

How to Study for Class 1 Introduction

Class 1 introduces the main theme of the course.

1. Begin by looking over the Objectives listed below. This will tell you the main points you should be looking for as you read the chapter.
2. Like most disciplines, Economics has its own technical language. It is important to understand this language. New words or definitions are highlighted in italics in the text.
3. As you read the text, other key points are highlighted in bold type.
4. You will be given an In Class Assignment and a Homework assignment to illustrate the main concepts of this chapter.
5. When you have finished the text and the assignments, go back to the Objectives. See if you can answer the questions without looking back at the text. If not, go back and re-read that part of the text. Then, do the practice quiz for Chapter 1 at the end of the book.

Objectives for Class 1 Introduction

At the end of Class 1, you will be able to answer the following:

1. What are the two **assumptions** made about people's desires for material goods and services?
2. What are the "**factors of production**"? Define each and give examples. What is meant by "entrepreneurship"?
3. What is "**scarcity**"?

Class 1 Introduction (latest revision August 2004)

You are about to begin your study of economics. The word "economy" is derived from the Greek word: "oikos", household. Economy means "management of the household" (ecology, also derived from the same Greek word, means "study of the household"). The "household" here refers to the entire society. We will begin this class by focusing on **Microeconomics**. "Micro" means "small". For the first half of the course, we will examine the parts of an economy: consumers, private businesses, workers, and the government. In the second half of the course, we will shift to **Macroeconomics**. "Macro" means "large". At that time, we will examine overall production (especially recessions and depressions), a change in overall prices (especially inflation), overall economic growth of the standard of living, the policies of the government to affect the overall economy, and the financial system.

An economy begins with the desires of the people in the society for material goods and services. Notice that we use the word "desires" or "wants", rather than "needs". We will not concern ourselves with the question of what it is that people truly need. (Someone once

ascertained that humans could survive by eating a diet of pork, lard, and molasses. It is a fair guess that few people would desire this diet.) Also notice that the focus is on material goods and services. We will be concerned with food, shelter, clothing, health care, recreation, entertainment, and so forth; we shall not be concerned with psychological desires such as love, power, or respect. *(Any product that satisfies people's desires is called a "good" or a "service". The act of obtaining these material goods and services is called "consumption".)*

Modern Economics makes two assumptions about people's desires for material goods and services. *First, they are insatiable.* No matter how many goods and services people have, they still want more. Today, even the poorest Americans have more goods and services than could have possibly been imagined by people living 200 years ago. Yet, we still desire more and more. *Second, they are rational.* People's desires are not to be questioned. I desire the things I desire for my own reasons. You desire the things you desire for your own reasons. I know what is best for me and you know what is best for you.

In order to satisfy their desires for consumer goods, the people in the society must engage in production. To produce, people begin with *natural resources*. Nature provides land, minerals, trees, water, fish, animals, and so forth. Usually the people must do something to these natural resources to satisfy their desires --- harvest the fruits and vegetables, dig the minerals, cut the trees, catch the fish, and so forth. The productive contribution made by the people is called *labor*. However, with natural resources and labor alone, the society will not be able to satisfy the desires of the people very well. From earliest times, people have learned that they could satisfy their desires better by taking some of the natural resources and converting them into a form that will not meet desires today but which will allow greater production in the future. Thus, wood and iron are used to make a hammer. The hammer is not desired by anyone for its own sake, but it allows people to build more of those things they do desire. We call this indirect use of natural resources *"capital goods"*. Do not confuse this meaning of the word "capital" with other meanings. In business use, for example, capital sometimes refers to the money invested by the owner of a business. *Capital here refers to goods made by people for the purpose of increasing production.* Examples are machines, tools, equipment, and factory buildings. Finally, there is a need for someone to recognize the desires that people have and then bring together the appropriate natural resources, labor, and capital goods to meet these desires. There is risk involved; if one does not recognize the desires correctly or if one organizes the production inefficiently, considerable loss could result. So, for example, Steve Wozniak and Steven Jobs recognized a desire of some people in the society --- a desire for a computer that could be operated at home. They didn't just develop such a computer. They started a company --- Apple. With others, they obtained the natural resources, hired and trained the workers, bought the necessary machinery, and organized the production process. The success of the Apple II allowed both of them to have wealth valued in the billions of dollars. A person who undertakes this activity is called an *entrepreneur*. Successful entrepreneurs become famous. So Ray Kroc (MacDonalds), Bill Gates (Microsoft), Sam Walton (Wal-Mart), Irwin Jacobs (Qualcomm), and many others are very well known. Unfortunately, most entrepreneurs are not so successful. *Natural resources, labor, capital, and entrepreneurship are called the factors of production.*

Test Your Understanding

Think of any restaurant you have ever been to: Dennys, MacDonalds, Taco Bell, Pizza Hut, or any other. Write a list of some of the things used by that restaurant that would qualify as natural resources. Write a list of some of the things used by that restaurant that would qualify as labor. Write a list of some of the things used by that restaurant that would qualify as capital. Who is the entrepreneur in this restaurant and what does the entrepreneur do?

Capital is obviously a very important factor of production as we name our economic system for it. We say that we have *capitalism*. By definition, capitalism refers only to the capital goods. *In capitalism, the capital goods are owned by private individuals*. The opposite of capitalism is *socialism*. This also refers to the capital goods. *Under socialism, the capital goods are owned by a government agency*. So the capital goods in your classroom are owned by a government agency, the Palomar Community College District. When the people who run this district are democratically elected, as they are for schools, we call it *Democratic Socialism*. When they are dictators, we call this *communism*.

To say that in capitalism, capital goods are owned by private individuals whereas in socialism, they are owned by a government agency seems to be a very clear distinction. However, the distinction becomes less clear if we explore what the word "**ownership**" actually means. I own my car. What does this mean? Certainly, it does not mean that I can do anything I desire with my car. I cannot legally drive it 100 miles per hour, I cannot park it along a curb painted red, I cannot operate it without proper smog control, and I certainly cannot drive it where you happen to be standing. However, I do have certain rights that go with the fact that I own my car. In the United States, there is very little socialism; the government owns only a small portion of the capital goods. However, in the United States, there have been many disputes regarding the exact rights that one gets with private ownership. (So, while I have no right to operate my car without proper smog control now, I certainly had this right 25 years ago.) We shall examine these property rights and consider the importance of the way by which they are specified later.

The factors of production determine the maximum amounts of the various goods and services that can be produced at the present time. But people's desires for these goods and services are insatiable. *As a result, the desires always exceed the ability to meet them, a phenomenon known as scarcity*. The fact of scarcity forces every society to have to answer three basic questions. We will consider these in Class 2.