The Basics of Economics

Economic Systems:

There are three types of **economic systems**. **Traditional** systems are found in farming societies where people make what they need to survive. In a **command** system, the government controls all production and distribution. In a **market** system, supply and demand determine what is produced and sold. Most countries have **mixed economies** that fall somewhere in between pure market and pure command economies. Every economic system has to answer three basic questions: *What to produce? How to produce it? Whom do we produce it for?*

Trade Barriers:

Countries sometimes set up **trade barriers** to restrict trade because they want to sell their own goods to their own people. They don't want foreign competition to come in with lower prices! Just about every country has some restrictions on foreign imports. Trade barriers include:

- **Tariffs:** are taxes placed on imported goods (items coming into the country). Tariffs cause the consumer to pay a higher price for an imported item, increasing the demand for a lower-priced item produced by their own country.

- **Quotas:** are restrictions on the amount of a good that can be imported into a country. Quotas can cause shortages that cause prices to rise.

- **Embargoes:** trade embargoes forbid trade with another country.

Money:

Because every country does not use the same type of money, international trade requires a system for **exchanging currencies** (money) between nations. Money from one country must be converted into the currency of another country to pay for goods in that country. This system is called the **foreign exchange**. The exchange rate is how much one currency is worth in terms of the other. For example, an exchange rate of 5 euros to the dollar means that five euros are worth the same as one dollar.

Economic Growth:

There are basic **factors that influence economic growth** in any part of the world. They are the productive resources used to produce goods and services. They include **human capital** (people who perform labor), **capital goods** (factories and machinery), and **natural resources** (things that come from the land like minerals and trees). Another factor is **entrepreneurship**, which includes the ideas, innovation, and risk involved in starting and owning your own business.

Gross Domestic Product:

Economists measure a nation's economic performance by a standard called the **Gross Domestic Product (GDP)**. The GDP is the total market value of the goods and services produced by a country's economy and compare it to other economies.

How a country manages its productive resources makes a big difference in the strength of its economy. For example, investment in human capital delivers long lasting rewards. Studies have shown that investment in education and skills training clearly has an effect on a country's GDP. Education creates a smarter and more productive workforce, which leads to greater economic growth.

There is also a clear relationship between investment in capital like factories, machinery, and technology and GDP. Examples include a company building a new factory or buying new computers. Investment in capital equipment helps economic growth by providing workers with the best and newest tools, making them more productive.

Entrepreneurs:

Entrepreneurs have a vital role in any country's economy. They come up with new ideas and use human capital, and natural resources to bring their ideas to the marketplace. They must be willing to take risks, and often share those risks with others by borrowing funds from a bank or a wealthy investor. Entrepreneurs are valuable because they introduce innovative products and help economies adapt to changing conditions—a common occurrence in our fast moving global society!