What is Economics?

Economics is part of social science concerned chiefly with description and analysis of the production, distribution, and consumption of goods and services. Economics is in many ways the study of everyday life. People put economics into practice almost daily—as they work to earn money and use their earnings to buy things.

Factors of production

Factors of production are usually divided into three categories: land, labor, and capital. **Land** in economics is a general term that includes not only the soil but also other natural resources, such as oil, coal, and forests. **Labor** means the human work, both physical and mental, used to produce goods or services. **Capital** in economics means human-made items, such as machinery, tools, and buildings that are used in production. In everyday language, capital may be used to mean money.

Scarcity

Scarcity means simply that people's wants are unlimited while the resources to satisfy those wants are limited. A person is dealing with the problem of scarcity, for example, if she wants a dishwasher and a new stove but has enough money to pay for only one of them.

Because of the scarcity problem, both individuals and nations must make choices that enable them to satisfy some of their unlimited wants with limited resources. People differ widely in the economic choices they make. Nations differ too, but each has an overall economic system that guides the choices made in that country. Every economic system must provide ways to make three basic economic decisions:

1. *What* will be produced?
2. *How* will it be produced?
3. *For whom* shall it be produced?

Opportunity cost

Opportunity cost refers to the gains that are passed over in the choice of doing one thing instead of another. Suppose after waking up in the morning you have option to have coffee or tea as breakfast but you cannot have both. If you choose to have coffee then the opportunity cost of having coffee is having tea.

Microeconomics and Macroeconomics

Microeconomics is the study of individual markets. A market is any place where the seller of a particular goods or service can meet with buyer.

The study of the overall workings of a national economy and of its relationship to international markets is called **macroeconomics**. Macroeconomics deals with what nations as a whole produce and trade, and with the major government and private institutions that operates in the national and world economy.

Modern economic systems

There are three basic economic systems: capitalism, socialism, and communism.

The main forces that make **capitalism** work are self-interest and competition. Private Citizens own most of the land and capital. They operate businesses to make profits for themselves. **Profit** is the money left after all the expenses of running a business have been paid. Business owners must compete, or try to stay ahead of other businesses that are also working for profits.

In a **communist** system, self-interest and competition are less important. Communists believe that the goals of society are more important than individual wants. The government controls the land, capital, and labor. The government plans the nation's economic goals and directs all the economic activities.

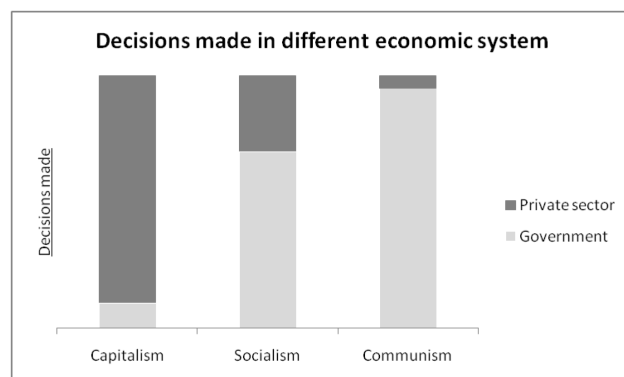
In a **socialist** system, the government controls the major resources and capital, such as the mines, steel mills, and air and rail networks. Individuals in the private sector may own smaller businesses.

Type	Characteristics	Examples

System	Characteristics	Examples
Capitalism	• Individuals and private organizations own and operate businesses. • Free market determines production and distribution of goods and services. • Prices set by supply and demand.	• United States of America
Socialism	• State owns and operates many businesses and services. • Private ownership is allowed. • Citizens pay high taxes to fund state-run social services, including healthcare, food, and housing.	• Sweden
Communism	• State, or the community, owns all businesses. • State controls distribution of goods and services. • State provides social services.	• China • Cuba • Former soviet union

The graph below shows these economic systems and who makes the basic economic decisions between government and private sectors.

The private sector makes most of the economic decisions under the system of capitalism. Under communism, the opposite is true: the government makes nearly all the economic decisions. Socialism is an in-between case: the private sector makes fewer decisions than the government does, but it still plays an important role in the nation's economy.



In actual practice, it is impossible to find examples of nations that follow either pure capitalism or pure communism. The United States is the world's leading capitalist nation, yet the government carries on a number of very important economic activities. The People's Republic of China is a leading communist nation. Yet in recent years, the government of China has encouraged a greater role for the private sector. That is why economists say most modern nations have "mixed economies" rather than pure forms of capitalism or communism.

Economic system in Bangladesh

Bangladesh employs mainly mixed economic system where Private sector and government has hands on most of the sectors.

Economic system in United States of America

The U.S. economic system is largely capitalistic. Another name for capitalism is free enterprise. Free enterprise is based on a principle known as the *free market system.* In economics, a **market** is business carried on between buyers and sellers.

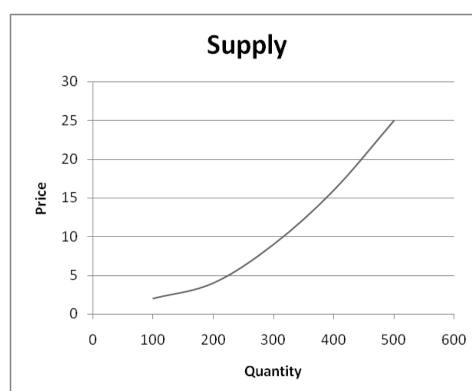
In the free market system, prices help decide what, how, and for whom to produce. Self-interest, profits, competition, and the right to own private property are the key factors in free enterprise and the free market system.

Self-interest is the single, most powerful force in the U.S. economy. **Consumers,** or the people who buy goods and services, shop for the best possible goods at the lowest prices. Producers look for ways to make the largest possible profits. Their search often leads them to invent better products and to develop the most efficient ways to produce them. High profits may encourage producers to expand their businesses. That growth will make more goods available to consumers and provide more jobs for workers. Competition has a similar effect. Because producers must compete with one another, each business tries to keep the quality of its goods high and prices low so that consumers will choose its products over others on the market. Consumers, in turn, get a broad choice of products to buy.

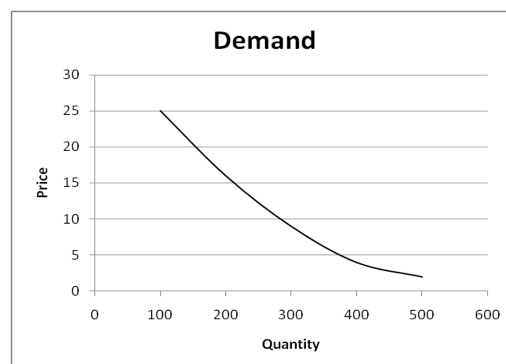
The U.S. economic system also protects the right to own private property. Private property includes factories and stores as well as people's homes.
Under free enterprise, the U.S. government makes no central plan for the nation's economy as the Communist government in the former Soviet Union once did. However, the government does make laws and regulations that limit the freedoms of private business owners. The minimum wage, for example, is a government regulation.
The government also produces certain kinds of goods and services. The postal system, local schools, and city bus lines are all government sponsored. The purpose of these government regulations and services is to keep the country running more smoothly.

Determination of price in an economy
In some countries, prices are set by the government. In a free enterprise system, however, prices are determined in the market. A market exists when buyers, who have money and want to buy goods and services, are in contact with sellers, who offer goods and services and want money. The price of a given product is established both by the buyers, who want to buy at the lowest possible price, and the sellers, who want to sell at the highest possible price.

Supply
Economists say that prices are determined by the relationship between supply and demand. **Supply** is the quantity of a good or service that a seller is willing to sell at a certain price. The **law of supply** says that if the price of a product is high, the producers will be willing to sell more of it. If the price is low, they will want to sell less of it Economists picture supply by using a line graph. Prices on a supply graph are shown on the vertical axis, and quantities are shown on the horizontal axis. The graph on the right is an example of a supply graph. The supply curve in the graph slopes upward. This shows that the quantity of product offered for sale increases as the price increases.



Demand
Demand is wanting a product, plus being willing and able to pay for it. The **law of demand** states that if the price of a product is high, consumers will demand less of it. If the price is low, they will demand more.
The demand curve in the graph to the right slopes downward. This is because the lower the price of product, the greater the quantity demanded.



Determination of price in a market
In a free market economy, the price of a product is determined at the point where the quantity that consumers want to buy is equal to the quantity that producers want to sell. This is called the **market price.** The market price of peaches is illustrated in the graph.

Savings
Any personal earnings that are not spent are called savings. Consumers may decide to save part of their money rather than spending their money. They may save for future, to by

house or for their children's education. The amount of saving depends on number of factors as the level of their income and personal preferences. The rich can afford both to spend more and to save more. People with low incomes are often unable to save; they may even have to borrow money to meet everyday expenses. And some people who can afford to save may prefer to spend most of their money.

Investments

Savings that are put to work to earn more money is called investment. Keeping saved money is not an investment, it is merely savings. A savings account in a bank, on the other hand, is an investment. It earns interest.

Interest

Any additional money paid by banks to people for depositing money into their savings account is interest. Money market funds, another form of investment, usually earn higher interest than savings accounts.

Insurance

Some people invest part of their savings in some kind of **insurance.** Insurance protects the insured person against possibly large financial losses that could occur from accidents, long illnesses, or deaths in the family. Under the terms of the insurance policy, the insured person agrees to pay a premium to the insurance company. In return, the insurance company agrees to pay up to a maximum amount to an insured person who suffers a loss. Insurance come in many form including automobile insurance, life insurance, home insurance etc.

Profit/Loss

Profit is any excess capital earned in selling any good for more than the cost to produce the good. A business has comparative advantage in producing good at lower price. A business with comparative advantage makes more profit. If spending is excess then it is called loss or deficit.

Productivity

Productivity is the output per unit of labor. It is the rate at which a labor can produce goods or service.

Entrepreneurship

Entrepreneurship is the quality of a person to own and manage a business. Entrepreneurship shoulders the effort and risk at running a business.

Specialization

Specialization is the method of limiting the area of economic activity. Companies and individuals specialize mainly because they do well in that economic activity.

Incentive

An economics incentive motivates people to do something. Positive incentive reward people financially for making certain choices and behaving a certain way. For example electricity companies offer price reduction for using less electricity and using energy efficient electric appliances.

Budgets

Many consumers plan ahead when it comes to spending their money. They do this by making budgets. A budget is simply a list of expected spending and expected income. A budget can cover different periods of time: a week, a month, or a year.

When people prepare a budget, they usually start with those costs they know they are going to have to meet. Rent, electric bills, and loan payments would be in this group. Then they compare these costs with their expected income for the same period of time. The difference between the two amounts gives them an idea of what they can spend on other things.

Competition
Competition occurs when more than one seller provides the same good or service. Sellers compete to attract buyers for their product. They set prices that attract consumers, or they improve their product in order to offer customers better value.

Monopoly
Monopoly is a situation when a seller is the only one to offer a certain product or service. When a seller has monopoly they can set prices as they want and they tend to set prices higher than they would have in a competitive market.

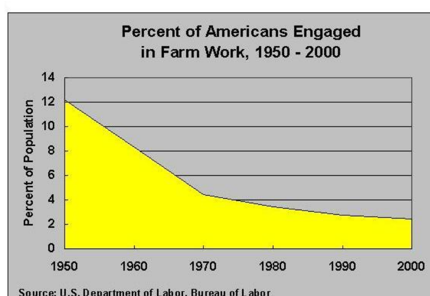
Sole proprietorship
Sole proprietorship is a business owned wholly by a person. The sole proprietor can either manage the business or choose persons to manage the business. Example of this type of business includes barber shops, repair shops, service stations, restaurants etc.
The owner of a sole proprietorship enjoys the advantage of not having to share the profits. The owner is also free to make decisions on his or her own. However, he or she is also responsible for all the losses and debts of the business. If the business fails, debts can ruin the owner financially. Unfortunately, a great many sole proprietorships do fail, and some owners are never able to repay their debts. For this reason, many banks do not like to lend money to sole owners.

Partnership
When a business is owned by multiple individuals or partners it is called a partnership. Every partner contributes to the business either by work or money or both. All the partners share the profits and losses the rights and responsibilities of each partner are usually specified in a written contract called a partnership agreement. Professionals such as lawyers, doctors, dentists, and accountants often form partnerships. Each partner can bring different skills and talents to the partnership. In a law partnership, for instance, each partner may be a specialist in a different aspect of the law.
Partnerships are less likely to face difficulties borrowing money than sole proprietorship. In a partnership business decisions are harder because partners may disagree on decisions. If a business fails all partners generally pay share of loss even if a single partner is responsible for the failure.

Corporations
Corporations vary from a few owners to hundreds of thousands of owners. Corporation ownerships are equally divided into number of shares. People owning the shares are called shareholders, who are the true owner of the corporation. Corporations are managed by board of directors elected by the shareholders. The board of directors selects the main officers in the corporation. The voting right during the election of board of directors is determined by the number of shares owned. Shareholders with many shares have considerable influence in the election of the board of directors. Sometimes these majority stockholders elect themselves to the board of directors.
It is easier for corporations to raise funds; they can do so by selling shares of stock or by borrowing money. If the corporation fails, its stock will lose value, but the stockholder cannot be held responsible for the debts of the corporation. The owners of a corporation do not have to be involved in management of the company; that is the responsibility of the corporation's board of directors and managers. If one of the owners of a corporation decides to sell his or her shares of stock, he or she can easily do it, unless the corporation is in very serious financial trouble. While sole proprietorships or partnerships have to be closed or reorganized if an owner withdraws or dies, corporations hardly change if an owner withdraws or dies.

The labor force and the economy
Labor is one of the important factors of production. Labor provides the work needed to produce goods and services. This work can be physical or mental. The **labor force** is the group of men and women who are available to work.
In the United States, the labor force is made up of people 16 years of age or older who either are employed in nonmilitary jobs or are looking for work. People with military jobs usually are not

considered part of the labor force. The U.S. labor force, in the early days of the country's history, was about 2 million people. Now it is more than 100 million.



The nature of the work also has changed. Most workers are now in white-collar office jobs, sales and marketing, managerial positions, or service industries. In contrast, when the United States became independent in 1776, about 90 percent of the people in the country were farmers. Today, the U.S. farm population is less than 2 percent of the total population. The dramatic decline of the farm population over the last five decades is illustrated in the graph on the left.

In return for their work, members of the labor force are paid wages. Some workers are paid by the amount of work actually completed; others are paid a specific amount by the hour, week, month, or year. In a free market economy like that of the United States, wages—like prices—are determined by supply and demand. For instance, wages of unskilled workers are usually low because the supply of workers is usually larger than the demand for such workers. On the other hand, **skilled workers,** who have received special training, usually receive higher wages. This is because the supply of skilled workers is not as large as the demand for them.

Labor unions are workers' organizations that have been formed to protect the members' interests and increase their bargaining power with employers. Labor unions are very influential in the United States, even though only about a fifth of all workers in the country are union members.

Gross Domestic Product (GDP)

GDP is one of the primary indicators used to measure the strength of the economy. It represents the total value (Usually in US dollars) of all goods and service produced by a country over a specific period of time (Usually a year or a quarter). GDP is the main measure of production in USA.

Gross National Product (GNP)

GNP measures a country's total production. GNP is the market value of all the goods and services a country produces in a given year. To avoid double counting, only the final goods and services are included. The values of the bricks, glass, mortar, and wood used to build a house, for instance, are not counted. Only the worth of the final good, the house itself, is included in the GNP.

Many economists think that in order to measure the true value of a country's GNP, they must look at the per capita GNP. The per capita GNP is the dollar amount they get when they divide the GNP by the number of people in the country. A country with a very large GNP may still be a poor country if its GNP must be distributed among a huge population. A country with a comparatively small GNP may be a rich country if its population is small.

Consumer Price Index (CPI)

A consumer price index (CPI) measures changes in the price level of a market basket of consumer goods and services purchased by households. Increases in the CPI are used to measure **inflation.**

Inflation

Inflation occurs when prices keep rising. The CPI is calculated by keeping track of price changes in a "basket," or a particular group of goods and services that consumers normally buy in all parts of the country.

Deflation

When prices of product keep falling it is classified as deflation.

Unemployment

Unemployment in a nation is measured by means of the unemployment rate. Unemployment occurs when there is not enough work for all the people who are looking for work. The unemployment rate is found by dividing the number of unemployed persons by the number of workers in the labor force, and then multiplying the result by 100. This gives a percentage figure. If 5 million people are unemployed, for example, and the labor force is 50 million, the unemployment rate will be 10 percent.

Economic Growth

If a country's gross national product is increasing each year, economists say that its economy is growing. The percent of change in the GNP or per capita GNP from one year to the next measures the rate of a country's economic growth. If a country's GNP stays the same or goes down, it has experienced no economic growth for that year.

Most countries believe that economic growth is a good thing. If more and more goods and services are produced, there will be more and more jobs for workers. There will also be more products for consumers, and life in general should keep getting better for the people of the country.

Economic growth can benefit more than one nation at a time. If the economy of the United States is growing, its producers will need to buy more materials from other countries. U.S. businesses will also have more money to invest in foreign businesses. The United States in turn can benefit from growing economies in other countries. The United States needs markets in other countries to sell its products. Countries with growing economies will have more money to buy U.S. goods. And the sale of U.S. goods abroad helps both business owners and workers at home.

Economic Instability

Economic stability is a difficult goal for most countries to achieve. In a perfectly stable economy, economic growth would be combined with little or no inflation and low employment. No country, however, is free from inflation or unemployment.

Inflation is a constant rise in prices. It does not affect all people in the same way. Most salaried people and wage earners will feel some ill effects from inflation. People drawing Social Security or public welfare checks will suffer the most. Their incomes increase too slightly or much too slowly to keep up with the rate of price increases. The rich suffer least from inflation. They usually cut back on their savings rather than their spending. In addition, they are apt to own many stocks and bonds. During times of inflation, the interest earned by stocks and bonds may also go up; the income of rich shareholders may keep pace with inflation.

Another form of economic instability is **recession.** When a country is suffering from a recession, the production of goods and services declines. Some capital equipment, such as factories and machines, will be idle, and some workers will be unemployed. As a recession becomes more severe, unemployment increases. A recession exists when a nation's GNP declines or fails to grow for a period of at least six months. When a recession lasts a long time and is very severe, it is called a **depression.** The worst depression in the history of the United States, the "Great Depression," occurred during the 1930s.

Inflation and recession occur under opposite circumstances. When the amount of money circulating—or being spent—in the economy greatly exceeds the value of available goods and services, prices go up. Inflation occurs. When there is too little money to pay for the available goods and services, production goes down and unemployment goes up. A recession occurs. At times, the United States and other countries have experienced yet a third form of instability, called **stagflation.** Stagflation means that the economy suffers from both high inflation and high unemployment.

Policies for economic stability

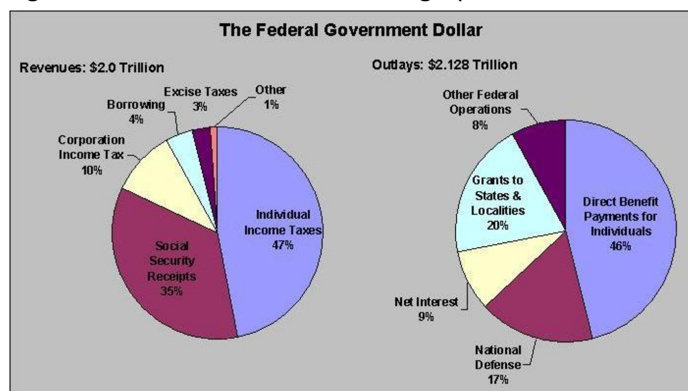
Government fights economic instability on two main fronts: **fiscal** (budget) policy and **monetary** (money) policy. The government's fiscal policies decide how it will tax the people and how it will spend the money it collects. Its monetary policies dictate how much money will flow through the economy.

Inflation occurs when total demand and spending are greater than total production. To control inflation, the government may adopt a fiscal policy to cut down on its spending. Reducing the government's demand for goods and services reduces total demand. The decrease in demand tends to reduce inflation. The government can achieve the same result by increasing taxes without increasing government spending. Higher taxes will mean that individuals and businesses will have less income to spend. This will lower total demand and will tend to reduce inflation.

To fight recession, the government will reverse its fiscal policy. Instead of trying to reduce spending, the government will try to encourage it. The government probably will increase its own spending

with the aim of boosting production, increasing jobs, and raising incomes. Or the government might reduce taxes. This would leave individuals and businesses with more money to spend and to invest.
Monetary policy in the United States lies with the Federal Reserve System, a government agency that is basically independent of Congress and the president. The Federal Reserve is basically a bank for banks. It holds a certain percentage of the banks' deposits, and it provides loans to banks.
The Federal Reserve controls the size of the money supply on a daily basis. During periods of *inflation,* the Federal Reserve *reduces* the amount of money flowing through the economy. Money then becomes scarcer, so it increases in value. The rise in prices slows down. During a *recession,* the Federal Reserve *expands* the money supply. This encourages producers to make more goods, and it gives the economy a needed boost.
Controlling the money supply has little to do with *printing* money. The Federal Reserve controls the money supply mainly through its dealings with banks. For instance, to fight inflation, the Federal Reserve can raise the **discount rate.** The discount rate is the rate of interest the Federal Reserve charges when it makes loans to private banks. Because banks must pay higher interest rates, they will raise the interest rates for their loans to customers. Individuals and businesses will borrow less money. Consequently, there will be less money in use and less pressure to increase prices. In times of recession, the Federal Reserve will take the opposite tack. It will lower the discount rate to increase the amount of money available for spending.

Government spending and Regulation
The government provides many services that are vital to all Americans. National defense, food and drug safety, highways, and Social Security's health and retirement benefits are just a few examples. The first graph below shows that the federal government gets most of the money to run its programs from taxes. It also borrows sizable sums from banks or from individuals who buy government bonds. The second graph shows that the government spends more than two-thirds of its money on national defense and benefit programs for individuals.



If the government spends more than it takes in, the federal budget will show a **deficit.** Each year that the budget shows a deficit, the government's debt grows larger. The amount of interest the government owes on money it has borrowed also grows. The federal deficit for 2003 is expected to exceed $200 billion. Many economists believe that large deficits will lead to higher interest rates. They also predict that other economic problems may result. Federal budget deficits have attracted the concern of thoughtful government leaders, citizens, and economists.
Private business is well aware of the government's presence in the economy. Government **antitrust laws** stand to prevent any one company from becoming so large that it eliminates all competitors. The government also plays public watchdog on private business practices. Factories that pollute the environment, for instance, must pay higher taxes.
Some people charge that the government's involvement in the economy does more harm than good. Some believe that government taxes discourage people in business. Other critics think that many of the government's safety standards are so high and so expensive that producers are forced to raise prices of goods. And then there is the enormous paperwork that government requires of business.

Protection and education
A number of different agencies protect consumers in the United States against fraud and harmful products. All levels of government—local, state, and federal—have such agencies.
At the local level, most cities have departments that inspect restaurants. Both state and local governments enforce laws to make sure that accurate weights and measures are used by sellers. To

accomplish this, inspectors frequently check merchants' scales and gasoline pumps. State and local governments also have strict regulations concerning the quality of perishable goods, such as milk.

The federal government has many agencies that protect consumer health and safety. The Food and Drug Administration (FDA) prevents dangerous foods, drugs, and cosmetics from reaching the market. The FDA has very strict standards for testing new drugs before they can be marketed. Another federal agency, the U.S. Department of Agriculture (USDA) is responsible for inspecting and grading food sold across state lines. The USDA also provides booklets on food and nutrition to the public.

There are several other federal agencies that work to educate and inform the consumer. For example, the Federal Trade Commission (FTC) tries to eliminate false or misleading advertising throughout the country. The list of ingredients and nutritional information on packaged food is included to fulfill FTC requirements. Another agency, the Consumer Information Center, publishes hundreds of booklets to provide important information to the buying public.

There are also some private organizations that help protect consumers. For instance, Better Business Bureaus are sponsored by private business in many cities. These bureaus fight misleading advertising and other unfair business practices. They keep information files on many companies and record any known complaints against them. If people have doubts about whether to deal with a specific company, a call to their local Better Business Bureau can often help them make up their mind. If consumers feel they have been misled or unfairly treated by a company, they can file a complaint with the Better Business Bureau.

Exports and Imports

Exports are goods and services that a country sells to other countries. On the other hand if a country buys goods and services from other countries it is called imports. All countries export and import goods and services, and all countries benefit from it. By exporting, a country gains income. By importing, it can obtain products that it does not have within its borders.

Balance of trade

A country's **balance of trade** is the difference between the value of its exports and the value of its imports in any given year. If the value of exports is greater than the value of imports, i.e. it is selling more than it is buying a country has a positive balance of trade or **trade surplus** for that year. If the value of its imports is greater, i.e. it is buying more than it is selling the country has a negative balance of trade or **trade deficit**. A trade surplus is more desirable. But in many case countries have a trade deficit.

Multinational Corporations

When corporation expands its reach by extending its business to all parts of the business they are called multinational corporations. A multinational corporation is a business organization that has its main office and possibly some production plants in one country. At the same time, it also has factories, sales offices, mining operations, or other business operations in foreign countries.

Conglomerate

A conglomerate is a group of businesses that come together under one name and one organization but produce many different products. Samsung is a good example of conglomerate. Samsung companies are spread around the world with different business including technology business to property business.

Foreign competition

Competition is a strong force in a country's free enterprise system. Sometimes countries try to reduce foreign competition to help domestic industry bloom. Government can protect the country's industries by charging **tariffs,** which are also called **duties.** Tariffs are taxes placed on imports to raise their prices. The consumer pays these taxes. Government can also set **quotas** to protect the country's producers. Quotas limit the amount of certain imports that may come into the country over a specific period, usually a year.

Key economic events in US history

McGraw-Hill education's Preparation for the GED Test book: Page 801-802

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