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Free to Choose E-portfolio Assignment

1. What are the three (3) functions of prices in organizing economic activity? Explain each of these functions.

The Three function of price are 1) determining supply and demand, 2) using the information to decide the cheapest method of production and where the resources are most valued, and 3) who gets the product. The higher the price, the less likely it will be bought so there has to be a balance created. It has to be determined what the consumer is willing to pay for the product. The consumer decides that, by various reasons, but a major factor is what the price of the product or similar products is in other places. Manufacturers also research this information, and then use it to determine the cheapest cost of making the product and to set the price of the product.

In determining supply and demand retailers of the product must predict if there is going to be an increase or decrease in the purchases of the product. That information then gets transmitted to the manufacturer in the form of orders, which lets them know how much of the product needs to be produced. By determining how many products will be manufactured they can transmit the information to other companies to let them know how many resources they will need to complete the orders. If they didn't try to predict the demand, than manufacturers and retailers could have excess products. This would reduce the value and price of the product. It would also take resources away from other companies and products that are producing a product where the demand is higher. The only problem with determining supply and demand is making sure everyone communicates with each other.

After the companies communicate and decide what the demand is they have an incentive to find the cheapest or most efficient way to produce the product. They need to find where the necessary resources will come from and where they are most valued. In order to lower prices and still make a profit manufacturers have incentives to find cheaper resources. If the manufacturers products are in high demand, than they will order more resources to create the products. The resources are more valued with products in higher demand.

The third function of price is who gets the product, through distribution of income. With income distribution a person weighs the cost of the price with what they will get out of the product to decide if it is worth purchasing. For most people income usually comes in the form of a wage or salary and is determined by the services they provide. The public must decide what they are willing to pay for something by the services they receive from it. There has to be a balance between incomes received and services paid. The person who gets the product is the person who is willing to pay for it. Products are distributed to the area where there is assumed to be many people who will purchase it, where the demand is the highest.

2. During the early years of the Great Depression, what did the Federal Reserve do or not do and what was the effect on the economy?

Leading up to the Depression the Federal Reserve didn't do enough to help at beginning of the recession. They seemed to sit by and let the economy spiral downward. The Federal Reserve set the interest rates very low. With the low interest rates and new credit options the public began buying on credit, more than what they could afford. It was assumed that the low interest rates and inflation would continue, but in any business cycle after inflation a recession follows. When the recession began the Federal Reserve began raising the interest rates, which helped turn the recession into a full blown depression.

The Federal Reserve was supposed to be a financial last option for the banks, but when it came time to help the banks they didn't do anything. The banks, which had severely over extended themselves, couldn't pay back their debts. They began closing their doors. The Federal government decided not to step up and help the banks from closing. With the banks closing, people started not trusting the banks and not putting their money into the banks. This just made things worse for the banks. With all the banks closing, businesses and people couldn't take out loans or payback the loans they already had. Without being able to take out the loans, people couldn't purchase as many products as they would have. This made product prices and output fall dramatically, which in turn made jobs fall.

In Free to Choose by Milton and Rose Friedman they describe the ways the Federal Reserve could have significantly helped the Great Depression. It says the Federal Reserve "could have provided a far better solution by engaging in large-scale open market purchases of government bonds." Just by taking this action, which is what the Federal Reserve was designed for, it could have dramatically changed that time in history and a lot of people's lives. The Federal Reserve may not have caused the Great Depression, but their lack of knowledge, lack of initiative, and their own self-interest made the economy much worse than it could have been.

3. Comment on this statement - "[World War II's] effect on public attitudes was the mirror image of the [Great] Depression's. The [Great] Depression convinced the public that capitalism was defective; the War, that centralized government, was efficient."

After the Great Depression and World War II, the public held the belief that capitalism was defective and a centralized government was efficient. The idea the public had about capitalism being defective was because the depression occurred in a capitalist economy and they thought it was responsible. In reality it was the government that was responsible for the severity of the depression and not the private owned companies. After the depression the public thought it was necessary for the government to be more active in the economy to prevent another depression from occurring. The idea to move to a centralized government was a bad idea because too much government involvement can lead to a complete control of the economy without any real way to solve the interests of all the public.

A capitalist economy helps create growth and give the public personal freedom. Without the government intervention, the public can choose where their tax money goes and put it towards their needs. There would be no more government telling the public what there tax money should go to. It also helps with progress because there is motivation to create and profit from making products. The downside would be that there can also be the problem of monopolies being created because the government wouldn't be regulating companies or blocking monopolies. Also, with no government hand in setting a minimum wage it is possible to have unfair wages.

After the Depression and World War II many people thought that a centralized government was the future for the United States. With a centralized government the public believed that the government would play a more active role which would lead to a way for everyone to become equal. Although the idea of everyone being equal might sound enjoyable, once it took place people would have been very dissatisfied with it. A centralized government would have allowed the government to become all controlling, which would have taken away from the public's rights. It would be impossible for a central government to try to achieve all of the public's different needs. The government would also have the ability to change their policies or laws at any time to reach their own self-interest.

Instead of the future of the United States turning to a centralized government, like the public's attitude leaned toward, it had gone to a mixed economy. The government expanded and is very involved in the economy, but it is not an all controlling government. The public realized from other countries and from experience that and all controlling government is not ideal and would cause a lot more problems than equality. The mixed economy allows the government and private companies to have control. There becomes balance involving the degree of government involvement and economic freedom.

4. Comment on this statement - "Government measures that promote personal equality of opportunity enhance liberty; government measures to achieve 'fair share for all' reduce liberty."

Personal equality will allow for people to be prosperous, have personal freedom, and achieve liberty. If the government tries to make everything fair for all, instead of aiming for personal freedom, than they end up controlling the public. Force will have to be used to keep things equal and those who decide what 'fair share for all' is will end up promoting their own self interests. If society puts freedom first they will end up with a better amount of equality because everyone will be equal in their chances to be the person they want to be. A free society allows everyone to go after their own interests. It creates ambition and motivation without destroying anyone else's self-interest. Personal equality makes it so everyone can achieve greatness and individuality.

Equality is everyone having the same level of living and income. Everyone would have exactly the same fair share of everything like food, clothes, and money. Motivation to work hard would be gone. Who wants to work hard when no matter how hard you work your income and living will be exactly the same as the person who doesn't work hard at all. As a result most people would eventually choose not to work hard. When no one is working hard, than there isn't anything really getting accomplished. Equality would reduce the public's liberty by not allowing them to achieve their dreams and reach their potential. There would be nothing to aim for.

'Fair share for all' goes against the people's rights. The Declaration of Independence says that people have the right to "Life, Liberty, and the pursuit of Happiness." Personal equality promotes each person's individual desires and without it there is no personal motivation to work hard and accomplish goals like getting a dream job and a better income. The public can't choose to lead the life that makes them happy. Force or threat becomes the only way for the government to get the public to continue to work hard. If the government is forcing or threatening the public, than there is no liberty. Also, who gets to decide what the "fair share for all' is. The person or group that does get to decide what a fair share is would be able to use the power to promote their own interests. What the person feels is fair for everyone surely wouldn't be what everyone feels is fair for themselves. If all was fair than those with talents and ambitions would be restricted to only those things considered 'fair', which wouldn't really be fair to them at all. Personal equality ends up enhancing liberty and freedom. You have the freedom to be the person you want to be as long as it doesn't interfere with anyone else's personal liberty.

5. Why inflation is a printing press phenomenon?

Paper money is printing press money because it is so easy for the government to print off more. When they print off too much money and add it to the money supply quickly than it causes inflation in the economy. Some inflation is a normal part of the economy but high inflation causes many problems like certain incomes and certain prices rising. This unfair rising helps a few people but hurts the majority of people whose income isn't rising but the price of the products they're buying are. They aren't able to afford as many products which will slow down manufacturing demand and output. Those on fixed incomes are especially affected because there income won't rise at all but the products they need to purchase will continue to rise. Inflation also makes consumers weary of planning to buy things like houses or cars for fear that the inflation will continue and they will end up paying more.

Government spending is always growing so they can either tax or borrow from the public, which is never a real popular idea, or they can increase the supply of money. Usually the Federal Reserve will decide to increase the supply of money by bringing new money into the circulation. They do this by buying notes and bonds from the United States Treasury but this ends up increasing the national debt. Every time more money is brought into circulation than it reduces the value of the dollar. Because of inflation, when the government pays back the money it borrows it is actually worth less than when they borrowed it. This just causes more debt piled on by more debt every year.

The Federal Reserve also increases the money supply to create a sense of "full employment". As product prices rise companies are forced to make cutbacks to make a profit. Some cutbacks come from reducing jobs. The Federal Reserve spends more money on "Full employment" to create positions of employment for those people who would be out of a job from cutbacks. By adding more money into the supply to create these positions, they are adding more money to the inflation. This causes prices to increase again and makes a cycle of overspending by the government. So the idea of “full employment” just rises government spending and increases the money supply.