Bussiness economic

Economics

When wants exceed the resources available we have scarcity. Scarcity occurs because human wants exceed the limits of available resources. Economics deals with the basic fact that scarcity exists in our everyday lives and in our economy. Resources such as raw materials are in finite supply and must be allocated to their best use. Virtually all resources are scarce, meaning that more of them are desired than is available. Economics is concerned with the way people have to make choices in order to overcome the problems of scarcity. Choice Given the presence of scarcity, choices must be made as to how resources are allocated.

Our lives are filled with a wide range of choices regarding the use of limited personal funds. Advertisers constantly inform consumers of their consumption possibilities and the choices available. The same principle applies for the economy as a whole. We elect politicians who work with policy makers to allocate government expenditures. Together they make difficult choices concerning how taxes will be spent. Opportunity Cost The relevant cost of any decision is its opportunity cost - the value of the next-best alternative that is given up.

This will mean that if we choose more of one thing, we will have to have less of something else. Economists use the term opportunity cost to explain this behavior. The opportunity cost of any action is the value of the next best alternative forgone. By making choices in now we use our time and spend ourmoneywe give something up. Instead to following the economics class, what else could you be doing? Your best alternatives may involve sports, leisure, work, entertainment, and more. Thus, the concept of opportunity cost is your best alternative to the choice that is made.

If you choose to go to a restaurant this evening, the money that you spend on dinner will not be available for other uses, even saving. Businesses and governments also deal with opportunity costs. Businesses must choose what type of goods to produce and the quantity. Given limited funds, the opportunity cost of producing one type of good will arise from not being able to produce another. Production occurs when we apply labor and capital to resources in order to increase the value of the resources. Given a scarcity of resources, it is desired that society will allocate them to their best uses.

In many economies, the market performs most of the resource allocation role. Consumers indicate their preferences by purchasing goods and services. Producers wish to satisfy the demands of consumers by using scarce resources to produce those goods and services that consumers demand. The Factors of Production There are three major factors of production: 1 . Land includes all natural resources, such as land, air, water, forests, wildlife, etc. , 2. Labor includes all mental and physical effort exerted by human beings, 3. Capital refers to the improvements made to natural resources.

Capital includes items such as buildings and machinery. While the definition of land and labor is readily apparent, let us briefly discuss the economic meaning of capital. Capital is used to assist labor in the production process and increase our capacity to produce goods and services. Workers use tools and machinery to become more productive and increase their output. In an economic sense we consider capital as the actual purchases of plant and equipment used in production. Investment is the term used to describe the additions to capital. By investing, a firm purchases new machinery hat adds to its capital stock.

THE PRODUCTION POSSIBILITIES FRONTIER (APP) Introduction to the Production Possibilities Frontier (APP) The production possibilities frontier is used to illustrate the economic circumstances of scarcity, choice, and opportunity cost. To describe the concept of the production possibilities frontier, assume that we live on an island that has only two cities (Lake and Desert), and two industries (cars and airplanes). Given the resources available on our island economy, the table below shows how labor and capital can be allocated to the production of autos and airplanes. The Production Possibilities for a Single Country Option Cars/Automobiles Airplanes 150 125 4 c 9 16 25 The table gives five production possibilities, options A through E. Each option shows what alternative mixes of cars and airplanes that society can choose to produce. Option A is one where our island dedicates all of its resources to the production of cars, entirely forsaking airplane production. Option B shows a preference for the production of a few airplanes, but giving up some automobiles in the process.

The tradeoff of airplanes for autos continues to point E, where our country dedicates itself o the production of airplanes (25), producing zero automobiles. Figure 1-1 is a graphical representation of the information presented in table above. The boundary presented in the graph represents the different possibilities that society has in the allocation to resources. The thornier boundary and its interior represent what is achievable given our island's currently available resources. In contrast, points outside the frontier are not attainable given the resources andtechnologypresent.

The APP is a graphical representation of the data found in the table and is known as the production possibilities frontier. Beginning at the vertical (y) axis, we have point E from the table where there are 25 airplanes and no cars produced. As the table shows, point D represents an output level with fewer airplanes but more autos. We continue to move Southeast along the frontier until we reach point A. The y-axis shows the number of airplanes that can be produced. If we begin at the origin and refer to the table above, as we move up along the axis, our output of airplanes increases.

The maximum number of airplanes that can be produced is 25 as given by production point E in the production possibilities. The x- axis shows the number of cars that can be produced. If we begin at the origin and refer to the table above, as we move to the right along the axis, our output of automobiles increases. The maximum number of cars that can be produced is 150 as given by production point A in the production possibilities Note two characteristics of the production possibilities frontier. First, it slopes downward to the right. This represents the tradeoff present in production.

By producing more cars, workers and capital must migrate from Lake to Desert. An increase in car production necessitates a reduction in the output of airplanes. In addition, the production possibilities frontier is " bowed outward. " The curvature of the production possibilities frontier reflects the increasing opportunity cost when substituting one type of production for another. This situation is caused by the specialization of workers. If society initially favors car production over airplanes so that we are located in the southeast portion of the frontier, workers become skilled in car production.

But as we move to the left along the curve, increasing airplane output and decreasing car production, some workers switch to making airplanes. For many workers, the skills seed in producing autos are not perfectly transferable. In addition, the machinery used for auto production may not be well suited to making airplanes. As a result, the output per worker falls as they are relocated to making goods in which they are less skilled. Assumptions of the Production Possibilities Frontier There are 3 assumptions that must be satisfied if our country is to achieve a point along the production poss. IL t b I ices thornier. . Finite resources - at any given time, the total amounts of labor, land and capital are fixed. 2. Full and efficient use of the resources - at any point along the APP we eave productive efficiency. We cannot increase the output of one good without decreasing the output of another. 3. A given state of technology - the production possibilities frontier represents the technology available to producers. For our society to end up at a point along the production possibilities frontier we assume that resources are used fully and efficiently and that the best available technology is utilized.

By satisfying these assumptions, the production possibilities frontier shows the maximum amount of any two products that can be produced at a given time from a fixed quantity of resources. Given that we satisfy our assumptions, what point along the production possibilities frontier we choose depends on society's preferences. If the majority of our citizens want to drive, then we will favor car production. On the other hand, if flying is the preferred way to travel, then more airplanes and fewer autos will be produced. Characteristics of the Production Possibilities Frontier (Summary) 1 .

Points along the frontier show the trade off between two different goods for society; to get more of one, we must give up some of the other. 2. Points outside the curve are unobtainable with given resources and technology. . Points inside the frontier are attainable, but do not utilize society's resources efficiently. 4. The production possibilities frontier illustrates concepts of a. Scarcity - resources are limited. B. Choice - choices in the production of different goods need to be made. C. Opportunity cost - to gain more of a good, something else must be given up.