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Economic Insights is an idea publication of the Colorado Council for Economic Education, a not-for-profit organization founded in 1973 to promote and improve economic literacy in Colorado schools.

We feel that an understanding of key economic concepts is vital for all citizens in order to live, work and make informed decisions in our modern economy. We present high-quality graduate courses designed to provide an understanding of important economic concepts to Colorado K-12 teachers, so they can then bring these concepts to their classrooms. Topics covered include monetary policy, taxation, spending, inflation, the environment, growth, conservation, trade and energy, to name a few.

The Economic Principles of Life

By Jerome V. Bruni

The science of economics is very relevant to people in their daily lives, both as consumers and as citizens, yet it has been said that if ignorance paid dividends, most people could retire on what they don't know about economics. Although it might seem presumptuous to try to distill the core of economics into a few pages, I'd like to take a stab at listing the critical economic principles that people should understand, together with a few of the most relevant characteristics of market economies.

Economics begins with scarcity.

If resources were unlimited—and thus free—there would be no need for economics, because economics is the science that studies how limited (economists say “scarce”) resources are used. Given scarcity, individuals—and society as a whole—face tradeoffs that require choices to be made. Simply put, economics examines the choices we face in addressing three questions central to any society: What goods and services will be produced? How will they be produced? For whom will they be produced?

Costs are best measured by opportunity costs.

Choice involves cost—opportunity cost. For private citizens, the cost of buying a new car, for example, is the lost opportunity to purchase other things.

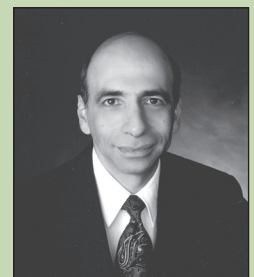
For governments, the cost of funding research to pursue a cure for Lou Gehrig's disease is the lost opportunity to use the same funds in other ways. Thus, it makes sense to consider not only the usefulness of what we purchase, but also the usefulness of that which we must forego. Buying a new car, for example, isn't the best choice for a family if they feel the same funds could more productively be spent on their home, health care or education. Similarly, it might not make sense to spend money searching for a cure for disease A if the same funds are likely to help more people in the pursuit of a cure for disease B.

Prices ration and provide incentives.

In market economies, prices ration goods and services and provide incentives for production and conservation, whereas something else (such as decisions from government planners, waiting in lines, etc.) must serve the rationing and incentive functions in non-market (“command”) economies. Modern economies involve an amazing number of products and services, and there are many possible ways for them to be produced. It would be very difficult for a centralized group of economic planners to accurately anticipate consumer demands and assess the relative strengths of various

About the Author

Mr. Bruni earned a Bachelor of Science degree in economics from the United States Air Force Academy and a Master of Arts degree in economics from UCLA. He has served on the Department of Economics faculty at the U. S. Air Force Academy, where he taught courses in microeconomics, macroeconomics and financial markets. He was twice named the Outstanding Educator in Economics. Mr. Bruni is the founder and president of J. V. Bruni and Company based in Colorado Springs. He is also a popular speaker for college students, teachers and community groups. Mr. Bruni, who is an active supporter of the non-profit community, also founded and is president of the Bruni Foundation, which supports education programs for students and adults, together with a variety of humanitarian programs. Additionally, he is a member of the board of directors of the Colorado Council for Economic Education, having served as its chairman during 2007 – 2008.



production methods. Further, economic planning has sometimes bred cronyism or corruption. Throughout history, marketplace prices have done a better job at rationing and guiding production, because prices have a big advantage—they represent the interplay of millions of individual consumers and thousands of suppliers.

Greed is neither good nor necessary.

Market economies are not based on greed—an excessive desire for things—but rather on incentives to produce what consumers want. In a similar vein, there is a difference between selfishness and self-interest. Selfishness represents the opposite of charity, whereas many humanitarian organizations, hospitals and educational institutions have been funded in large part by donations from individuals who, fulfilling their own self-interests, earned their wealth by creating products and services desired by society.

Successful decision-making occurs at the margin.

When faced with the need to decide on a course of action, it is best to consider the going-forward (“marginal”) costs and benefits of various alternatives. For example, before purchasing a car it makes sense to consider the cost and the expected benefits of owning the car. A car dealer’s claim that the vehicle is on sale isn’t relevant. The fact that different people will evaluate marginal costs and benefits differently adds diversity to an economy.

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Economic growth comes primarily from growth in productivity.

Productivity gains come from a better educated workforce; advances in science, medicine and business methods; and from capital formation (additions to business plant and equipment). The most effective and lasting ways to help the disadvantaged are to improve their work skills through education and to encourage the development and use of capital equipment that enhances worker productivity.

Inflation is a monetary phenomenon.

Simplistically, inflation results from too many dollars chasing too few goods. More specifically, inflation approximates the rate by which money supply growth (addressed by the Federal Reserve) exceeds productivity growth. Most other alleged causes of inflation (budget deficits, big companies, powerful unions, etc.) either create short-term price pressures or simply promote in-

creases in some prices offset by declines in other prices.

“NAIRU” rules.

Over the period of a few quarters to a few years, economically stimulative monetary or fiscal policies may temporarily lower unemployment—though at the cost of eventually increasing inflation. Once consumers and businesses correctly anticipate and react to these policies, however, unemployment ultimately returns to its “natural” or NAIRU (non-accelerating inflation rate of unemployment) level, which is a function of factors such as labor force mobility and, importantly, the extent to which employers’ demand for skills corresponds with the skills workers actually possess.

Trade is essential for modern economies.

Whether trade is interpersonal, intercity, interstate or international, it results in specialization of labor and production, and it raises living standards for trading partners, taken as a whole. Barriers to trade may help some segments of society; however, trade barriers intended to protect specific industries and workers typically provide, at best, short-term protection (at a cost of higher prices to all consumers). These barriers frequently cause more harm than good for a society as a whole by forcing its resources to be used in comparatively less productive ways. For trade to benefit trading partners, it is not necessary

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that every partner have an absolute production advantage. Instead, trade improves living standards as long as trading partners specialize in what they produce comparatively best.

Governments can help.

Governments can promote strong economies by maintaining peace and social order, establishing and enforcing property rights, and bringing economic incentives to bear when there are “external” costs or benefits. (Pollution is an example of an external cost, and it makes sense for governments to take steps—such as taxing it—to internalize such costs to producers.) Judging from history, if more governments followed these policies, there would be more strong economies. In practice, some governments attempt to redistribute income within their countries. Redistribution of income—via tax, spending and regulatory policies—is typically justified as helping lower income citizens. Sometimes it is partially successful, yet redistribution efforts don’t always work as planned. Sometimes they simply make most citizens more equally poor, and too often they lead to an encroachment on political freedoms and entrepreneurship. At other times, these efforts result in an unchanged income inequality within a society—but at lower overall levels of income. Further, political or corporate interests often wield significant influence, and many have succeeded in using government programs for their own advantage to trump competitive market forces with politics. Agricultural quotas or tariffs, for example, seldom help the poor.

There is a vital role for nonprofit organizations.

Nonprofit organizations produce or distribute critical goods and services to those with physical, mental or educational needs, among many other activities that benefit society. Since one alternative to nonprofit activities—government programs aimed at helping the needy—is ultimately funded with tax dollars from all citizens, an important issue arises: should a society provide for its needy primarily through nonprofit organizations selected by (millions of) individual contributors or primarily through government programs selected

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by legislators? Put differently, as with the provision of all other goods and services, there are market approaches to charity and there are non-market approaches.

Ethical conduct matters.

While there will always be unethical people, market economies create more incentives for ethical conduct than non-market economies do. Organizations that depend on consumers and citizens voluntarily doing business with them need to maintain reputations for ethical conduct—or they will be abandoned by their customers and supporters.

Economic freedoms and political freedoms reinforce each other.

While most people are familiar with the

concept of freedom in a political context, fewer people understand that market economies represent the freedom to live and work as we choose. Throughout the world today, there is a relatively high degree of correlation between countries with political freedom and those with economic freedom. Further, there is a high correlation between freedom and living standards. Free countries have relatively large middle classes and the fewest disadvantaged poor, while un-free countries typically consist of ruling elites together with many poor people. Freedom—both political and economic—lies at the very core of our nation and its success as a society.



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