**Chapter 1: Ten Principles of Economics**

**Introduction**

Economics studies how societies with limited resources decide what to produce, how to produce it, and who consumes what. It is similar to managing a household where choices must be made about work, resources, and rewards.

• Scarcity means resources are limited while wants are unlimited.

• Economists study decision-making, market interactions, and big trends like growth, unemployment, and inflation.

• This chapter introduces 10 key principles of economics.

**Principle 1: People Face Trade-offs**

• Choosing one thing means giving up another due to limited resources.

• Examples: A student dividing time between subjects; a family dividing income between food, clothes, and vacations.

• Society faces choices such as 'guns vs. butter' (defense vs. consumer goods).

• Efficiency = getting the most out of resources; Equality = fair distribution. Policies often balance the two.

**Principle 2: The Cost of Something Is What You Give Up to Get It**

• Opportunity cost = the value of the next best alternative you give up.

• Example: The true cost of college includes not just tuition and books but also lost income from not working.

• Athletes may skip college because the opportunity cost (forgone millions) is too high.

**Principle 3: Rational People Think at the Margin**

• Rational people make decisions by comparing marginal benefits and marginal costs.

• Marginal change = small, step-by-step adjustment to a plan.

• Example: Airlines sell last-minute tickets below average cost because marginal cost is nearly zero.

• Water vs. diamonds: Water is essential but plentiful (low marginal benefit). Diamonds are rare (high marginal benefit).

• Decision rule: Take an action if marginal benefit exceeds marginal cost.

**Principle 4: People Respond to Incentives**

• Incentive = something that motivates people to act (reward or punishment).

• Higher prices → buyers consume less, sellers produce more.

• Gasoline tax encourages smaller cars, carpooling, and public transport.

• Seat belts improve safety but may lead drivers to drive faster, increasing accidents (unintended consequences).

• Real-world examples: Fuel price increases led to small car sales, higher transit use, and changes in lifestyle.

**Principle 5: Trade Can Make Everyone Better Off**

• Trade is not win-lose; both sides can benefit.

• Families and countries gain by specializing in what they do best and trading for the rest.

• Trade allows greater variety and lower costs.

**Principle 6: Markets Are Usually a Good Way to Organize Economic Activity**

• Market economy = decisions made by households and firms, not central planners.

• Adam Smith’s 'invisible hand': prices guide buyers and sellers toward efficient outcomes.

• Policies that block prices (e.g., rent control, heavy taxes) disrupt efficiency.

**Principle 7: Governments Can Sometimes Improve Market Outcomes**

• Governments enforce rules and protect property rights so markets work properly.

• They correct market failures such as externalities (e.g., pollution) and monopolies.

• They may also act to improve equality, even if it reduces efficiency.

**Key Definitions**

• Scarcity → limited nature of society’s resources.

• Economics → study of how society manages scarce resources.

• Efficiency → getting the most from scarce resources.

• Equality → fair distribution of resources.

• Opportunity cost → what must be given up to obtain something.

• Rational people → systematically do the best they can with available opportunities.

• Marginal change → small incremental adjustment to a decision.

• Incentive → something that motivates behavior.

• Market economy → system where households and firms interact through markets.

• Property rights → ability to own and control resources.

• Market failure → when markets fail to allocate resources efficiently.

• Externality → impact of one person’s actions on others.