

The 5 Foundations of Economics

Economics - study of how people make decisions
- how people allocate limited resources to unlimited wants

Time is always scarce.

Microeconomics - decisions of individuals/households/businesses

Macroeconomics - looks at broader economics - inflation
growth
employment rates
interest
productivity

5 Foundations

- 1) Incentives matter
- 2) Trade-offs
- 3) Opportunity costs
- 4) Marginal Thinking
- 5) Trade creates Value

1) Incentives matter

- Motivating factors like : positive incentives - pay raise, extra credits, etc
negative incentives - fees, fines, jail, etc

Direct incentives - get an A, get £500

Indirect incentive - maybe motive student to cheat, or not joining extracurricular activities

Unintended consequence - an unplanned result
usually negative and unwanted,
like cheating, or patents ↓ innovation

2) Trade-offs

Decisions incur costs

e.g. Movie, which movie do I watch?

Do I eat chinese or italian for lunch?

There's

Ain't

No

Such

Thing

As

A

Free

Lunch

Go to mall or pool?

mall ✓, lost opportunity for pool

3) Opportunity costs

Highest-valued alternative that must be sacrificed in order to get something else

The next best choice

What you give up to get it

Scarcity → Choice → Opportunity cost

4) Marginal Thinking

- evaluating whether the benefit of an action is more than cost

e.g. 2 more hour of sleep, eating another slice of pizza

Economic thinking - systematically evaluating a course of action to make best decision e.g. going to uni

e.g. Cleaning room. Clean under sofa?

Marginal benefits - more clean carpet, peace of mind

Marginal cost - more vacuuming, moving sofa

Cost-benefit analysis - if really want a clean room, move sofa

5) Trade creates Value

Markets - bring buyers and sellers together to exchange goods/services

Trade - Voluntary exchange of goods/services between 2(+) parties

Without trade, you will have to produce everything you consume.

Comparative advantage, Specialization, Trade controversies

Lower opportunity cost, gains from trade (mutual)

Doctor, plumber

Cheap labour in different countries result in outsourcing