Economics Basics:

What Is Economics?

In order to begin our discussion of economics, we first need to understand some important concepts. For instance, what is the economy anyway? When we hear that "the economy is growing" or that "the economy is doing poorly," what does that mean? At the most abstract level, the economy is a system that exists to produce and provide people in a society with the goods and services they need to live and do what they want. The size of this system can grow as the population gets larger or as the existing population gets wealthier. Economists often measure the size of the economy with metrics such as gross domestic product (GDP), which measures the value of all the goods and services produced by a country in a year.

Types of Economic Systems

Types of economic systems are defined either by the way that stuff is produced or by how that stuff is allocated to people. For example, in primitive agrarian societies, people tend to self-produce all of their needs and wants at the level of the household or tribe. Family members would build their own dwellings, grow their own crops, hunt their own game, fashion their own clothes, bake their own bread, etc. This self-sufficient economic system is defined by very little division of labor and is also based on reciprocal exchange with other family or tribe members. In such a primitive society, the concept of private property didn't typically exist as the needs of the community were produced by all for the sake of all.

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Later, as society developed, economies based on production by social class emerged such as feudalism and slavery. Slavery involved production by enslaved individuals who lacked personal freedom or rights and existed as the property of their owner. Feudalism was a system where a class of nobility, known as lords, owned all of the land and leased out small parcels to peasants to farm, with peasants handing over much of their production to the lord. In return, the lord offered the peasants relative safety and security including a place to live and food to eat.

Capitalism emerged with the advent of industrialization. Capitalism is defined as a system of production whereby business owners (capitalists) produce goods for sale in order to make a profit and not for personal consumption. In capitalism, capitalists own the business including the tools used for production as well as the finished product. Workers are hired in return for wages, and the worker owns neither the tools he uses in the production process nor the finished product when it's complete. If you work at a shoe factory and you take home a pair of shoes at the end of the day, that's stealing even though you made them with your own hands. This is because capitalist economies rely on the concept of private property to distinguish who legally owns what.

Capitalist production relies on the market for the allocation and distribution of the goods that are produced for sale. A market is a venue that brings together buyers and sellers, and where prices are established that determine who gets what and how much of it. The United States and much of the developed world today can be described as capitalist market economies.

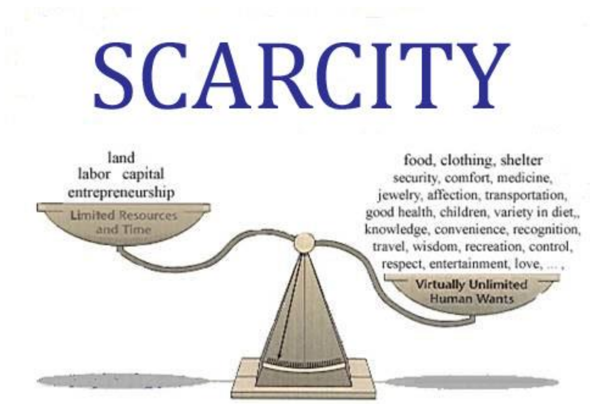
Two alternatives to capitalist production are worth noting.

Socialism is a system of production whereby workers collectively own the business, the tools of production, the finished product, and share the profits – instead of having business owners who retain private ownership of all of the business and simply hire workers in return for wages. Socialist production often does produce for profits and utilizes the market to distribute goods and services. In the U.S., worker coops are an example of socialist production organized under a broader capitalist system.

Communism is a system of production where private property ceases to exist and the people of a society collectively own the tools of production. Communism does not use a market system, but instead relies on a central planner who organizes production (tells people who will work in what job) and distributes goods and services to consumers based on need. Sometimes this is called a command economy.

Scarcity

Scarcity, a concept we already implicitly discussed in the introduction to this tutorial, refers to the tension between our limited resources and our unlimited wants and needs. For an individual, resources include time, money and skill. For a country, limited resources include natural resources, capital, its labor force and its level of technology. If scarcity didn't exist, economics wouldn't matter since everybody would be able to provision all of their needs and wants at all times, and for free.



Because, however, our resources are limited in comparison to all of our wants and needs, individuals, firms, and nations have to make decisions regarding what goods and services they buy or produce and which ones they must forgo. For example, if you choose to buy one new video game as opposed to two old games, you must give up owning a second game of inferior technology in exchange for the higher quality of the newer one. Likewise, a company that produces video games must decide how to allocate its workforce, time, and money to produce a small number of high quality games or a large number of lower quality products. Because of scarcity, people, firms, and nations must all make decisions over how to allocate their individual resources. Economics, in turn, aims to study why we make these decisions and how we allocate our resources most efficiently.

Macro and Microeconomics

Macro- and microeconomics are the two main vantage points from which the economy is studied. Macroeconomics looks at the economy on a national and international level. It examines total output of a nation (GDP) and the way the nation allocates its limited resources of land, labor supply and capital. Macroeconomics is concerned with international trade, a nation's fiscal and monetary policy, the level of inflation and interest rates, national unemployment, and more.

Microeconomics studies the level of the individual and the firms within the economy. Analyzing certain aspects of human behavior, microeconomics shows us how individuals and firms respond to changes in price and why they demand what they do at particular price levels. Microeconomics tries to explain how and why different goods command different values, how

individuals make financial decisions, and how individuals best coordinate and cooperate with one another.

Micro- and macroeconomics are intertwined; as economists gain understanding of certain phenomena, they can help us make more informed decisions when allocating resources. Many people believe that the micro foundations of individuals and firms acting in aggregate constitute macroeconomic phenomena.