The Foundation of Economics

Scarcity Exists

- A **want** is something that we desire to have.
- **Resources** are needed to produce the goods and services that satisfy our wants. However, resources are limited. **Scarcity** occurs when our wants are greater than the resources available to meet them.
- Scarcity results in the need to make choices. Regardless of our level of income, each of us must make a choice when purchasing goods or services.

Making Choices Leads to Opportunity Costs

- An **opportunity** cost is the most valued opportunity or alternative we give up when we make a choice. Opportunity costs affect people's decisions every day (See Transparency 1-1).
- A **trade-off** is a situation in which more of one thing necessarily means less of something else.

TRANSPARENCY 1-1: Opportunity Cost

What to do	What you would have done	Opportunity cost
Go shopping for two hours	Watch a two-hour movie	The opportunity cost of going shopping for two hours is watching a movie.

The most valued opportunity or alternative you give up to do something–the next best choice–is that something's opportunity cost.

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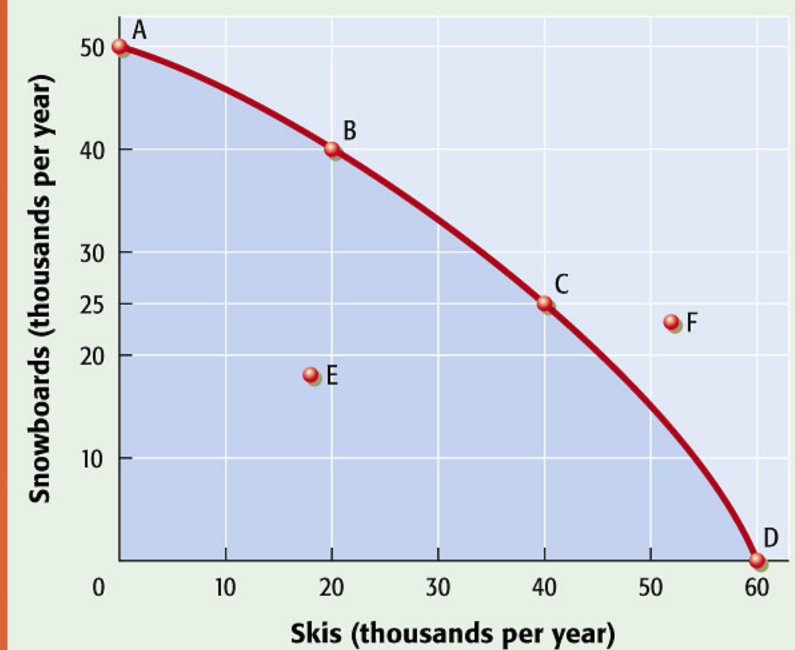
- A **production possibilities frontier** is a graphic representation of all possible combinations of two goods that an economy can produce. Scarcity, choice, and opportunity cost work together in a production possibilities frontier. (See Transparency 1-2.)
- Combinations A–D show us examples of how many skis and/or snowboards the economy is capable of producing in a given amount of time. These combinations, when graphed, form a line. The economy can produce any combination of skis and snowboards along or below this line.

TRANSPARENCY 1-2: The Production Possibilities Frontier

- The economy can produce any of the four combinations of snowboards and skis in part (a).
- These combinations are plotted in part (b).
  - The economy can produce any combination of snowboards and skis along, or below, the PPF.

Combination	Snowboards	and	Skis
A	50,000	and	0
B	40,000	and	20,000
C	25,000	and	40,000
D	0	and	60,000

(a)



(b)

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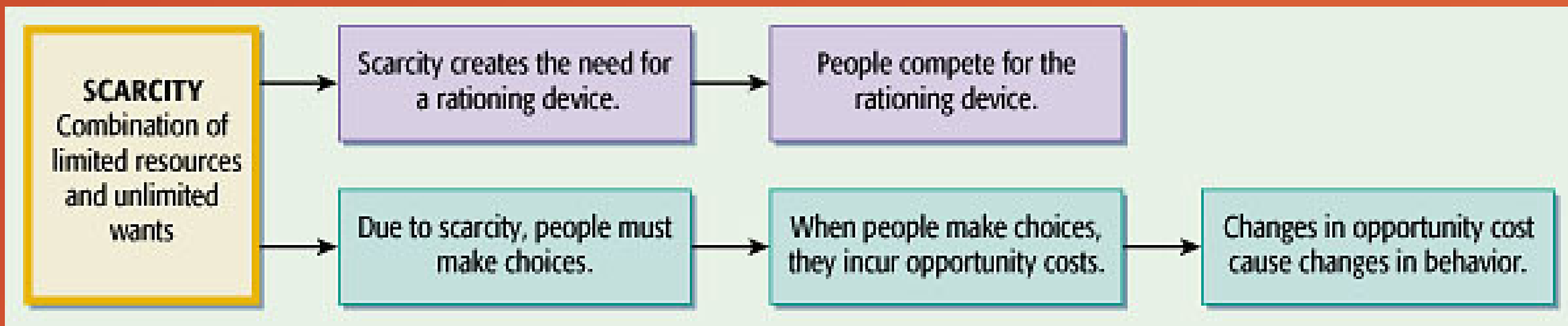
- Let’s compare points B and C. When the economy reduces snowboard production from 40,000 to 25,000, the production of skis is able to increase from 20,000 to 40,000. The opportunity cost of not producing 15,000 snowboards is equal to the production of 20,000 skis.
- Point F shows us a production combination that is not possible. There are not enough resources available to produce this quantity of both skis and snowboards.

A Rationing Device Is Needed to Deal with Scarcity

- Because of scarcity, we need a **rationing device** to determine who gets what portion of all the resources and goods available. What is one common way our society determines who gets a certain good? Money is the most widely used rationing device in our society.
- Because people compete for the rationing device, competition is a consequence of scarcity.
- If scarcity did not exist, everyone would get everything that he or she wanted. (See Transparency 1-3).

TRANSPARENCY 1-3: Economic Facts of Life



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Economics Defined

- **Economics** is the science that studies the choices of people trying to satisfy their wants in a world of scarcity. Put another way, economics studies how people use their limited resources to satisfy their unlimited wants.