# Cheat Sheet: Economic Fundamentals

## Essential Concepts

### Understanding Economics

Economics focuses on the ways in which people, businesses, and governments make decisions when faced with scarce resources. Every choice involves giving up other options, known as opportunity cost, whether it's the cost of missing out on learning by skipping class or the trade-offs in societal decisions such as allocating funds for specific purposes. Economists study the economy at either the microeconomic level (focus on individuals) or the macroeconomic level (focus on systems).

### Understanding Economic Systems

Economic systems can be organized as traditional, planned, or market economies. Traditional systems are hunter-gatherer economies in which people consume what they produce. In command economies, such as communism and socialism, the government exercises a high degree of control over production and pricing. In market economies, such as capitalism, free-market supply and demand drives what is produced and consumed. The increasing complexity of the world has led to mixed economic systems that have characteristics of both command and market economies.

In a free market system, market structures are determined by the number of suppliers competing with each other, with economists recognizing four types: perfect competition, pure monopoly, monopolistic competition, and oligopoly.

| Comparison of Market Structures | | | | |
|---|---|---|---|---|
| **Characteristics** | **Perfect Competition** | **Pure Monopoly** | **Monopolistic Competition** | **Oligopoly** |
| **Number of firms in market** | Many | One | Many, but fewer than perfect competition | Few |
| **Firm's ability to control price** | None | High | Some | Some |
| **Barriers to entry** | None | Subject to government regulation | Few | Many |
| **Product differentiation** | Very little | No products that compete directly | Emphasis on showing perceived differences in products | Some differences |
| **Examples** | Farm products such as wheat and corn | Utilities such as gas, water, cable television | Retail specialty clothing stores | Steel, automobiles, airlines, aircraft manufacturers |

## Microeconomics

Demand is the quantity of a good or service that consumers are willing and able to purchase at any given price. There is an inverse relationship between price and quantity demanded. In general, consumers demand more of a good or service when prices are lower and less of a good as prices increase. This relationship is referred to as the law of demand and is illustrated on a graph as a downward-sloping curve, with price on the vertical axis and quantity on the horizontal axis. There is a distinction made between the term demand, which refers to the demand curve, and quantity demanded, which refers to a specific quantity and price point on the demand curve.

Supply is the quantity of a good or service that a business is willing to produce at any given price. There is a positive relationship between price and quantity supplied. In general, an increase in price will result in an increase in quantity supplied, and a decrease in price will result in a reduction in quantity supplied. This relationship is referred to as the law of supply and is illustrated on a graph as an upward-sloping curve, with price on the vertical axis and quantity on the horizontal axis. There is a distinction made between the term supply, which refers to the supply curve, and quantity supplied, which refers to a specific quantity and price point on the supply curve.

Equilibrium is said to exist at the point where quantity supplied equals the quantity demanded, and therefore, there is no excess or shortage in the market. The market is "in balance." The *equilibrium price* is the price where the quantity that consumers want to purchase is equal to the quantity that the producers are willing to supply. The *equilibrium quantity* is the quantity supplied and demanded at the *equilibrium price*.

Changes in income can have a significant impact on demand. Higher income generally leads to increased demand for most goods and services, shifting the demand curve to the right. Other factors that affect demand include changes in tastes and preferences, the composition of the population, prices of related goods (substitutes and complements), and expectations about future prices or other factors. These factors can cause shifts in the demand curve, either to the right or left, indicating an increase or decrease in the quantity demanded at every price.

## Macroeconomics

Economists use several measures to evaluate the health of an economy. Among the most important are GDP (Gross Domestic Product), the unemployment rate, and the CPI (Consumer Price Index). These three key economic indicators are used to measure how well the economy is achieving the goals of growth, high employment, and price stability.

The business environment is cyclical, meaning it goes through a cycle of stages, each of which is characterized by a different set of economic conditions. The four stages of the business environment are expansion, peak, contraction, and trough.

Another macroeconomic goal is full employment, or having jobs for all who want to and can work, which is typically around 94 to 96 percent. Unemployment is measured through the unemployment rate, which indicates the percentage of the labor force actively seeking work. There are four types of unemployment: frictional, structural, cyclical, and seasonal, each with its own characteristics and causes.

Price stability is an important macroeconomic goal, as inflation can erode purchasing power. Inflation occurs when the average prices of goods and services rise, reducing the value of money. There are two types of inflation: demand-pull inflation, driven by excessive demand, and cost-push inflation, caused by increased production costs. Inflation is measured using indexes such as the consumer price index (CPI) and producer price index (PPI), which track changes in prices over time.

Countries face trade-offs and conflicting choices when striving to achieve macroeconomic goals. Political considerations sometimes override economic needs, leading to challenging decisions. To guide the economy towards a balance of growth, employment, and price stability, governments utilize monetary policy, which involves controlling the money supply and interest rates, as well as fiscal policy, which involves taxation and government spending. Monetary policy influences economic activity and inflation rates through adjustments in the money supply, while fiscal policy stimulates or restricts the economy through changes in taxation and government spending. However, fiscal deficits and increasing national debt raise concerns and necessitate borrowing to cover shortfalls.

### Career Connection: Career and Self-Development

Working on your career and self-development involves continuous personal and professional learning, including reflection on strengths and weaknesses, building relationships through networking, and exploring various job opportunities aligned with your interests and assessment results.

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# Glossary

**budget deficit**

government spending more than it collects in taxes

**budget surplus**

government revenue exceeds spending

**business cycle**

upward and downward changes in the level of economic activity showing that the economy is expanding or contracting

**career and self-development**

a continuous process of personal and professional learning, assessment of your strengths and weaknesses, exploring career options, and building relationships

**capitalism**

businesses are privately owned with minimal government ownership or interference

**communism**

the government owns all or most enterprises

**competitive market**

one in which there is a large number of buyers and sellers, so that no one can control the market price

**complement**

a good often used together with another because consumption of one good tends to enhance consumption of the other

**consumer price index**

a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services

**contractionary monetary policy**

restricting the money supply or raising interest rates to slow economic growth

**cost-push inflation**

triggered by increases in production costs

**crowding out**

when government spending discourages private spending

**cyclical unemployment**

occurs when a downturn in the business cycle reduces the demand for labor throughout the economy

**demand**

the quantity of a good or service that people are willing to buy at various prices

**demand curve**

a graphical representation of the relationship between the quantity demanded of a good at different prices

**demand-pull inflation**

occurs when the demand for goods and services is greater than the supply

**depression**

a prolonged and severe period of decreased economic activity

**discouraged workers**

unemployed people who are not seeking jobs because they think no one will hire them

**economics**

the study of production, distribution, and consumption of goods and services

**economic system**

the combination of policies, laws, and choices made by a society and its government that determine what goods and services are produced and how they are allocated

**equilibrium price**

the price of a good when supply equals demand

**equilibrium**

the point where the quantity demanded equals the quantity supplied

**expansionary monetary policy**

increasing the money supply and lowering interest rates to stimulate economic growth

**Federal Reserve System**

the central banking system of the United States

**fiscal policy**

how a government spends money and taxes individuals and organizations as decided by their legislative body

**free market**

one in which the government does not intervene in any way

**frictional unemployment**

short-term unemployment that is not related to the business cycle and includes people who are unemployed while waiting to start a new job, college graduates entering the workforce, and people who left paid work for personal reasons and are reentering the workforce

**full employment**

a condition where there are jobs available for all who want to and can work

**gross domestic product**

the total market value of all final goods and services produced within a nation's borders each year

**inferior good**

a product whose demand falls when income rises and whose demand rises when income falls

**inflation**

the situation in which the average of all prices of goods and services is rising

**macroeconomics**

the study of broader economic issues such as economic growth, full employment, and price stability, and how they influence the economy

**market**

any situation that brings together buyers and sellers of goods or services

**market economy**

a type of economy where decisions about what products are available and at what prices are determined through the interaction of supply and demand

**market structure**

the number of suppliers determines the characteristics of the market

**microeconomics**

the study of the actions of individual people or businesses within the economy

**mixed economy**

private ownership of land and businesses but government control of some enterprises. The private sector is typically large

**monetary policy**

a government's programs for controlling the amount of money circulating in the economy and interest rates

**monopolistic competition**

many competitors with some ability to control prices through differentiating their products or services

**national debt**

the total amount the U.S. government has borrowed to pay for budget deficits

**normal good**

a product whose demand rises when income rises and whose demand falls when income falls

**oligopoly**

very few competitors with some ability to control prices, high barriers to enter the market, and some product differentiation

**opportunity cost**

what must be given up to obtain something that's desired

**perfect competition**

many competitors with no ability to control price and little product differentiation

**planned or command economy**

economic effort is devoted to goals passed down from a ruler or ruling class

**price control**

a government regulation that sets maximum or minimum prices for goods or services

**producer price index**

measures the prices paid by producers and wholesalers for various commodities, such as raw materials, partially finished goods, and finished products

**purchasing power**

the value of what money can buy

**pure monopoly**

one business dominates and set the price for the market; no competitors or competing products

**recession**

decline in GDP that lasts for two consecutive quarters (each a three-month period)

**recovery**

increased economic activity after a recession

**scarcity**

the condition that exists because resources that we value, such as time, money, labor, tools, land, and raw materials, exist in limited supply so that there are never enough resources to meet all our needs and desires

**seasonal unemployment**

occurs during specific times of the year in certain industries

**shortage**

the condition where the quantity demanded rises above the available supply

**socialism**

basic industries such as railroads and utilities are owned by the government. Very high taxation as the government redistributes income from successful private businesses and entrepreneurs.

**structural unemployment**

unrelated to the business cycle but is caused by a mismatch between available jobs and the skills of available workers within an industry or region

**subsidy**

when the government pays a firm directly or reduces the firm's taxes if the firm carries out certain actions

**substitute**

a good or service that can be used in place of another good or service

**supply curve**

a graphical representation of the relationship between the quantity of a good businesses will supply at different prices

**supply**

the quantity of a good or service that businesses will make available at various prices

**surplus**

an excess quantity that consumers are unwilling to buy

**unemployment rate**

the percentage of the total labor force that is not working but is actively looking for work