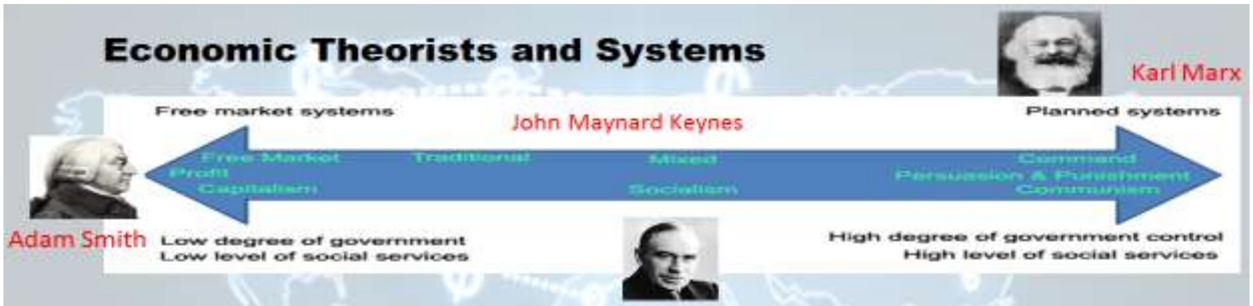
# Module 5 Review Guide




| Economist | Beliefs/Ideologies… | What they did <u>not</u> believe in or would <u>not</u> support today | Relate to… |
|---|---|---|---|
| **Adam Smith** | ○ *Laissez-faire* – No government intervention.<br>○ Let the market work on its own.<br>○ Individuals own and control the factors of production (see mod 3)<br>○ Supply and Demand determines what will be produced.<br>○ Free Trade | ○ Social Security<br>○ Minimum Wage<br>○ Environmental regulations<br>○ Protectionism in trade | Free Market |
| **Karl Marx** | ○ Government controls all of the economy. Government owned companies and resources<br>○ Government decides what and how things would be produced. | ○ Free Trade<br>○ De-regulation<br>○ Private Entrepreneurs | Command Economy |
| **John Maynard Keynes** | ○ Government and Private industry working together to regulate the economy.<br>○ Government would step in to help struggling economy by using Monetary + Fiscal Policy (see mod 4)<br>○ Believed in government deficit spending to help the economy | ○ Reduction in Minimum wage<br>○ De-regulation<br>○ No government action in a recession<br>○ A balanced budget amendment | Mixed Economy |

*When answering questions about the economists, remember to think about what they believe in and what they are against!

**“It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest”. - Adam Smith**

**“The theory of Communism may be summed up in one sentence: Abolish all private property.” – Karl Marx**

**“The political problem of mankind is to combine three things: economic efficiency, social justice and individual liberty.” — John Maynard Keynes**

**Economics Goals of Nations** – think of these as long term goals for nations. Low unemployment and low inflation would be short term goals.

| National Goal | Definition | Related Economic Indicator | Examples |
|---|---|---|---|
| **Freedom** | Extent of personal choice, extent of ability to enter, compete, and exchange in markets, protection of personal property | (EFW)Economic Freedom of the World Index – it compares economic freedom in countries throughout the world to be able to start and maintain private business. | An example of this would be how open a country would be to letting you start a business. If a law was passed to make all companies owned by the state then that would impact Freedom. |
| **Equity** | Extent to which citizens of a society have equal opportunities to share in the country's overall wealth | Income gap between rich and poor, Statics showing differences in wealth by groups such as age, gender, ethnicity or career | If a law was passed for tuition free college then that would try to give equal opportunity. If the country restricted women from holding certain jobs then that would go against Equity. |
| **Growth** | Increasing overall output of the country's economic goods over time and increasing standard of living | GDP(Gross Domestic Product), CPI, Other rates such as housing starts or car sales | These are where you would see GDP changing. If it went up you would have growth. Another example would be in the recent recession housing starts went way down showing a decrease in growth. |
| **Security** | Extent to which citizens of a society are able to provide their own material well-being even in time of crisis | Jobless claims, Unemployment rate, Poverty rate | This goal shows how much personal security individuals have not military security. If the unemployment rate was increasing. Then security would be going down. If the poverty rate was decreasing then the countries security would be getting better. |
| **Efficiency** | Maximizing the use of resources in a society's production | Balance of trade—A country's exports value minus imports value | This goal goes with specialization and comparative advantage. Anything that would make a country better able to produce items will increase Efficiency and allow them to export more. For example China has a high Efficiency since they export more than they import. |

**Why Do Countries Trade?** Countries trade in order to obtain resources and products the country's people are unable to produce efficiently themselves.

**Specialization** (focusing on specific products for production in higher quantities) allows a country to produce higher quality products and potentially enter into trade agreements with other countries. Those countries, in turn, specialize in their own goods and services. Each country specializes in certain products and trade to obtain other products.

**Comparative advantage** - when a country has a **lower opportunity cost** than another country to produce a particular good or service.

**Absolute advantage-** This is when an individual, company, or country requires less physical resources than another to produce a particular good or service.

Understanding how to interpret advantage charts:

| | **Worker hours to produce one unit of natural gas** | **Worker hours to produce one unit of oil** | **Additional hours to produce oil instead of natural gas** |
|---|---|---|---|
| Saudi Arabia | 1 | 8 | 7 |
| Canada | 1 | 10 | 9 |
| Iran | 2 | 8 | 6 |

Using the chart above, look at the number of hours it takes each country to produce natural gas and oil, respectively. Does anyone have an absolute advantage in all areas? The answer is no, because Saudi Arabia and Canada both only take 1 hour to produce natural gas, there is no absolute value shown. The same applies for oil with Saudi Arabia and Iran producing oil at the same rate of worker hours so no absolute advantage is shown here either.

Now look at the additional hours it takes to produce oil instead of natural gas. We see that Iran has the comparative advantage, because it takes them fewer additional hours than either Canada or Saudi Arabia. It makes sense to let Iran specialize in oil since they have the lowest opportunity cost (give up less natural gas production) when producing oil.

## Should Free Trade Be a Goal?

**Arguments to ban trade**:

1. **National Security** - Avoid dependence on imports for items critical to defense

2. **Prices** - Avoid oversupply of cheap foreign products forcing domestic producers to lower prices

3. **Domestic Businesses** - Avoid competition of low pay for foreign workers or recognition of a foreign brand

4. **Domestic Jobs** - Avoid sweatshops, child labor, forced labor, and other undesirable working conditions that attract companies to employ foreign workers

5. **Consumer Confidence** - Avoid drops in market

## Barriers to Trade

| **Barrier** | **Description** |
|---|---|
| **Quota** | A quota sets a maximum amount of a product for import. With less product available, quantity supplied decreases and price increases. |
| **Tariff** | A tariff is a tax on imported goods. It is added onto the selling price when it enters the country and increases the price of import goods, thus decreasing the quantity demanded. In addition, it provides more tax revenue to the government. |
| **Regulation** | A regulation is a safety and quality standard. It may result in the ban of specific ingredients proven to be hazardous. If a product includes these ingredients, it is not allowed to enter the country. A regulation also serves as a standard for environmental or ethical impact. |
| **Impact** | Impact limits consumer access to goods that are considered to be of poor quality or do not meet social expectations. |
| **Embargo, "ban"** | An embargo is the complete refusal to import a good or even all goods from a particular country. It can create a black market for those goods and hurts the political relationship with the country that has been banned. It could also potentially hurt the economy of one or both countries. |

**Balance of Trade** – the value of a country's exports minus it's imports.  Countries want to have more exports than imports.  This includes both goods and services.


When analyzing free trade maps, look at areas where free trade agreements are heavily found.  Look at this map in terms of the U.S.  This map shows you that the U.S. trades heavily with the other North American countries.  This map also shows that other free trade agreements we hold are often with countries bordering a large body of water. Logical reasoning will tell you this is because it is less expensive to trade by sea than by air or land.  It should also not be surprising that we have the most free trade with our neighbors to the immediate north and south of us, as it is cheaper to trade with countries that are geographically closest and also good for keeping good relations.

## Benefits and Costs of Free Trade

| Benefits | Costs |
|---|---|
| ○ Comparative advantage works its magic. (Countries will produce and export what is most efficient for them.)<br>○ Competition has its own mojo. (Competition drives down prices, increases efficiency, and encourages innovation. This is no different when talking countries instead of small town businesses.)<br>○ Cooperation solves problems. (Some say problems between countries are more likely to be addressed when leadership has close economic ties through trade. They might make agreements that help prevent the illegal drug trade or even prevent war, for example.)<br>○ Economic growth is promoted. (Growing employment options and wages can help reduce social problems such as unemployment and poverty.)<br>○ Free trade defends against others barriers. (Creating a regional free trade agreement helps secure a market for domestic producers and thus provides a cushion against other countries' trade barriers.)<br>○ New roles for tech and industry develop. (Free trade can open the door to technology and industry into poorer countries.)<br>○ Democracy may expand. (The reduction of government regulation on people's economic choices can represent an increase in democracy and individual choice.) | ○ Domestic industry is threatened. (Free trade creates mobility for resources, including labor. Domestic industries, especially in developed nations, can see their production and jobs disappear. Factories and workers will go to countries where it is cheaper. Unemployment will rise.)<br>○ Infant industries are vulnerable. (The lower prices that often result from free trade can make it very difficult for newer businesses to compete or to encourage new businesses in a certain industry. Without protection they are more likely to fail.)<br>○ Fewer goods can mean disaster. (Specialization often encourages smaller economies to depend on a few resources or products. Without diversity, a loss of demanded nose products could destroy the economy.)<br>○ Some won't play fair. (Many countries, even those that say they support free trade, have leaders that create barriers to trade. Those who play by the rules can be at a significant disadvantage.)<br>○ Dependency threatens security. (Free trade will encourage certain industries to move to countries that have a comparative advantage in it. The disintegration of some key domestic industries, especially those related to defense, can pose a security threat. For example if a country depends on another for its weapons, they may find themselves unable to defend themselves if that supply is cut off suddenly.) |

## Does inflation matter?

**Inflation** – general rise in prices over time

**S**ome inflation is good. Individuals, businesses, and countries all seek to increase their earnings. People want higher pay. Businesses wish to increase profits. Governments seek to increase revenue. Growth requires people to produce more goods and services. Producing more costs more, and prices increase in response. People expect some inflation, but when prices rise too quickly or drastically sometimes people panic. "Hyperinflation" occurs when the rate of inflation rises quickly and faster than a rise in income.

Similar to the way you compared the price of your favorite goods to the cost years ago, we can calculate the rate of inflation using the Consumer Price Index, or CPI for short. The Consumer Price Index is a statistic comparing the cost of a "market basket" of goods and services American households normally purchase to the cost from a prior time.