**The Three Questions of Economics:**

* *What* shall we produce?
* *How* shall these goods be produced?
* *For whom* shall these goods be produced?

**The Invisible Hand:**

* Adam Smith coined this term
* The invisible hand is a kind of economic guidance system that makes everything work out
* The invisible hand is made possible by people pursuing their own self-interest
* The bottom line is the “profit motive”

**The Price Mechanism:**

* The price mechanism is based on the law of supply and demand
* Prices send signals to both consumers and producers

**Competition:**

* To have real competition, you need many firms in a particular industry
  + You need so many that no one firm is large enough to have any influence over price
* When sectors of American industry are not very competitive the price system doesn’t work well
  + The invisible hand becomes less active and more ineffective
  + The forces of supply and demand are distorted

**In Conclusion:**

* The United States of America has an imperfectly functioning price system
  + It functions in a less than competitive economy
  + It is guided by a not too vigorous invisible hand

**Equity and Efficiency:**

* Does this system allocate limited resources efficiently?
  + Most economists agree that this system leads to a very efficient allocation of resources
* Does this system lead to a fair distribution of income?
  + No
* The case for equity
  + Tax money from the rich and middle class and redistribute it to the needy
    - This raises the questions
      * How much do we tax and who do we tax?
      * Will “handouts” lessen incentives to work?

**The Economic Role of Government:**

* Federal government
  + Fifty state governments
    - Tens of thousands of local governments
* Each
  + Collects taxes
  + Provides services
  + Make laws and regulations
* This somewhat alters the outcome of the three questions: What? How? For Whom?

**Market Failure:**

* When our resources are not allocated efficiently, we have market failure
* Two basic classes of market failure are
  + Externalities
  + Public goods
    - Both provide an opportunity for government to improve on Adam Smith’s “invisible hand”
* Another cause of market failure is “monopolies”
* External cost
  + This is where the production or consumption of some good or service inflict cost on a third party without compensation
    - When you drive your car you cause a certain amount of pollution and congestion
    - Millions of drivers wear out the highways
      * This results in costs for the maintenance and construction of highways
* External Benefits
  + An external benefit occurs when some of the benefits derived from the production or consumption of some good or service are enjoyed by a third party
    - It is not uncommon for these additional socially beneficial things to be an unintended consequence
    - If you paint your house
      * You add beauty to the neighborhood
      * You increase property values
* The private market
  + Is governed solely by the forces of supply and demand
  + Does not take into account external costs and external benefits
* Market failure occurs when resources are not used efficiently
* When a market failure imposes a high cost on society, we demand that the government do something about it

**Government Action on External Costs and Benefits:**

* If you are doing something that provides external benefits the government may provide you with a subsidy to encourage you to continue
  + For example, the government subsidizes farmers to help keep them from going out of business
* If you are incurring external costs
  + The government can tax you to encourage you to discontinue or change what you are doing
  + The government can impose stringent regulations and impose heavy fines for noncompliance

**Public Goods and Services:**

* A public good is something whose consumption by one person does not prevent its consumption by other people
  + Some examples are national defense, a court system, police and fire protection, the construction and maintenance of streets and highways, bridges, water and sewer mains, environmental protection, public parks, public schools, and public libraries
* Tend to be indivisible
* Usually come in large units that cannot be broken into pieces for purchase or sale in the private market
* Often can’t be provided by private enterprise because there is no way to exclude anyone from consuming the goods even if she or he did not pay for them

**Capital:**

* Capital is the *CRUCIAL* element in every economic system
* Capital consist of plant & equipment
* Capital is the key to every country’s standard of living
* Capital comes from
  + Cutting consumption by saving [Americans are now consuming too much and saving too little.]
  + Increasing production

**Specialization and Its Consequences:**

* Specialization can make it possible to be more productive and efficient
* Specialization is worthwhile only if someone wants what you make or do
* specialization is made possible by money
* Specialization sometimes causes worker alienation
  + This can lower productivity

**Economic Theorists:**

1. **\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_**
2. **\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_**
3. **\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_**

**Adam Smith:**

* The Father of the Modern economics
* 1776 - wrote “A Study into the Nature and Causes of the Wealth of Nations”
* often seen as the beginning of the study of economics.
* outlines the workings of capitalism

**Key ideas from this work:**

* The Invisible Hand
  + business cycle - regulated through the balance of supply and demand
* Self-Interest
  + Individuals acting in their own self-interest create wealth
* The Division of Labour
  + Basically assembly line production. Specialization results in increased output.
* Laissez-faire
  + The government is to leave the economy alone.

**KARL MARX and frederick engles:**

**the theories of marx**

* Capitalism is evil - and destined to lead to it’s own demise.
  + The workers (proletariat) are being exploited (taken advantage of) by the owners of business (the bourgeoisie)
  + As a result a class struggle is inevitable.
* Ultimately the Proletariat will rise up and revolt against the Bourgeoisie resulting the
  + Dictatorship of the Proletariat
    1. As Marx said: "The proletarians of the world have nothing to lose but their chains. They have a world to win. Workers of all countries: Unite!"
* Proletariat=\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_
* Bourgeoisie=\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_
* A class struggle is inevitable
  + It is a simple matter of educating the proletariat
  + They do not need to live this way.
  + They are blinded by assumed custom and religious belief.
* The opium of the people
  + In the actual Communist Manifesto religion (not ham) is described as the opium of the people.
    1. Generally Marx’s point was that religion works to make people feel better about their poor existence and the exploitation they were living under.
* The dictatorship of the proletariat (Socialism):
  + Revolutionaries overthrow the government
  + This creates a new system in which (appointed representatives of) the working class control the government - make all political and economic decisions.
    1. Thus creating a socialist state.
    2. wealth is redistributed to create equality
    3. The state - not the people - now own all means of production - private property is abolished.

**Creating a pure communist system:**

* In time members of such a society will produce according to their ability and consume according to their needs - thus creating a pure communist regime.
* No need for government or central authority
* No need for currency
* No whole nation of the world has ever achieved this level.

**John Maynard Keynes:**

* Believed it is possible to eliminate Laissez-faire without reverting to a Dictatorship of the Proletariat.
* 1936 - wrote General Theory of Employment, Interest, and Money
* This outlined the ideas for a MIXED MARKET SYSTEM

**Mixed market system:**

* Keynes looked at the conditions of the Great Depression and argued that the invisible hand simply was not working - sometimes the government does have to get involved in the
* The Mixed Market system, therefore, contains elements of both the command and market systems.
* The resulting combination depends on the political system in place. (I.e. Canada has a great deal more command elements than the United States.)