Chapter 1. 10 Principles of Economics

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Economic Ideas in Ancient Times

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- While the formal discipline of economics as we know it today did not exist, ancient civilizations engaged in economic activities and laid the groundwork for later economic thinking.

Economic Ideas in Ancient Times

- Ancient Greece (8th to 4th centuries BCE):
  - Greek philosophers, such as Aristotle, made notable contributions to economic thought.
  - Aristotle's work "Politics" discussed economic topics, including the nature of wealth, money, and the concept of "oikonomia" (household management), laying the groundwork for later economic ideas.

Economic Ideas in Ancient Times

- Ancient India (circa 1500 BCE–500 CE):
  - Ancient Indian texts, particularly the Arthashastra attributed to Chanakya, addressed economic principles and governance.
  - The Arthashastra covered topics such as taxation, trade, and statecraft, providing insights into economic administration.

Economic Ideas in Ancient Times

- Ancient China (circa 2000 BCE–220 CE):
  - Ancient Chinese philosophers, including Confucius and Mencius, discussed economic matters in the context of ethical governance.
  - The idea of a well-regulated state and the importance of agriculture and trade were central themes in Chinese economic thought.

Economic Ideas in Ancient Times

- Roman Empire (circa 27 BCE–476 CE):
  - The Roman Empire had a complex economy based on agriculture, trade, and slave labor.
  - Roman thinkers like Cicero and Seneca discussed economic issues, but their writings were more focused on ethical considerations.

Economic Ideas in Ancient Times

- While these ancient societies engaged in economic activities and laid the groundwork for economic thought, it's important to note that the formalization of economics as a distinct discipline with systematic theories and methodologies began much later, particularly during the mercantilist and classical periods in Europe.
- Ancient economic ideas, however, provided foundational concepts and discussions that influenced later economic thinking.

The Path to Modern Economics

- Mercantilism (16th to 18th centuries):
  - This economic theory dominated Europe during the early modern period. Mercantilists believed in the importance of accumulating wealth, primarily in the form of gold and silver.
  - Policies focused on promoting exports and limiting imports to achieve a favorable balance of trade.

The Path to Modern Economics

- Physiocracy (18th century):
  - Originating in France, physiocrats like François Quesnay emphasized the role of agriculture as the primary source of wealth.
  - They believed in natural economic laws and advocated for minimal government interference, laying the groundwork for later ideas of laissez-faire.

The Path to Modern Economics

- Classical Economics (late 18th to 19th centuries):
  - Economists such as Adam Smith, David Ricardo, and John Stuart Mill contributed to classical economics.
  - Adam Smith's "The Wealth of Nations" (1776) is considered a foundational work, promoting the concept of free markets and the invisible hand.
  - Classical economists explored the principles of supply and demand, labor theory of value, and the role of government.

The Path to Modern Economics?

- Marxian Economics (19th century):
  - Building on classical economics, Karl Marx and Friedrich Engels developed a socio-economic theory known as Marxism.
  - They focused on the role of class struggle and predicted the eventual overthrow of the capitalist system by the working class, leading to a classless communist society.

The Path to Modern Economics

- Neoclassical Economics (late 19th to early 20th centuries):
  - Neoclassical economists, including Alfred Marshall and Leon Walras, shifted the focus from classical labor theories to subjective value theory.
  - They emphasized marginal utility, individual preferences, and market equilibrium. Neoclassical economics became dominant in the late 19th and early 20th centuries.

The Path to Modern Economics

- Keynesian Economics (20th century):
  - In response to the Great Depression, John Maynard Keynes introduced Keynesian economics.
  - Keynes advocated for government intervention in the economy, including fiscal and monetary policies, to manage aggregate demand and stabilize economic cycles.

The Path to Modern Economics

- Monetarism and New Classical Economics (mid-20th century):
  - Economists like Milton Friedman emphasized the role of money supply in influencing economic outcomes.
  - Monetarism and new classical economics questioned the effectiveness of Keynesian policies and promoted the importance of monetary policy.

What is economics?

- Greek: "One who manages a household"
- Household faces many decisions:
- $$\left.\begin{array}{l}\text{Who takes the pet out?}\\ \text{Who clean the dishes?}\\ \text{Who pays the bills?}\end{array}\right\} \longrightarrow \begin{array}{l}\text{All these facts depend on each member's}\\ \text{abilities, efforts and desire}\end{array}$$
- Society faces decisions as well:
- $$\left.\begin{array}{l}\text{Who will park on campus?}\\ \text{Should the government subsidize electric cars?}\\ \text{How much to spend on medicare and how much on defense?}\end{array}\right\}$$

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- **Scarcity**: the society has limited resources and, therefore, cannot produce all the goods and services people want.
- **Economics**: the study of how society manages its scarce resources.

Principles of economics

- How people make decisions.
  - 1. People face trade-offs.
  - 2. The cost of something is what you give up to get it.
  - 3. Rational people think at the margin.
  - 4. People respond to incentives
- How people interact
  - 5. Trade can make everyone better off.
  - 6. Markets are usually a good way to organize economic activities.
  - 7. Governments can sometimes improve market outcomes.

Principles of economics

- How the economy as a whole works.
  - 8. A country's standard of living depends on its ability to produce goods and services.
  - 9. Prices rise when the government prints too much money.
  - 10. Society faces a short-run trade off between inflation and unemployment.

1. People Face Trade-offs

- Making decisions requires trading off one goal against another
  - For every hour you devotes to economics, you give up an hour you could have used studying psychology
  - Government faces trade off between "guns and butter".
  - Society faces trade off between a clean environment and the level of income.
  - Another trade-off is between efficiency and equality.

2. The Cost of Something Is What You Give Up to Get It

- To make decisions, people need to compare the costs and benefits of alternative decisions.
  - The benefits to attend college are intellectual enrichment and a lifetime of netter job opportunities.
  - The costs to attend college include payments of tuition and apartment, and **your time** .
- Opportunity cost: whatever must be given up to obtain some item.

3. Rational People Think at The Margin

- Rational people: people who systematically and purposefully do their best they can to achieve their goals.
  - Suppose that flying a 200-seat plane from Memphis to New York costs the airline \$40, 000.
  - What is the average cost of each seat?
  - Suppose the plane is about to take off with ten empty seats. The cost of adding one extra passenger is \$100 cost of fuel. Should the airline sell one more ticket for \$150?

4. People Respond to Incentives

- Because people make decisions by comparing costs and benefits, their behavior may change when costs or benefits change.
  - Are you willing to sell your dog for $10, 000?
  - A higher tax on gasoline encourages people to drive electric cars or compact ones or ride bikes.
  - The surprising results of a seat belt law.

5. Trade Can Make Everyone Better Off

- Even when trade in the world economy is competitive, it can lead to a win-win outcome. Why?
- Trade allows people or countries to specialize in what they do best and to enjoy a greater variety of goods and services.
  - Colombia in coffee
  - Japan in automotive sector
  - Tiger Woods in golf

6. Markets Are Usually a Good Way to Organize Economic Activity

- **Market Economy**: An economy that allocates resources through the decentralized decisions of many firms and households as they interact in market for goods and services.
- Prices and self interest guide the decisions.
  - Firms decide whom to hire and what to produce.
  - Households decide where to work and what to buy.

6. Markets Are Usually a Good Way to Organize Economic Activity

- **Self-interest**: means you want more power to control resources, whether for your own or for someone else's benefit..
- Because we engage in market exchanges, without the intent of aiding other persons, some "philosophical critics" are misled into believing that economic principles presume people are purely selfish.
- People often intentionally act in ways to benefit others, such as in times of emergencies, even though that's costly to them.
- Though people act primarily with their own benefits in mind, others are benefited by market exchanges.

7. Governments Can Sometimes Improve Market Outcomes

- First, we need government to enforce the rules and maintain the institutions that are key to a market economy, like property rights.
- Second, government can improve efficiency when there is market failure, or promote equality when the market does not ensure that everyone has enough food, adequate healthcare and basic educations.

7. Governments Can Sometimes Improve Market Outcomes

- Market failure: a situation in which a market left on its own does not allocate resources efficiently.
  - Externality: the impact of one person's actions on the well-being of a bystander. Pollution, Smoking
  - Market power: the ability of a single person of firm (or a small group of them) to have a substantial influence on market prices.

8. A Country's Standard of Living Depends on Its Ability to Produce Goods and Services

- People in high-income countries have more computers, more cars, better nutrition and better health care.
- Almost all variation in living standards is attributable to differences in countries' productivity
- Productivity: the quantity of goods and services produced from each unit of labor input.

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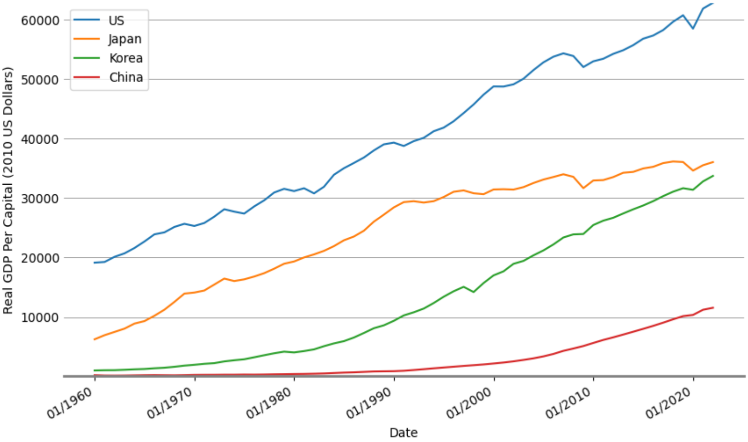

9. Prices Rise When the Government Prints Too Much Money

- **Inflation**: an increase in the overall level of prices in the economy
- **Deflation**: a decrease in the overall level of prices in the economy
- In almost all cases of large or persistent inflation, the cause is growth in the quantity of money.

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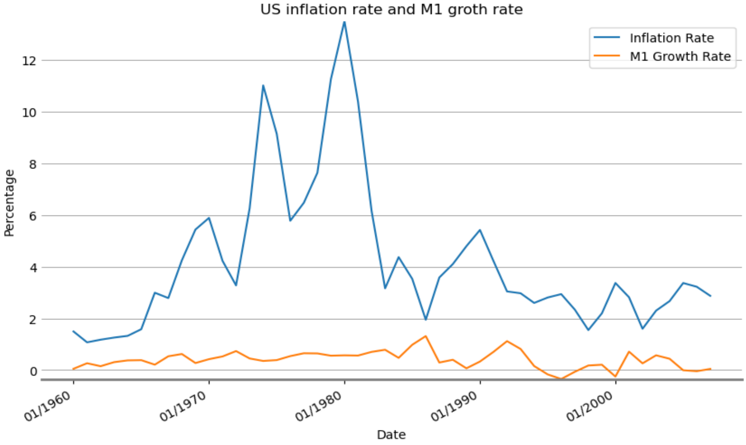

10. Society Faces a Short-Run Trade-Off between Inflation and Unemployment

- Most economists describe the short-run effects of money growth as follows:
  - Increasing the amount of money stimulates spending and the demand for goods and services.
  - Higher demand will cause firm to raise their prices. Firms also hire more workers and produce more.
  - More hiring means lower unemployment.

10. Society Faces a Short-Run Trade-Off between Inflation and Unemployment

- Policymakers can exploit the short-run trade-off between inflation and unemployment using various policy instruments.
  - Government spending.
  - Taxes.
  - Print more money.

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