

Chapter 0: The Big Ideas



Chapter 0

- Big ideas in economics:
 1. Incentives Matter
 2. Good Institutions Align Self-Interest with the Social Interest
 3. Trade-offs Are Everywhere
 4. Thinking on the Margin
 5. The Power of Trade
 6. The Importance of Wealth and Economic Growth
 7. Institutions Matter
 8. Economic Booms and Busts Cannot Be Avoided but Can Be Moderated
 9. Prices Rise When the Government Prints Too Much Money
 10. Central Banking Is a Hard Job

The Big Ideas

1. Incentives Matter

- People respond in predictable ways to incentives of all kinds.
- **Incentives:** *Rewards and penalties that motivate behavior.*

Self-Check

Which of the following is an incentive to read your economics text?

- a. The title of the book.
- b. The time it takes you to read a chapter.
- c. Better grades in economics.

Answer: c – better grades are the expected reward for reading the text.

The Big Ideas

2. Good Institutions Align Self-Interest with the Social Interest

- When markets work well, individuals pursuing their own interest also promote social interest.
- When markets do not work well, government can change incentives with taxes, subsidies, or regulation.

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3. Trade-offs are Everywhere

- We live in a world of Scarcity (Scare does not mean rare)
- Because of scarcity , we are constantly facing choices
- Opportunity cost of a choice is the value of the opportunities lost.
- Example:

Self-Check

What is the opportunity cost of reading your economics text?

- a. Spending time with friends or family.
- b. Better grades in economics.

Answer: a – reading the text means you have less time to spend with friends or family.

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4. Thinking on the Margin

- Trade-offs involve choices about a little more or a little less- Thinking on the margin.
- “Marginal” means one more or one less.
- Thinking on the margin is just making choices by thinking in terms of marginal benefits (MB) and marginal costs (MC).

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5. The Power of Trade

- The benefits of trade go beyond the benefits from exchange.
- Trade leads to increased production through specialization.
- Trade makes people better off. 

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6. The Importance of Wealth and Economic Growth

- Economic growth creates wealth.
- Wealthier economies enable richer and healthier lives.

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7. Institutions Matter

- Institutions are growth promoting
- should have the following properties and/or characteristics
 - Honest government
 - Political stability
 - Protects property rights
 - Dependable Legal System
 - Competitive and Open Markets

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8. Economic Booms and Busts Cannot Be Avoided but Can Be Moderated

- The government can use fiscal and monetary policy to reduce the swings in output and unemployment.

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9. Prices Rise When the Government Prints Too Much Money

- A country's central bank regulates the supply of money.
- A sustained increase in the supply of money, without an increase in the supply of goods, causes prices to rise.
- **Inflation:** *An increase in the general level of prices.*

The Big Ideas

10. Central Banking is a Hard Job

- The U.S. Federal Reserve (“The Fed”) is often called on to combat recessions.
- There may be a long lag between a decision and the effects of the decision.
- Too much money leads to inflation.
- Not enough money can lead to economic slowdown or recession.

The Biggest Idea of All

Economics is Fun

- Economics is linked to everyday life.
- See the invisible hand, understand your world.