

Introduction to economics

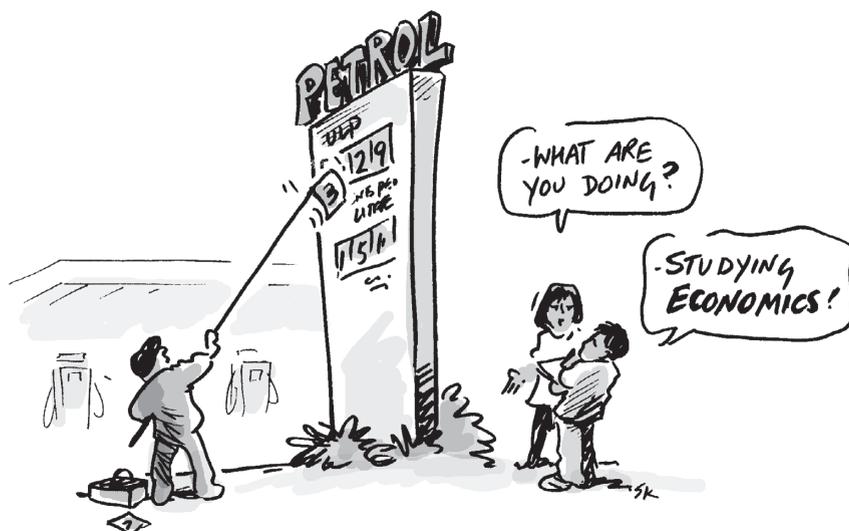
What is economics?

Economics is the study of how different societies attempt to satisfy their never-ending wants with the limited resources that are available to them. It therefore considers the production of goods and services, their exchange between buyers and sellers, and distribution and consumption. The economics student studies various aspects of the basic economic problem of scarcity, which relates to firms and countries just as it relates to you and your own decision-making.

Economics affects the lives of each and every one of us. If, for instance, interest rates increase, you could find yourself receiving more interest on your savings. On the other hand, it may cost your family more to service any loans that they have. The pace of technological change renders some jobs redundant and creates other new ones. These changes in the workforce could influence your own employment prospects one day. Many other economic issues, including inflation, could affect your life too, as if prices are generally rising you may find that you are paying more for goods and services.

So you can see that economics can have significant effects, even on a personal level.

Studying economics should assist you to make informed decisions as a citizen in a rapidly changing world.



Economics as a social science

If we were conducting a scientific experiment, we could throw certain chemicals into a beaker of water and be certain that we would create a spectacular reaction. We know that for a fact. Jump off a roof and we know that the laws of gravity will force you to the ground. We cannot make predictions with the same degree of certainty in economics because we are dealing with people, who do not act in entirely predictable ways. If interest rates fall it should help the economy to grow, as borrowing money will be cheaper and consumers are more likely to spend. On the other hand, if people are worried about losing their jobs or having their hours of work reduced, they are less likely to borrow and spend, even if interest rates fall quite significantly.

Economics therefore deals with human behaviour and is considered a **social science**.

Hint: We can rarely state with absolute certainty what will happen in the economic world. Please avoid using absolute terms such as ‘will’, ‘everyone’, ‘no-one’, ‘all’ in your answers, as these terms tend to detract from an answer’s quality. Instead, start using words such as ‘should’, ‘could’, ‘perhaps’ and ‘maybe’. Using absolute terms is a very common error students make and it is one that can be relatively easily addressed.

Economic models

Economists use scientific methods when studying problems and seeking solutions. However, they cannot test their theories under controlled laboratory conditions because they are dealing with human behaviour. Despite this, economists can still theorise, collect data, analyse it and make predictions.

Because of the complexity of the real world, economists attempt to simplify situations through the use of **economic models**. These models may be in various formats, for instance in graphs, diagrams or flow charts. An economist often begins with what appears to be an over-simplification of a real-life situation. Assumptions are then made upon which the model can be based. This allows the model to be built up and conclusions reached. By eventually relaxing the assumptions we gain a clearer picture of what approximates the real-world situation.

To explain the concept of assumptions a little further, let us consider your economics teacher talking to your class for the first time. The teacher might make the assumption that all students have enrolled because they have an interest in learning about economics. As time goes by, the teacher makes observations of individual students based on their responses, enthusiasm and output and may be surprised to learn that the initial assumption was incorrect. Amazingly, some students may display no interest in the subject whatsoever. Thus when the assumption is tested against real world experiences it may need to be rejected or modified.

Hint: The concept of assumptions will become clearer to you in the next few weeks as we construct our first economic models.

It is important to realise that there are many and varied theories underpinning economic practice. We will consider the theories of some well-known economists as this book unfolds. Economists use different models and different assumptions to test their hypotheses. Debate and controversies abound. It is little wonder that the Treasurer trying to run our country is often under fire for not getting it right.

It has been jokingly said that if the entire world’s economists were placed end to end they still wouldn’t reach a conclusion.

Activity

You should compile an economic glossary in your notebook to enter economic terms and their meanings. Add new words as you progress through this book and build up an economic dictionary. Use these terms in your writing. One of the desired learning outcomes from your study of economics is to communicate using the terminology of the subject.

Enter the following words in alphabetical order in your economic glossary and outline their meanings from what you have read in this chapter:

- economics
- social science
- economic model

The economic problem

Needs and wants

As individuals we have both needs and wants. **Needs** are those items which are essential for our survival: food and water, shelter and clothing. In a high-income country such as Australia many people are able to satisfy their needs and their attention then turns to **wants**. These are items that improve our quality of life and standard of living, but are non-essential.

In our study of economics we are concerned with the wants that can be fulfilled through the spending of money on goods and services. We call this spending **consumption**. Consumer goods and services directly satisfy our wants. **Goods** have a physical presence; we can touch them. **Services**, however, are those innumerable wants that do not have a tangible existence, like legal fees, transport costs and gym memberships.

Not all of our human desires have a price. For instance, although we may want to be rich, in an economic sense we are not concerned with such wishes when we are considering needs and wants. Neither do we consider emotions such as happiness. We consider only those wants that can be satisfied with expenditure.

Common characteristics of wants

Our wants tend to be **unlimited**. As our income grows and the ability to satisfy our wants increases, rather than wanting less because our wants can be fulfilled, we tend to change or upgrade our wants. For instance, the second-hand Commodore which is our pride and joy as an 18-year-old may find itself replaced with a Subaru WRX in our early 20s when we start our professional careers.

Wants also **vary** from one person to the next. Your own taste in music could be quite different from your best friend's. Similarly, those not conversant with Chinese opera might find it quite challenging, and have no desire to buy a CD featuring it. Therefore, cultural differences can affect wants too. Geographical location can also play a part. A teenage boy in the USA may want to spend money on equipment to play baseball, whereas in South Australia he is more likely to buy a football.

We all have **recurring** wants. Items such as food and drinks are wanted on a daily basis. People who go to the gym probably do so regularly. Those who read newspapers and those who use make-up may want to do so daily.

Some wants are **complementary**. By this, we mean that they tend to go together. Examples are cars and petrol, fish and chips, shoes and socks. There is not much point in buying a bicycle helmet without having the bicycle to accompany it. Buying a car will satisfy one want, but will also generate the desire for necessities such as petrol and oil, without which the car cannot be driven.

Collective wants are community wants and include society's desire for facilities such as schools, hospitals, parks, roads and libraries. Many of these wants are provided by the government using the money we pay in taxes. It would be difficult for a privately-owned business to make a profit from construction of a country road for instance, so in many cases the government provides goods and services which would be very unattractive for private firms, and therefore unlikely to be otherwise provided.

Wants also **change over time**. Your grandmother probably bought records to play her favourite music 40 years ago and perhaps your mum purchased cassette tapes. A few years ago you might have bought CDs, then DVDs, but today you are more likely to be sourcing your music online. And in 10 years time? You can see that as technology changes so do our wants.

Age has an impact also. The things you buy will probably be quite different from those your grandmother buys because your tastes are different. Some of your needs are different too. With the ageing population that we have in Australia there will probably be an increase in demand for wheelchairs and hearing aids rather than for nappies and toys.

Resources

Anything that we can use to satisfy our wants is considered a resource to an economist. Unfortunately many of our resources are non-renewable and this leads to considerable problems. If our wants are unlimited but our resources are not, the issue of scarcity arises. Think about this issue in relation to the types of resources which follow.

Classification of resources

Land

To an economist, a resource classified as 'land' refers to anything which is natural or, in other words, not manufactured. Therefore, a log from a tree is classified as land, but the chair that is made from the wood is not. Agriculture, mining, forestry and fishing would all come under this category. Some of these resources are renewable in a relatively short time frame, for example forests, but others, such as minerals, are not.

Labour

Human effort used in the production of goods and services is a resource. You can sell your labour to a firm and receive a wage or a salary in return. Plumbers, accountants, dancers and teachers, for instance, earn their income by providing their labour to firms or charging clients directly if they run their own business.

Capital

You might think of capital as being to do with money, but in economics its meaning is quite different. Anything produced which can help in the production of something else is considered capital. A neat definition is 'produced means of production'. You can see then why money is not considered a resource, as it does not actually help in the production process. What it does do is to provide a medium of exchange so that you can buy equipment for instance, and it is this equipment which is capital in an economic sense.

Other obvious examples include machinery and tools, but the term is also used in a much broader sense. To a restaurant, a bottle of wine is a capital good as it is being used to produce the dining experience which the consumer is willing to pay for. To a hospital or a hotel, a towel is a capital good as it is helping to produce a service. To a consumer shopping for their family's supplies, however, the bottle of wine and the towel would be consumer goods as they will be used to directly satisfy their wants. So whether you classify an item as a consumer good or a capital good depends on the purpose for which it will be used.

Enterprise

Enterprise is to do with human effort but it goes much further than the term labour. Another name for enterprise is **entrepreneurship** and it relates to the person who has a new idea/invention and who brings that idea to fruition in the marketplace. If you invent something in your shed at home, and do nothing about it, this does not make you an entrepreneur. However, if you raise the finance and market the project you are showing enterprise. An entrepreneur is a risk-taker who comes up with an idea and then combines land, labour and capital resources to produce the final goods or services.



Figure 1: Resources used in the production of steel

The economic problem

Perhaps you can see the problem that is emerging. Our wants are unlimited but generally our resources are finite. This means that resources are scarce, relative to our wants, and decisions then have to be made as to which wants should be satisfied. We can use the steel produced in a steel mill for many purposes. Should it be used to provide the frames for houses, or in bridges to improve communications within the country? Should it be used instead in the manufacture of motor cars to satisfy the wants of consumers? Choices have to be made as to what will be produced, what methods are best used in the production process, and who should be the recipients of the goods and services produced. More on this later!

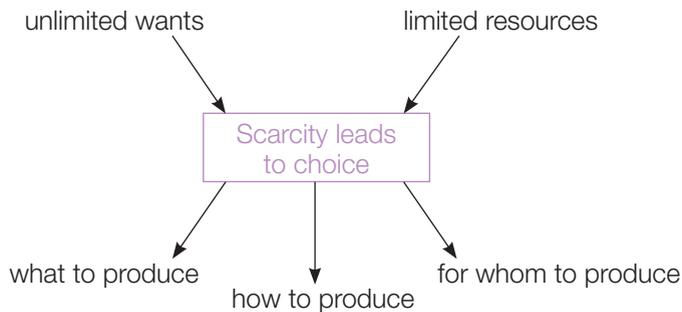


Figure 2: The economic problem of scarcity

Activities

1. Enter the following words into your glossary and outline their meanings:

- consumption
- collective wants
- capital
- complementary wants
- land
- enterprise

2. Match one of the words below to one of the 12 descriptions shown in the following list:

- collective wants
- economics
- capital
- consumption
- labour
- unlimited
- scarcity
- recurring
- resources
- economic model
- enterprise
- land

Description	Correct term
a study of how scarce resources are allowed to satisfy unlimited wants	economics
a simplified view of the world	
the term used for the using up of goods and services	
Bill Gates, the founder of Microsoft	
a characteristic of a want such as a newspaper	
the basis for the economic problem	
anything which can be used to satisfy our wants	
resource classification of fruit and vegetables	
human effort	
wants such as schools and hospitals	
produced means of production	
the key nature of our wants	
the decision we must make because of limited resources	