Chapter 1

Ten Principles of Economics

Introduction

- **Economy** comes from the Greek word for "one who manages a household." (**Similarities?**)

- Why do we read economics?-**Scarcity** of **resources**

- **Economics** is the study of how society manages its scarce resources

Principle 1: People face tradeoffs

- No provision for **free lunch** (example: **time allocation, spending decision, budget etc.)**
- **Efficiency:** the property of society getting the most it can from its scarce resources
- **Equity:** the property of distributing economic prosperity fairly among the members of society
- **Creating pie** and **distributing** it often becomes a **conflict**

Principle 2: The cost of something is what you give up to get it

- I want to **pursue masters degree**

- What is the **cost**?-tuition fees, books, copies, stay, food and so forth

- **Opportunity cost!**

Principle 3: Rational people think at the margin

- Decisions at **margin** becomes crucial (extra meal confusion)

- **Disasters**:
  - Salman Khan and Sanjay Leela Bhansali
  - Sourav Ganguly and Greg Chappell

- Confusion on purchase of **refrigerator** (**marginal cost & benefit**)

Principle 4: People respond to incentives

- Legends
  - Sushant Singh Rajput
  - Sonu Nigam
  - SRK
  - AB De Villiers
- Economic Problems
  - Seat belt & **Moral Hazard**
  - Technology & **Rebound**

Principle 5: Trade can make everyone better off

- Trade is **good or bad**?-Adam Smith, David Ricardo …

- Think of **globalization** (1991's policy-Manmohan Singh)

- Anything is possible now-**global value chain**; e.g. medicines of covid

Principle 6: Markets are usually a good way to organize economic activity

- Communist countries have worked with the idea of central planners
- **Market economy** has become the key driving force under decentralized plans
- Selfish but effective and successful!
- **Invisible hand, free market**, and distortion

Principle 7: Governments can sometimes improve market outcomes

- Govt. promotes **efficiency** and **equity**

- **Market failure**: a situation where market fails to allocate resources efficiently
  - **Externality**: the impact of one person's actions on the well-being
  - **Market power**: a single or a few economic actors can influence the market price

- Invisible hand does not ensure **equity**. Thus, govt. intervenes.. (WTP; social securities)

Principle 8: A country's standard of living depends on its ability to produce goods and services

- Why does the **standard of living vary** across countries, or even across states within a same country?
- **Productivity**: the amount of goods and services produced from each hour of a worker's time
- **Deficit financing** through **public borrowing** may have an **adverse impact** on productivity

Principle 9: Prices rise when the government prints too much money

- “In Germany in January 1921, a daily newspaper cost 0.30 marks. Less than two years later, in November 1922, the same newspaper cost 70,000,000 marks…”

- **Inflation**: A case of sustainable price rise

- **Source**: Money printing (Quantity Theory of Money)

Principle 10: Society faces a short-run tradeoff between inflation and unemployment

- **Phillip's curve**: shows the trade-off between inflation and unemployment rate
- Money supply reduced-prices are reduced but not uniformly in every sectors (prices are rigid in the short-run)-lay-off becomes common-increase in unemployment
- **Fiscal policy** and **monetary policy** are crucial instruments