

## CHAPTER 1

# What is an Economy?

Economics is the study of the economy. So we first need to figure out what an economy is. The global economy teeming with seven billion people is too big to wrap our minds around. So we'll start with a smaller one.

A middle-aged accountant named Max goes on a vacation cruise, has one too many free drinks, falls overboard, grabs a passing log, drifts for days, and washes up on the sandy beaches of a pleasant-looking island. He lies there for a while, hoping the kindly native islanders will carry him to their hut and feed him coconuts and spring water. When no one shows up all afternoon, he realizes he's alone. He sits up and takes stock of his situation.

Max wants some things. He wants food, clothes, shelter, entertainment, good health, companionship, and to not be eaten by a tiger. How can he get these things?

He has some resources at his disposal. The island has coconut trees, farmable land, forests, wild turkeys, and streams filled with trout. We call these resources *capital*. Max also has the ability to work. He can

perform physical tasks like lifting a rock and climbing a tree. He can perform mental tasks like figuring out which coconut tree has more coconuts. This ability to work—to perform physical tasks with his body and mental tasks with his brain—we call *labor*.

Max needs to use what he has (coconut trees, streams, wild turkeys, a strong back, and a sharp mind) to get what he wants (log cabin, shirts, coconuts, and spring water). He clears land and plants pineapples, climbs coconut trees to collect coconuts, weaves a shirt out of tall grass, and cuts down trees to build a cabin. He befriends a dog for company, and dances around a bonfire for entertainment.

These activities constitute Max's economy. Max *produces* what he wants using the labor and capital available to him, and he *consumes* it to satisfy his wants. This daily rhythm of producing and consuming constitutes his economy. The economy, broadly defined, is his daily life.

Now, instead of just Max on a small island, let us put seven billion people together on a much bigger island called Earth, and we have the global economy. The scale is bigger, but many of the problems are the same. Like Max, these seven billion people want food, clothes, shelter, companionship, and entertainment. Like Max, they have to figure out a way to get these things using the limited resources that they have on their planet. They harness their land, minerals, forests,

and sunlight to produce cornflakes, aspirin, TV shows, and townhouses, which they then consume. Whether as cooks or carpenters, bankers or yoga instructors, shoppers or moviegoers, students or retirees, this describes what everyone does all day. Every morning, seven billion people wake up and play their part in an incredibly vast and intricate ballet of production and consumption that constitutes the global economy, and life itself.