

AP/IB[®]

Economics

Unit 1: Basic Economic Concepts

Scarcity Means There Is Not Enough For Everyone



Government must step in to help **allocate**
(distribute) resources

Scarcity Bus Ride

Scenario:

A group of 40 college students get on a bus to go to a dance 30 miles away.

Shortly after leaving, the bus finds that it is too heavy to go over a large hill

10 students need to get off the bus

You and your partner need to find 5 different ways to decide who should get off the bus.

- 1. Are any of the solutions fair?**
- 2. How are resources allocated in communism?**
- 3. How are resources allocated in capitalism?**
- 4. What role do prices play in capitalism?**

Every society must answer three questions:

The Three Economic Questions

- 1. What goods and services should be produced?**
- 2. How should these goods and services be produced?**
- 3. Who consumes these goods and services?**

**The way these questions are answered
determines the economic system**

An economic system is the method used by a society to produce and distribute goods and services.

Economic Systems

- 1. Centrally-Planned
(Command) Economy**
- 2. Free Market Economy**
- 3. Mixed Economy**

Centrally-Planned Economies (aka Communism)

Centrally Planned Economies

In a centrally planned economy (communism) the government...

1. owns all the resources.
2. answers the three economic questions

Examples:

Cuba, North Korea, former Soviet Union, and China?

Why do centrally planned economies face problems of poor-quality goods, shortages, and unhappy citizens?

Little incentive to work harder and central planners have a hard time predicting preferences

Advantages and Disadvantages

What is GOOD about Communism?

1. **Low unemployment- everyone has a job**
2. **Great Job Security- the government doesn't go out of business**
3. **Equal incomes means no extremely poor people**
4. **Free Health Care**

What is BAD about Communism?

1. **No incentive to work harder**
2. **No incentive to innovate or come up with good ideas**
3. **No Competition keeps quality of goods poor.**
4. **Corrupt leaders**
5. **Few individual freedoms**



REVOLUTIONARIES

Even if you spend your whole life combatting the forces of capitalism, you still might wind up on a t-shirt sold in a store owned by the Gap.

Free Market System **(aka Capitalism)**

Characteristics of Free Market

1. Little government involvement in the economy.
(Laissez Faire = Let it be)
2. Individuals OWN resources and answer the three economic questions.
3. The opportunity to make PROFIT gives people INCENTIVE to produce quality items efficiently.
4. Wide variety of goods available to consumers.
5. Competition and Self-Interest work together to regulate the economy (keep prices down and quality up).

Example of Free Market

**Example of how the free market regulates itself:
If consumers want smartphones and only one
company is making them...**

- Other businesses have the INCENTIVE to start making smartphones to earn PROFIT.**
- This leads to more COMPETITION....**
- Which means lower prices, better quality, and more product variety.**
- We produce the goods and services that society wants because “resources follow profits”.**

The End Result: Most efficient production of the goods that consumers want, produced at the lowest prices and the highest quality.

Example of Central Planners

Example of why communism failed:

If consumers want smartphones and only one company is making them...

- **Other businesses CANNOT start making computers.**
- **There is NO COMPETITION....**
- **Which means higher prices, lower quality, and less product variety.**
- **More phones will not be made until the government decides to create a new factory.**

The End Result: There is a shortage of goods that consumers want, produced at the highest prices and the lowest quality.

The Invisible Hand

The concept that society's goals will be met as individuals seek their own self-interest.

Example: Society wants fuel efficient cars...

- Profit seeking producers will make more.**
- Competition between firms results in low prices, high quality, and greater efficiency.**
- The government doesn't need to get involved since the needs of society are automatically met.**

Competition and self-interest act as an invisible hand that regulates the free market.

**WOULD YOU GIVE UP
THE INTERNET
FOR 1 MILLION DOLLARS?**



Mixed Economies

A system with free markets but also some government intervention.

Almost all countries, including the US, have mixed economies



Productivity Creates Wealth

Countries with free markets, property rights, and The Rule of Law, have historically seen greater economic growth because they are more productive

3rd World Countries

Developed Countries



Index of Economic Freedom





The difference between North and South Korea at night

North Korea's GDP is \$13 Billion

South Korea's GDP is \$1.6 Trillion