Ch.1 Ten Principles of Economics

- **Scarcity**
  - Society has limited resources
  - We cannot produce all the goods and services people wish to have
- **Economics is the study of how society manages its scarce resources**
  - How people decide what to buy, how much to work, save, and spend
  - How firms decide how much to produce, how many workers to hire
  - How society decides how to divide its resources between…

- **Principle 1: People Face Trade-offs**
  - To get something that we like, we have to give up something else that we also like
  - No Free lunch ex. Going to a party the night before an exam
  - Society faces trade-offs between efficiency and equality

- **Principle 2: The Cost of Something Is What You Give Up to Get It**
  - Making decisions: Compare costs and benefits of alternatives… Need to include opportunity costs
  - Opportunity cost : Whatever must be given up to obtain some item
  - Ex. The opportunity cost of going to college for a year? Going to the movies?

- **Principle 3: Rational People Think at the Margin**
  - Rational people make decisions by evaluating costs and benefits of marginal changes
  - Ex. A manager considers whether to increase output compares the cost of the needed labor and materials to the extra revenue

- **Principle 4: People Respond to Incentives**
  - Incentive : Something that induces a person to act
  - Ex. Gas prices and SUVs. Cigarette taxes and teen smoking

- Principle 1~4 are on **"How People Make Decisions"**

- **Principle 5: Trade Can Make Everyone Better Off**
- People benefit from trade
  - Can buy a greater variety of goods and services at lower cost
- Countries benefit from trade and specialization
  - Get a better price abroad for goods they produce… Buy other goods more cheaply from abroad

- **Principle 6: Markets Are Usually a Good Way to Organize Economic Activity**
- A market economy allocates resources by Decentralized decisions of many firms and households as they interact in markets
- **Adam Smith in 'The Wealth of Nations (1776)'**
  - "Each of these households and firms acts as if "led by an invisible hand" to promote general economic well-being"
  - "Invisible hands" : Prices guide self-interested households and firms to make decisions that maximize society's economic well-being

- **Principle 7: Governments Can Sometimes Improve Market Outcomes**
- Government enforce **property rights**
- Government promote **efficiency**
  - Avoid market failures: market left on its own fails to allocate resources efficiently
  - Two major sources of market failure: <u>**Externalities, Market power**</u>
- Government promote **equality**
  - Avoid disparities in economic wellbeing
  - Use taxes or welfare policies

- Principle 5~7 are on **"How People Interact"**

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

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

- **Principle 10: Society Faces a Short-run Tradeoff between Inflation and Unemployment**

- Principle 8~10 are on **"How the economy as a whole works"**