SECTION 1: Basic Economic Concepts
Need to Know:

Economics is the study of making choice. Choices are necessary because resources are scarce (we can't always have everything we want).

Resources (factors of production):

- labor (the effort of workers),
- land (come from nature),
- capital (machinery, buildings, tools, etc)
- Entrepreneurship (risk taking, innovation, and the organization of resources for production).

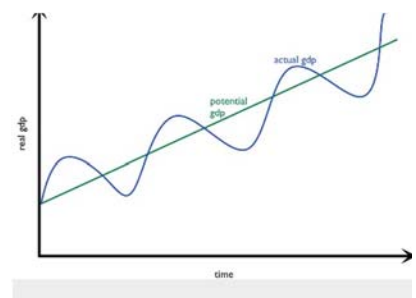
Opportunity Cost: the real cost of something is what you must give up to get it

Positive economics: Economic analysis used to answer questions about the way the world works. Statements of "what is" or "what will be". No value judgments are applied. Positive economic analysis can be tested to determine if it is correct or not.

Normative economics. Economic analysis that involves saying how the world should work. Statements of "what should be". These involve value judgments of what is "right", "wrong", or "best".

Business cycle: The alternation between economic downturns and upturns in the macro-economy.

- Depression
- Recession
- Expansion
- Labor Force LF = E + U
- Unemployment rate UR% = 100*(#U)/(#LF)
- The unemployment rate is defined as the percentage of the labor force that is not employed.



Aggregate Output: the economy's total production of goods and services for a given time period, usually a year.

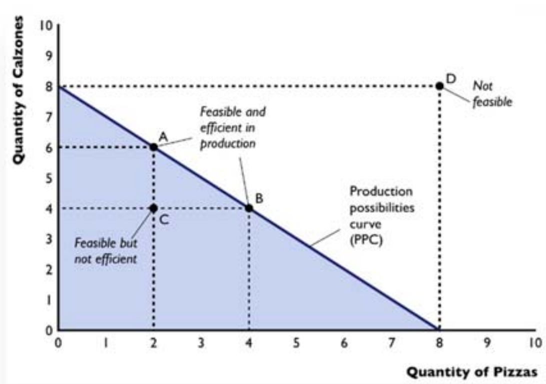
The economy has price stability when the aggregate price level is changing only slowly

Inflation: a rise in the overall price level.

Deflation: a fall in the overall price level.

Ceteris paribus: the other things equal assumption means that all other relevant factors remain unchanged

Production Possibility Curve



All models have simplifying assumptions: Available supply of resources is fixed in quantity and quality at this point in time. • Technology is constant during analysis. • Economy produces only two types of products.

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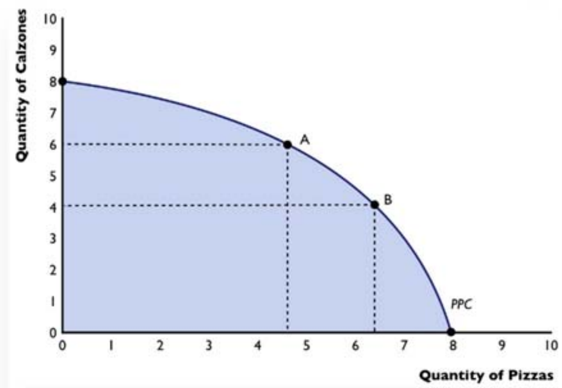
A PPC with a straight line has a constant slope, and therefore, constant opportunity cost.

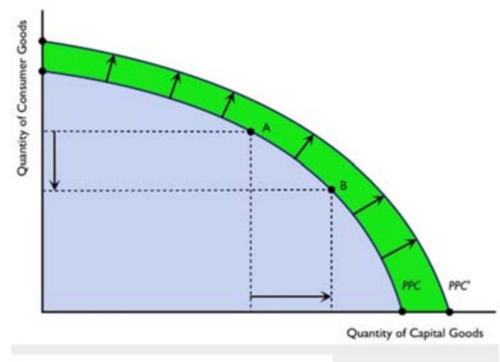


"Law of Increasing Opportunity Costs"

1. **The amount of other products that must be foregone to obtain more of any given product is called the opportunity cost.**
2. **The more of a product produced the greater is its (marginal) opportunity cost.**
3. **The slope of the production possibilities curve becomes steeper (going left to right), demonstrating increasing opportunity cost.**

Economic Growth means an *expansion of the economy's production possibilities:* the economy *can* produce more of everything.

- **Factors of production expand in quantity or quality. A bigger or a more educated/skilled work force.**
- **When technological advances are occurring.**

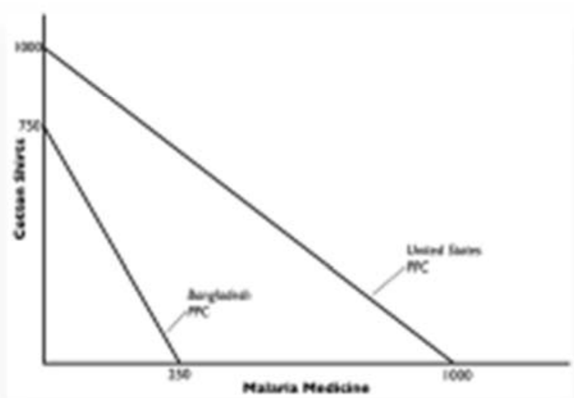


Production Possibilities for Two Countries

Bangladesh has a comparative advantage in Cotton Shirts (C) because they only give up 1/3 unit of medicine while The United States must give up 1 unit of medicine to gain 1 cotton shirt.

The United States has a comparative advantage in Malaria Medicine (M) because they only give up 1 cotton shirt while Bangladesh must give up 3 cotton shirts to gain 1 unit of medicine.

	Bangladesh	United States
Cotton Shirts (C)	750C = 250M 1C = 1/3M	1000C =1000M 1C = 1M
Malaria Medicine (M)	250M = 750C 1M = 3C	1000M =1000C 1M = 1C



A country can have Absolute Advantage in production of both goods, <u>but cannot have Comparative Advantage in both.</u>
A country has Comparative Advantage in production if the opportunity cost of producing the good is lower for them than for other people.
The terms of trade are mutually beneficial as long as they are between the two countries' opportunity costs.