

## Chapter 1: Ten Principles of Economics

- What kinds of questions does economics address?
- What are the principles of how people make decisions?
- What are the principles of how people interact?
- What are the principles of how the economy as a whole works?

### Scarcity:

### Economics:

Just like a household, a society is faced with many decisions.  
Decision-making is at the heart of economics.

Economists study how people make decisions, how people interact.

### 10 Principles of Economics

#### A. HOW PEOPLE MAKE DECISIONS

##### Principle 1: People Face Tradeoffs

Making decisions requires trading one thing for another.

Examples:

Efficiency vs. Equity

**efficiency:**

**equity:**

Example: Welfare programs, food stamps and unemployment insurance

##### Principle 2: The Cost of Something Is What You Give Up to Get It

Making decisions requires comparing the costs and benefits for alternative choices.

**opportunity cost:**

##### Principle 3: Rational People Think at the Margin

**rational:**

**marginal changes:**

Rational people make decisions by comparing marginal benefits to marginal cost.

Example:

Marginal benefit of first taco when hungry when compared with marginal cost.

Marginal benefit of seventh taco vs. marginal cost.

**Principle 4: People Respond to Incentives**

**incentive:**

Example – extra point, cigarette taxes

**B. HOW PEOPLE INTERACT**

**Principle 5: Trade Can Make Everyone Better Off**

If trade did not make everyone better off, why would you trade?

*Example – island*

Trade allows for specialization in products that countries can do best.

**Principle 6: Markets Are Usually a Good Way to Organize Economic Activity**

**Market:**

**Market Economy:**

Famous insight by Adam Smith in *The Wealth of Nations* (1776)

The invisible hand works through the price system.

**Principle 7: Governments Can Sometimes Improve Market Outcomes**

The invisible hand will only work if the government enforces property rights.

Example – a firm will not extract resources unless assured no one will steal it  
a restaurant won't serve food unless assured customers will pay

Markets do not always allocate resources efficiently.

**market failure:**

Causes of market failure:

**1. Externality:**

## **2. Market power:**

In such cases, public policy may promote efficiency.

## **C. HOW THE ECONOMY AS A WHOLE WORKS**

Decisions and interactions make up the “economy”.

### **Principle 8: A Country’s Standard of Living Depends on Its Ability to Produce Goods and Services**

Living standards vary from one country to the next, and over time.  
By living standards what do we mean?

The explanation for differences in living standards is differences in productivity.

#### **productivity:**

Productivity is driven by education, tools needed to produce goods and services, technology.

### **Principle 9: Prices Rise When the Government Prints Too Much Money**

#### **inflation:**

Cause of inflation is the growth in the quantity of money, decreasing the value of money.

### **Principle 10: Society Faces a Short-Run Trade-off between Inflation and Unemployment**

Increase in the amount of money in the economy stimulates the overall level of spending (demand for goods and services).

Higher demand encourages firms to increase the quantity of goods and services produced and to hire more workers to produce those goods and services

Hiring more reduces unemployment

**Suggested Problems: Problems and Applications- 3, 9, 12**

**FYI: How to read your Textbook**

**1. Read before class.**

You'll get more out of class.

**2. Summarize.**

Summarize each section in your own words. Then, compare your summary to the one at the end of the chapter.

**3. Test yourself.**

Try the "Quick Quiz" that follows each section before moving on to the next section. Write your answers down; compare them to the answers in the back of the book. If your answers are incorrect, review the section before moving on.

**4. Practice, practice, practice.**

Work through the review problems for each chapter and suggested textbook problems. They are often good practice for the exams. And the more you use your new knowledge, the more solid it will become.

**5. Go online.**

The book comes with excellent web resources, including practice quizzes, tools to strengthen your graphing skills, helpful video clips, and other resources to help you learn the textbook material more easily and effectively. Visit:

<http://academic.cengage.com/economics/mankiw>

**6. Study in groups.**

Get together with a few classmates to review each chapter, quiz each other, and help each other understand the material.

**7. Teach someone.**

The best way to learn something is to teach it to someone else, such as a study partner or friend.

**8. Don't skip the real world examples.**

Read the Case Studies and "In The News" boxes in each chapter. They will help you see how the new terms, concepts, models, and graphs apply to the real world. As you read the newspaper or watch the evening news, see if you can find the connections with what you're learning in the textbook.