

## SECTION 1

# The Basic Problem in Economics

### COVER STORY

THE COLUMBUS DISPATCH, MARCH 23, 1999



When 5-year-old Michael Badurina spied a classmate wearing *Blue's Clues* clothes, he implored a higher power, "Mommy, I want some of those! I *need* some of those!"

... For the uninitiated, *Blue's Clues* is the most-watched preschool TV program in the United States, with 14 million viewers each week.

### READER'S GUIDE

#### Terms to Know

- economics
- scarcity
- factors of production
- land
- labor
- goods
- services
- capital
- productivity
- entrepreneurship
- technology

#### Reading Objectives

1. How do wants and needs differ?
2. Why does scarcity face all people at all times?
3. What are the four factors of production?

Starting at a very young age, many Americans use the words *want* and *need* interchangeably. How often do you think about what you "want"? How many times have you said that you "need" something? When you say, "I need some new clothes," are you stating a want, or a real need? As you read this section, you'll find that economics deals with questions such as these.

What, exactly, is economics? **Economics** is the study of how individuals, families, businesses, and societies use limited resources to fulfill their unlimited wants.

**economics:** the study of how individuals and societies make choices about ways to use scarce resources to fulfill their wants

ZITS



**FIGURE 1.1** ...

**Wants Versus Needs**  
 Luxuries such as concert tickets often become necessities in the eyes of consumers. *How do consumers satisfy their seemingly unlimited wants?*

### Wants Versus Needs

Typically the term *need* is used very casually. When most people use the word, as shown in **Figure 1.1**, they really mean that they want something they do not have. Obviously, everyone needs certain things to survive—food, clothing, and shelter. Americans also consider education and health care as needs.

To economists, however, everything other than basic survival needs is considered a *want*. People want such items as new cars and personal computers. What begins as a luxury, or want, becomes to many people a necessity.

So how do individuals satisfy their unlimited wants in a world of limited resources? They must do this by making choices.



**FIGURE 1.2** ...

**Economic Choices**  
 Everyone, including governments, must make choices in a world of limited resources. If the government allocates funds to build Stealth bombers, then funds for higher education could be limited. *What is the basic economic problem that makes choices necessary?*

CONTENTS

## Choices

As a student, you probably have a small income from an allowance or a part-time job. As a result, you have to make choices about its use. Whenever you make such a spending decision, each available choice competes with every other available choice. Suppose you have \$20.00 to spend. When you decide whether to spend your money on lunch or clothes or a new CD, you are making an economic choice.

Like individuals, businesses must also make choices. Businesspeople make decisions daily about what to produce now, what to produce later, and what to stop producing. These decisions in turn affect workers' incomes and people's ability to buy. Societies, too, face choices about how to utilize their resources in the production of goods and services. As shown in **Figure 1.2**, elected government representatives in the United States must decide how much to spend on defense (Stealth bombers) versus higher education, for example. How people and societies make these choices is the focus of economics.

## The Problem of Scarcity

The need to make choices arises because everything that exists is limited, although some items (such as trees in a large forest) may appear to be in abundant supply. At any single moment, a fixed amount of resources is available. At the same time, people have competing uses for these resources. This situation results in scarcity—the basic problem of economics.

**Scarcity** means that people do not have and cannot have enough income, time, and other resources to satisfy their every want. What you buy as a student is limited by the amount of income you have. In this case, your income is the scarce resource. Even if everyone in the world were rich, however, scarcity would continue to exist—at least with respect to time. Even the richest person does not have unlimited time.

It is important not to confuse scarcity with *shortages*. Scarcity always exists because of competing alternative uses for resources, whereas shortages are temporary. Shortages often occur, for example, after hurricanes or floods destroy goods and property.

**scarcity:** condition of not being able to have all of the goods and services one wants, because wants exceed what can be made from all available resources at any given time

## Factors of Production

When economists talk about scarce resources, they are referring to the **factors of production**, or resources needed to produce goods and services. Traditionally, economists have classified

**factors of production:** resources of land, labor, capital, and entrepreneurship used to produce goods and services



these productive resources as land, labor, capital, and entrepreneurship. **Figure 1.3** shows you the four factors of production.

**land:** natural resources and surface land and water

**Land** As an economic term, **land** refers to natural resources present without human intervention. "Land" includes actual surface land and water, as well as fish, animals, forests, mineral deposits, and other "gifts of nature."

**labor:** human effort directed toward producing goods and services

**Labor** The work people do is **labor**—which is often called a human resource. Labor includes anyone who works to produce goods and services. As you know, economic **goods** are tangible items that people buy, such as pharmaceuticals, shampoo, or computers. **Services** are activities done for others for a fee. Doctors, hair stylists, and Web-page designers all sell their services.

**goods:** tangible objects that can satisfy people's wants or needs

**services:** actions that can satisfy people's wants or needs

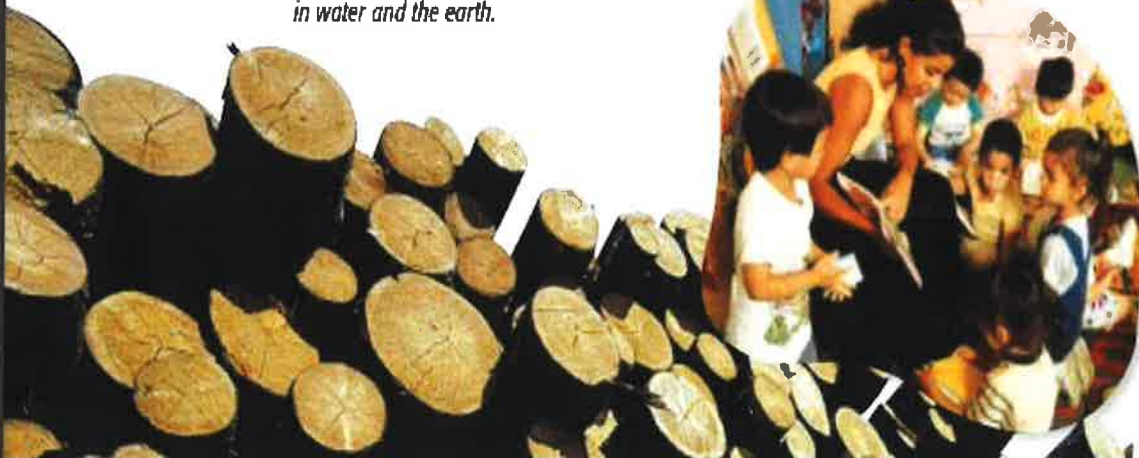
**Capital** Another factor of production is **capital**—the manufactured goods used to make other goods and services. The machines, buildings, and tools used to assemble automobiles, for example, are **capital goods**. The newly assembled goods are not considered capital unless they, in turn, produce other goods and services, such as an automobile performing services as a taxicab.

**FIGURE 1.3**

**The Four Factors of Production** The four general categories of resources needed in the production of all goods and services include land, labor, capital, and entrepreneurship.

**A** Land  
Natural resources, such as timber, are all the things found in nature—on or in water and the earth.

**B** Labor  
This child-care worker falls under the category of labor—she is performing a service for a fee.



When capital is combined with land and labor, the value of all three factors of production increases. Think about the following situation. If you combine an uncut diamond (land), a diamond cutter (labor), and a diamond-cutting machine (capital), you end up with a highly valued gem.

Capital also increases **productivity**—the ability to produce greater quantities of goods and services in better and faster ways. Consider how much faster a mechanical reaper—a capital good—can harvest grain than a person clearing the field with a scythe.

**productivity:** the amount of output (goods and services) that results from a given level of inputs (land, labor, capital, entrepreneurship)

**Entrepreneurship** The fourth factor of production is **entrepreneurship**. This refers to the ability of individuals to start new businesses, to introduce new products and processes, and to improve management techniques. Entrepreneurship involves initiative and willingness to take risks in order to reap profits.

**entrepreneurship:** ability of risk-taking individuals to develop new products and start new businesses in order to make profits

Entrepreneurs must also incur the costs of failed efforts. About 30 percent of new business enterprises fail. Of the 70 percent that do survive, only a few become wildly successful businesses such as Microsoft, The Limited, or Blockbuster Video.

**Technology** Some economists add technology to the list of factors of production. In the past, **technology** included any use of land, labor, and capital that produced goods and services more efficiently. For example, computerized word processing was a technological advance over the typewriter.

**technology:** advance in knowledge leading to new and improved goods and services and better ways of producing them



**C** Capital

Capital goods, such as these robots, are unique in that they are the result

**D** Entrepreneurship

These entrepreneurs are taking a financial risk to make a profit for themselves and to bring innovative products and services to consumers.

