cannot be touched or felt.

**Consumers:** people who use these goods and services.

**Conspicuous Consumption:** Use of a good or service to impress others.

**Value:** An assignment of worth. The assignment is usually based upon the utility (usefulness) or scarcity of the item (supply and demand).

**Utility:** capacity to be useful.

**Paradox of value:** assignment of the highest value to those things we need the least, like water and the highest things we often don't need at all like diamonds. Why do we do this? **Wealth:** the sum collection of those economic products that is tangible, scarce and useful.

**Productivity** - the ability to produce vast amounts of goods (economic products) in an efficient manner. The American capitalist economy is productive because:

We use our resource efficiently.

We **specialize** to increase efficiency and productivity.

We invest in Human Capital (our labor pool)