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2010-2011

CHAPTER

3

Economic Decision

Makers

Designed by
Amy McGuire, B-books, Ltd.

The Household

- ◆ Demand goods and services
 - ◆ What gets produced
- ◆ Supply resources
 - ◆ Produce output
- ◆ Choices



LO¹

The Evolution of the Household

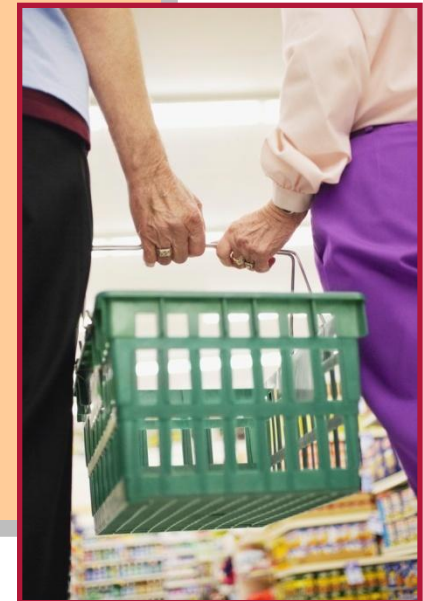
- ◆ Farm household
 - ◆ Self-sufficient
- ◆ Better technology
 - ◆ Increased productivity
- ◆ Factories
 - ◆ Specialization; less self-sufficient
- ◆ Women in labor force
 - ◆ 1950: 15%
 - ◆ 2007: 70%



LO¹

The Household

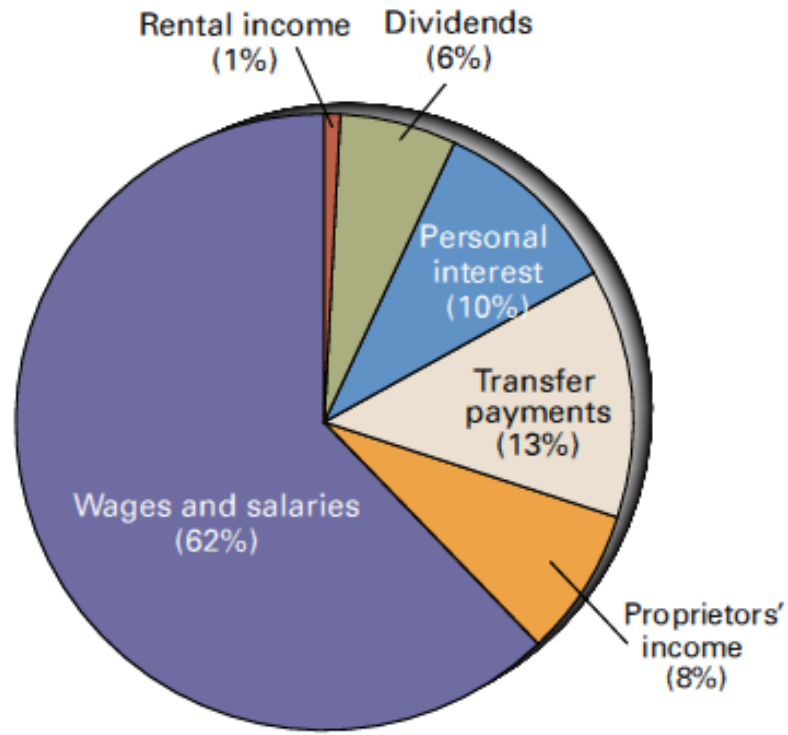
- ◆ Maximize utility
- ◆ Supply resources
 - ◆ To satisfy unlimited wants
 - ◆ Earn income
- ◆ Demand goods and services
 - ◆ Durable goods
 - ◆ Nondurable goods
 - ◆ Services



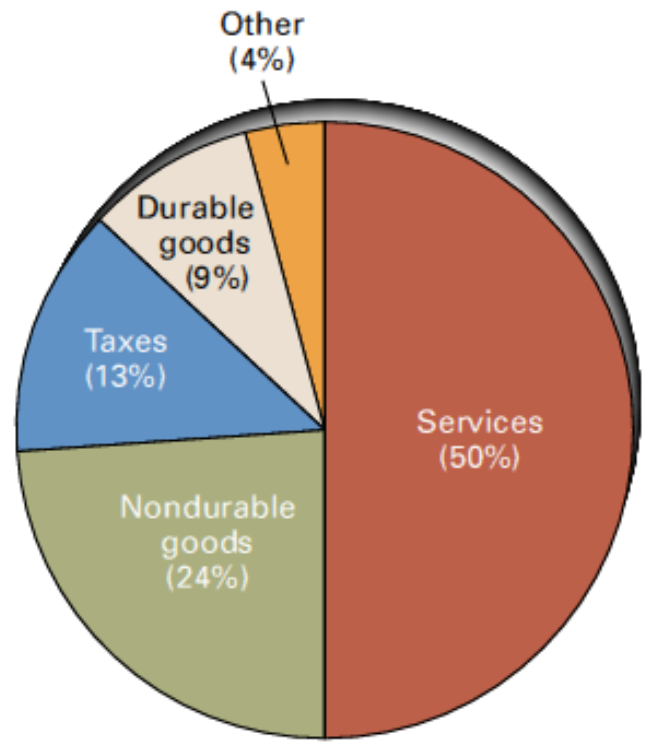
LO¹

Where U.S. Personal Income Comes From and Where It Goes

(a) Over two-thirds of personal income in 2007 was from wages, salaries, and proprietors' income



(b) Half of U.S. personal income in 2007 was spent on services



SOURCE: Based on figures from *Survey of Current Business*, Bureau of Economic Analysis, October 2008, Tables 2.1 and 2.3.5. For the latest figures, go to <http://www.bea.gov/sch/index.htm>.

Exhibit 1

The Evolution of the Firm



- ◆ Specialization
- ◆ Comparative advantage
- ◆ Transaction costs
- ◆ Entrepreneur
- ◆ Cottage industry system
- ◆ Technological developments



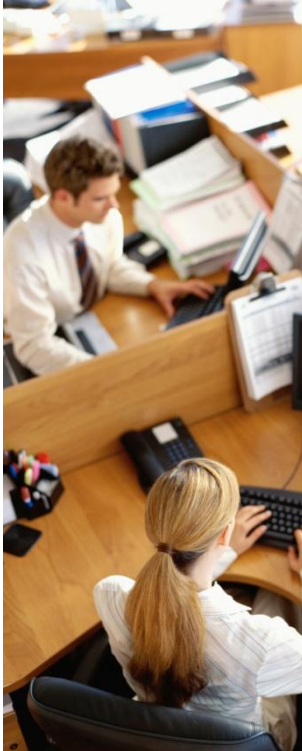
The Evolution of the Firm



- ◆ **Factories**
 - ◆ Efficient division of labor
 - ◆ Direct supervision of production
 - ◆ Reduce transportation costs
 - ◆ Bigger machines
- ◆ **Industrial Revolution**



The Firm



◆ Firms

- ◆ Economic units
- ◆ Entrepreneurs
- ◆ Combine resources
- ◆ Produce goods and services
- ◆ Maximize profit



Types of Firms

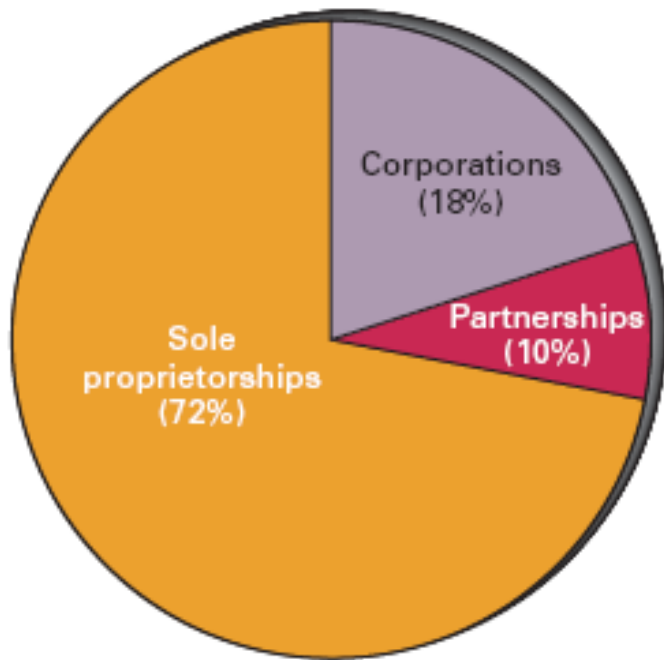


- ◆ **Sole proprietorship**
 - ◆ **Single owner**
- ◆ **Partnership**
 - ◆ **Two or more owners**
- ◆ **Corporation**
 - ◆ **Legal entity**
 - ◆ **Shares of stock**
- ◆ **S corporation**

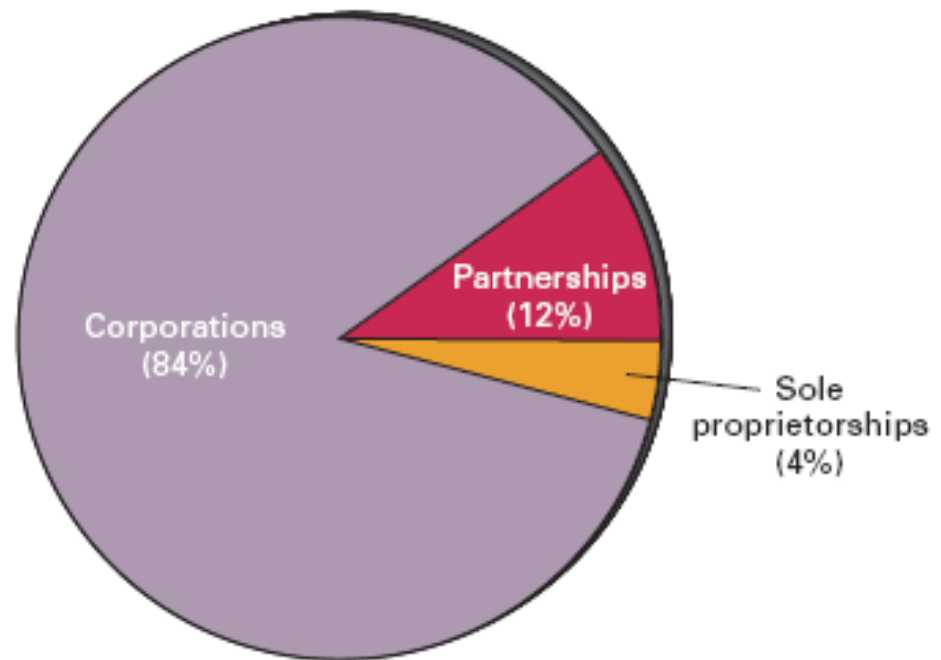


Number and Sales of Each Type of Firm

(a) Most firms are sole proprietorships



(b) Corporations account for most sales



SOURCE: U.S. Census Bureau, *Statistical Abstract of the United States: 2007*. U.S. Bureau of the Census, Table No. 724 and Table No. 806. For the latest figures go to <http://www.census.gov/compendia/statab/>.

Types of Firms



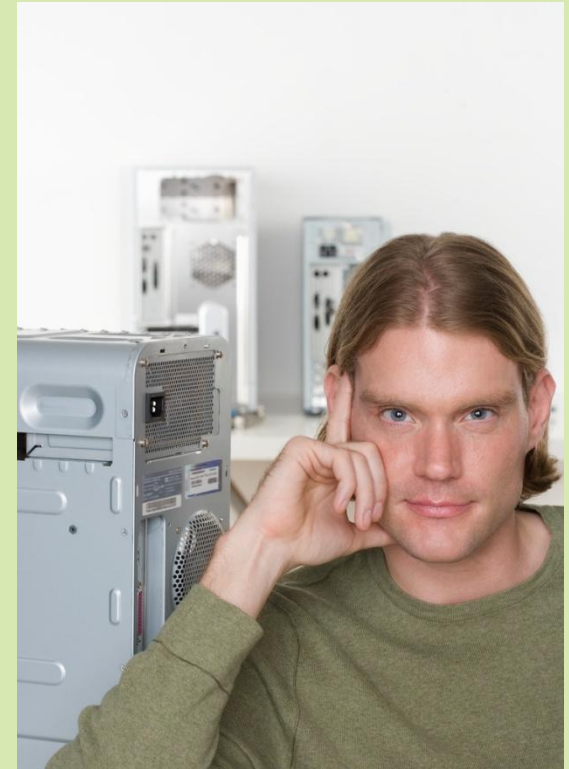
- ◆ **Cooperatives**
 - ◆ Consumer cooperatives
 - ◆ Producer cooperatives

- ◆ **Not-for-profit organizations**
 - ◆ Charitable
 - ◆ Educational
 - ◆ Humanitarian
 - ◆ Cultural
 - ◆ Professional



User Generated Products

- ◆ **Computer programming: open source**
 - ◆ **Linux; Apache; MySQL; Firefox; OpenOffice**
 - ◆ **Wikipedia;**
 - ◆ **MySpace;**
 - ◆ **Facebook;**
 - ◆ **YouTube**
- ◆ **Radio call-in shows**
- ◆ **Create new products**
- ◆ **Improve existing products**



Household Production



- ◆ Opportunity cost
 - ◆ Below market price
- ◆ No skills or special resources are required
- ◆ Avoid taxes
- ◆ Reduce transaction costs
- ◆ Technological advance



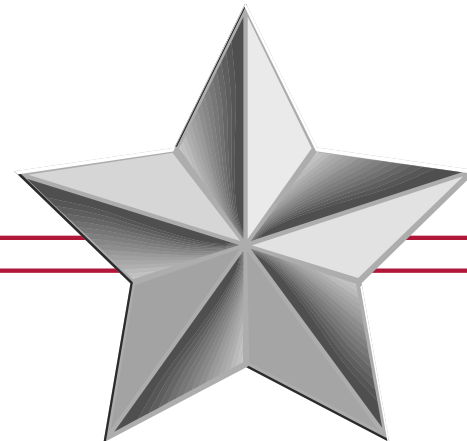
The Electronic Cottage

- ◆ Information revolution
 - ◆ Telecommute
 - ◆ Doubled in the last decade
 - ◆ Videoconference
 - ◆ Online database
 - ◆ Virtual offices
 - ◆ Cell phones;
Blackberries



The Government

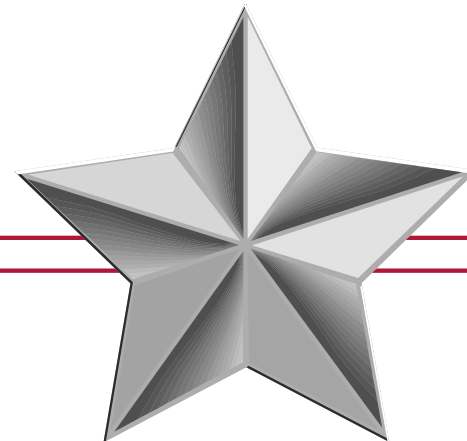
- ◆ Establish & enforce rules of the game
- ◆ Promote competition
- ◆ Regulate natural monopolies
- ◆ Provide public goods
- ◆ Deal with externalities
- ◆ More equal distribution of income
- ◆ Full employment
- ◆ Price stability
- ◆ Economic growth



LO³

Government's Structure, Objectives

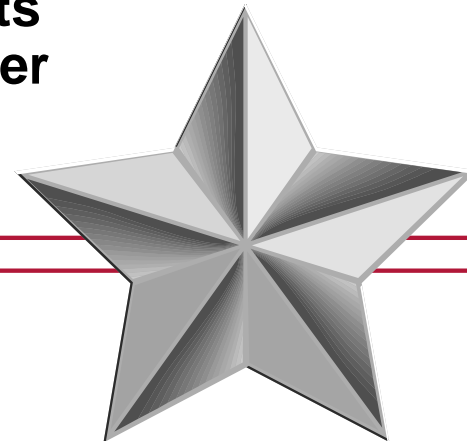
- ◆ **National/federal government**
 - ◆ National security, economic stability, market competition
- ◆ **State government**
 - ◆ Public higher education, prisons, highways, welfare
- ◆ **Local government**
 - ◆ Primary and secondary education, police, fire protection



LO³

Government's Structure, Objectives

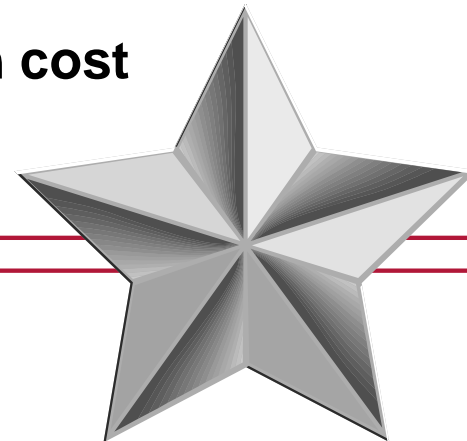
- ◆ **Difficulty**
 - ◆ 87,600 jurisdictions
 - ◆ 1 nation
 - ◆ 50 states
 - ◆ 3,034 counties
 - ◆ 35,933 cities and towns
 - ◆ 13,506 school districts
 - ◆ 35,052 special districts
 - ◆ Not a single decision maker
- ◆ **'Vote maximization'**



LO³

Government's Structure, Objectives

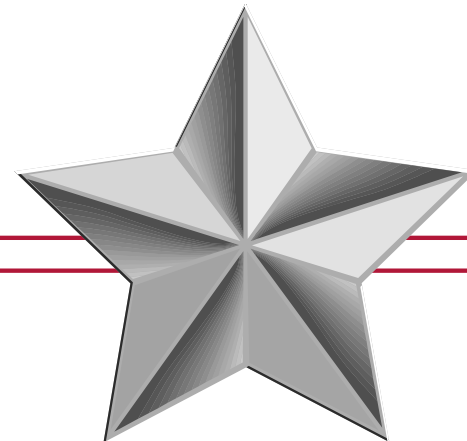
- ◆ **Voluntary exchange vs. coercion**
 - ◆ Some government coercion
 - ◆ Enforced by the police
- ◆ **No market prices**
 - ◆ Public output
 - ◆ Zero price
 - ◆ Below the production cost



LO³

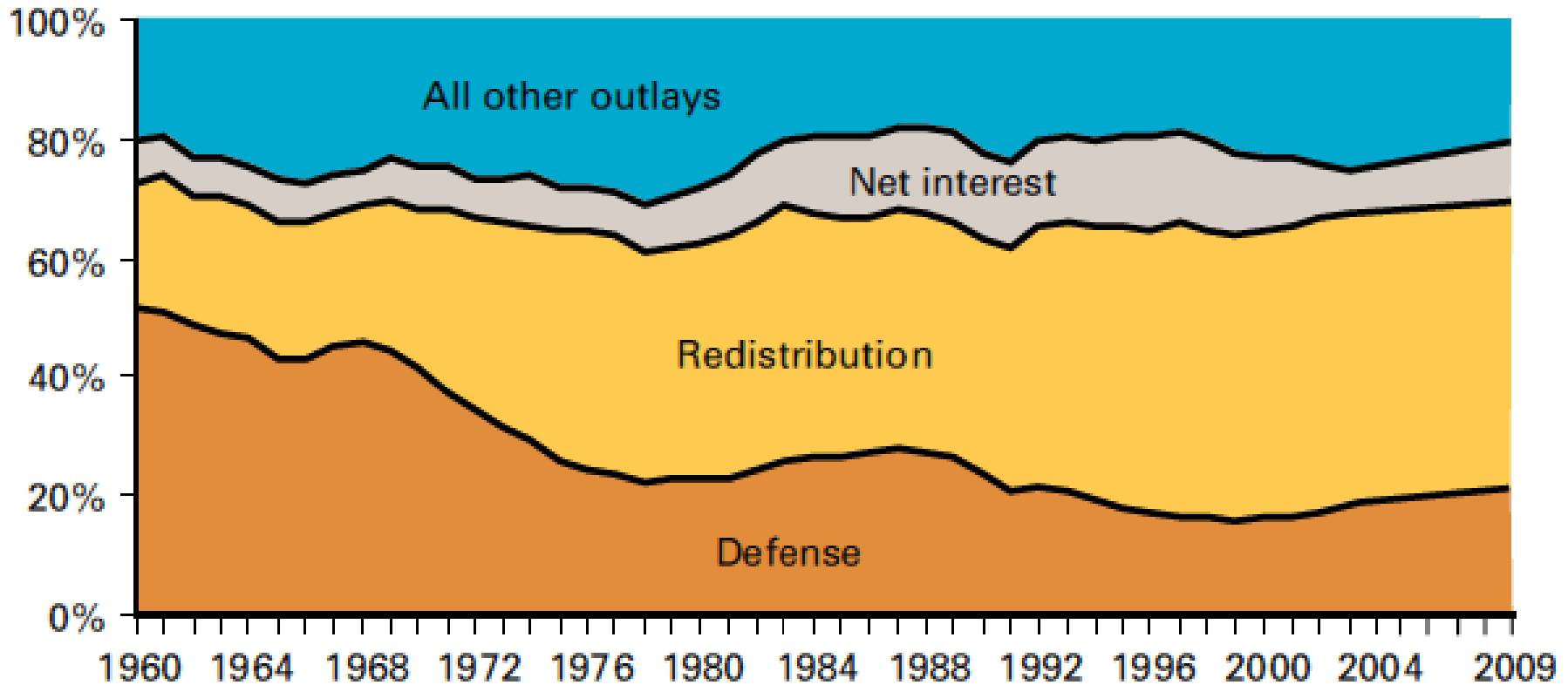
The Size and Growth of Government

- ◆ **Government outlays relative to GDP**
 - ◆ 1929: 10% of GDP
 - ◆ Mostly state and local
 - ◆ 2007: 37% of GDP
 - ◆ Mostly federal
 - ◆ Defense
 - ◆ Decreased
 - ◆ Redistribution
 - ◆ Increased



LO³

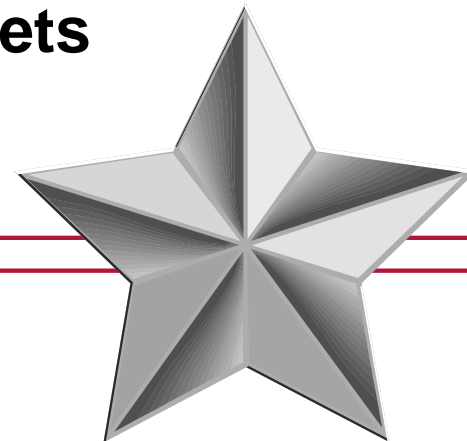
Redistribution Has Grown and Defense Has Declined as Share of Federal Outlays Since 1960



SOURCE: Computed based on figures from the *Economic Report of the President*, February 2008, Table B-80. For the latest figures, go to <http://www.gpoaccess.gov/eop/>.

Sources of Government Revenue

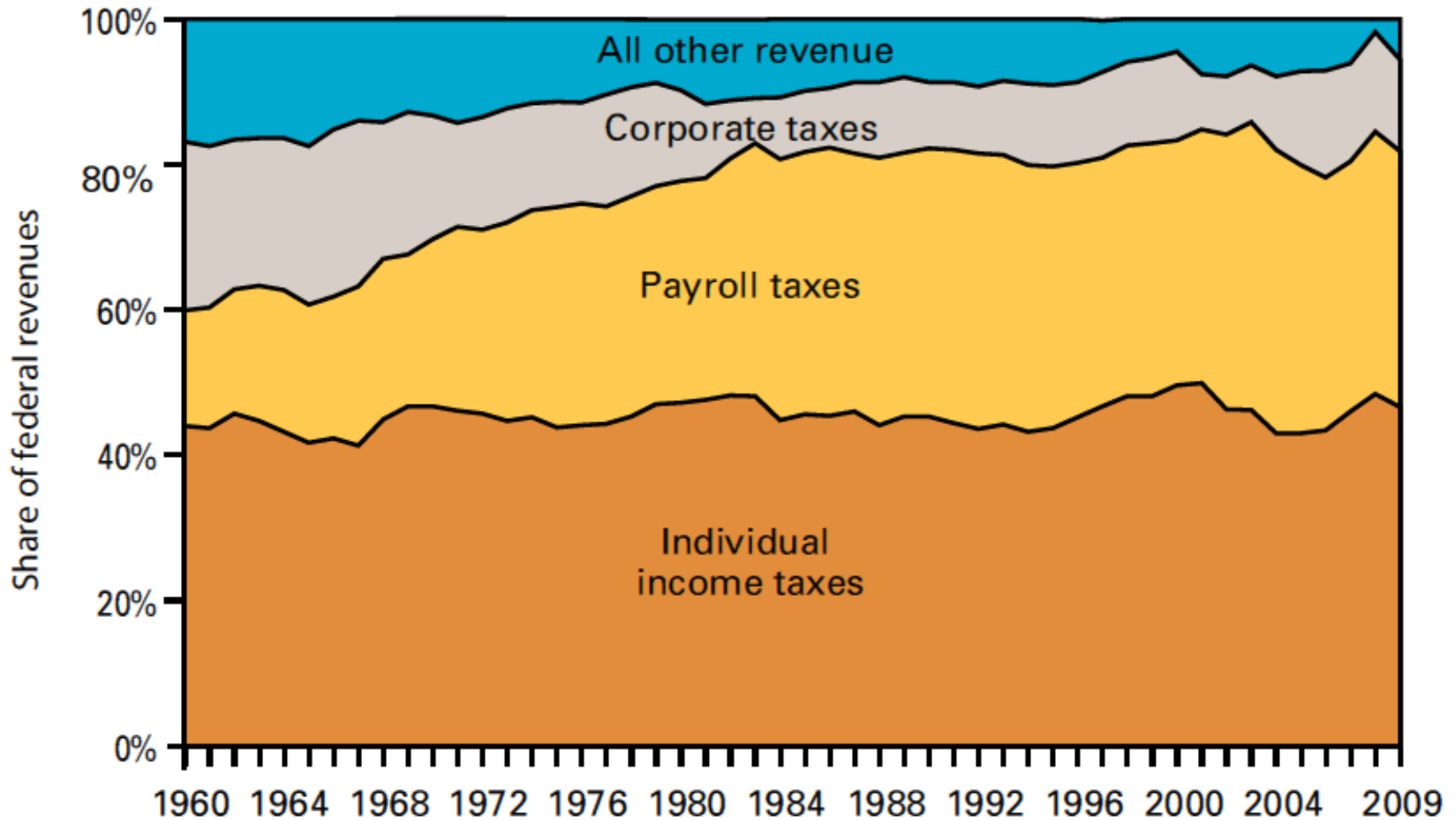
- ◆ **Taxes**
 - ◆ Individual income tax (federal)
 - ◆ Income tax; sales tax (state)
 - ◆ Property tax (local)
- ◆ **User charges**
- ◆ **Borrowing**
- ◆ **Monopolize certain markets**



LO³

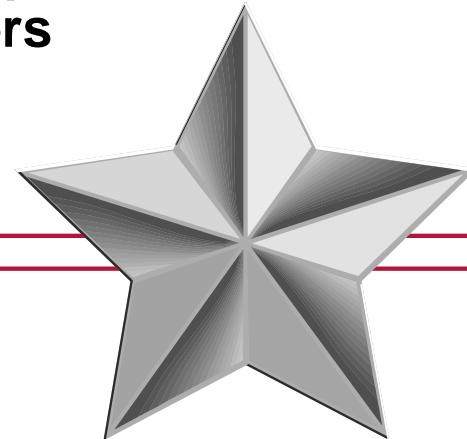
Exhibit 4

Payroll Taxes Have Grown as a Share of Federal Revenue Since 1960



Tax Principles and Tax Incidence

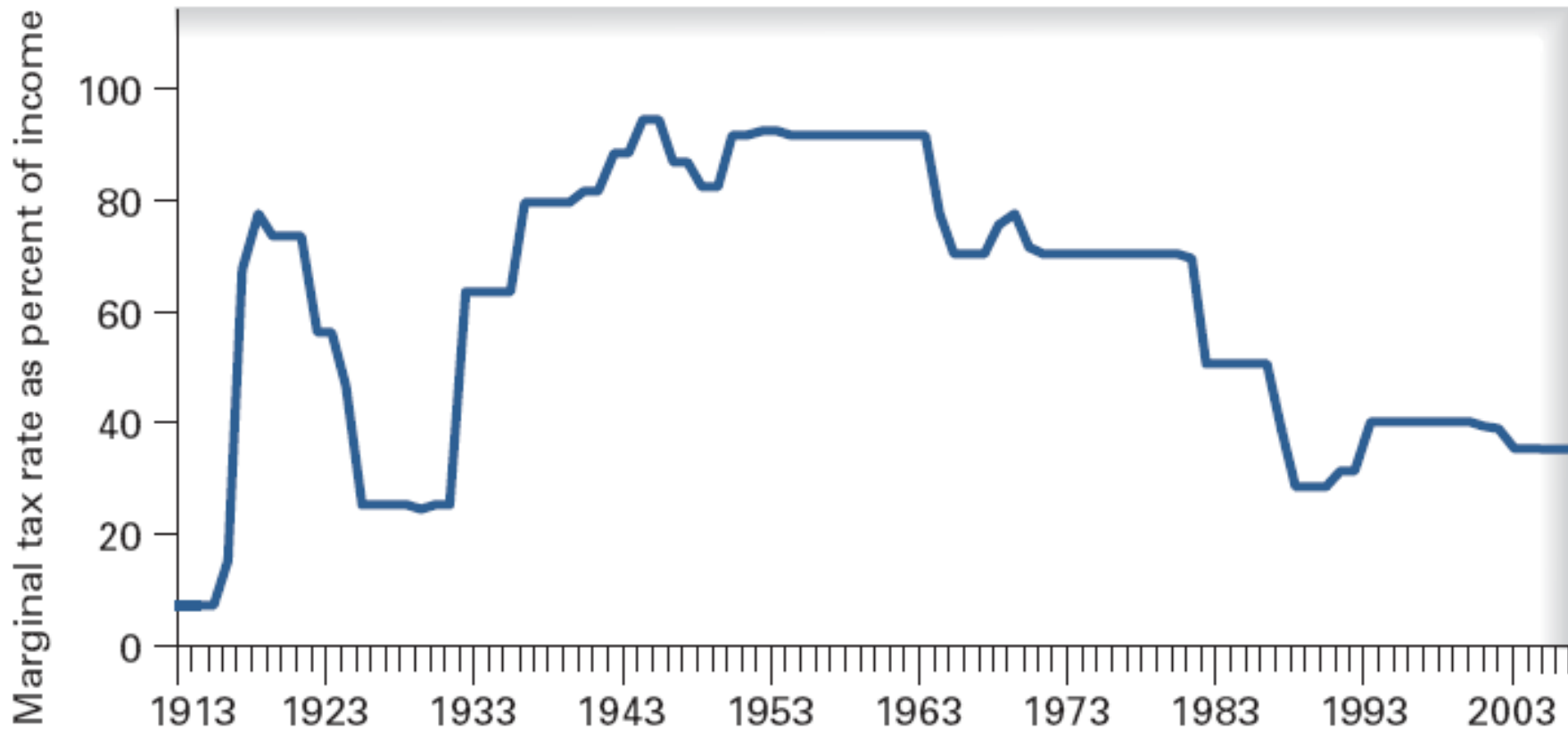
- ◆ Ability-to-pay tax principle
- ◆ Benefits-received tax principle
- ◆ Tax incidence
 - ◆ Proportional taxation: Flat tax (as % of income)
 - ◆ Progressive taxation: marginal tax rate
 - ◆ Top 1% of tax filers – paid 39.4% of taxes
 - ◆ Top 10% of tax filers – paid 70.5% of taxes
 - ◆ Bottom 50% of tax fillers – paid 3.1% of taxes
 - ◆ Regressive taxation



LO³

Exhibit 5

Top Marginal Rate on Federal Personal Income Tax Since 1913



SOURCE: U.S. Internal Revenue Service. For the latest figures on the personal income tax go to <http://www.irs.gov/individuals/index.html>.

The Rest of the World

- ◆ Foreign households, firms, governments
- ◆ International trade – different opportunity costs
 - ◆ Merchandise trade balance
 - ◆ Balance of payments
- ◆ Exchange rates
 - ◆ Foreign exchange markets
- ◆ Trade restrictions
 - ◆ Tariffs; quotas; others

