

The Economic Way of Thinking (part 2)**name:**

Introduction to Economics

Unit 1

Key Idea: How do the various economic systems (traditional, market, command, mixed) answer the questions: (1) What to produce?; (2) How to produce?; and (3) For whom to produce?

4. People create economic systems to influence choices and incentives.

Economic Systems are a means of a society answering the three basic economic questions:

1) _____

2) _____

3) _____

- Coordinating the needs of the people in a society takes the cooperation of many people involved
- There are _____, written and unwritten that guide people's behavior by adding _____ to trade in certain ways

Command Economy

- The _____ answers the three basic economic questions for everybody.

Traditional Economy

- The three basic economic questions are answered _____.

Market Economy

- The _____ determines the answers to the three basic economic questions

5. People gain from trade voluntarily.

- People will trade when they believe the trade will _____
- Like any Rational Choice, trade is another _____
- Economic Systems are about trade, and therefore about _____

6. People's Choices Have Consequences for the Future.

Every decision has side effects both direct and indirect (these are called _____ or _____)

- These secondary effects, where predictable, are _____
- When these secondary effects are not predicted the will result in _____

In a Market economy, whenever any information is unknown or unavailable in the decision making process, it is considered a "_____."

- A **Market Failure** occurs whenever any of the requirements for a competitive market (such as, adequate competition, knowledge of prices and opportunities) are _____.

What was one time when you made a choice and afterwards realized that there was an extra benefit you hadn't thought of? If you knew about the extra benefit ahead of time, what would you have done differently?

What was one time when you made a choice and afterwards realized that there was an extra cost you hadn't thought of? If you knew about the extra cost ahead of time, what would you have done differently?

- Because people behave _____, the institutions such as government and businesses will make choices expecting secondary effects that will _____
- In this way, creating these secondary effects amounts to changing the incentive as per rule #3

7. Economic thinking is marginal thinking.

Marginal is the economists' term for "_____"

- In economics, decisions are made "_____" – "How much benefit will I gain from one more of <the item I am considering>?"
- Remember, as long as Marginal Benefit \geq Marginal Cost ($MB \geq MC$), we _____

(See the example of Park Hopper passes to Disney World)

8. The value of a good or service is affected by people's choices.

Value is _____; it is determined by the preferences of the _____ and _____

- Keeping in mind rule #2, people seek to _____ while _____
- Therefore, the value of any given _____ is based on any individual person's evaluation of the _____
- This includes the decision to _____ AND the decision to _____

9. The test of a theory is its ability to predict.

Theories differ from laws in that theories have not been tested on every single possibility

- In economics, most of what is dealt with is theory since only MOST people behave in predictable ways
- Theories and models are the basis for _____ and is what makes economics _____

Demonstrate your understanding of the topic by answering the Key Idea: How do the various economic systems (traditional, market, command, mixed) answer the questions: (1) What to produce?; (2) How to produce?; and (3) For whom to produce?
