Principle of Economics

Ten basic princples of economic decision making

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Hi welcome to my class of principle of economics.

I hope you have seen the introductory video of the class.

So you have a little bit of the idea what to we will cover.

Just to repeat quickly this is the standard class of principle of economics we will spend two third of the semester studying microeconomics, the decisions that individual consumers and companies make.

The way company is interacted in the market place and in the last of the third semester we will study aggregate phenomenon after we cover the decision making that takes place at in individual house hold and the companies.

We will see how that translate into aggregate behavior and the aggregate of the performance.

As I said in the introductory vedio we will use the very standard text book, principle of economics by Gregory Mankiw a very known US professior of economics and we will cover most of the chapters in this text book.
We will cover many different topics.

So to give you little bit of guidance on what we will see, chapter 1 goes through the basic ideas underlying all of this textbook.

We will cover ten principles ideas that underlie all of the specific topics that we will cover.

We will see that…

We say through out this semester that the underlying idea that economics based on the most resources in the world are scarce.

And the role of ecnomics will be to decide how scarce resources should be used, and how should they should be allocated among the members of a society.

Really there are ten basic principles in which that we can use to decide how scarce's resources should be managed and allocated within the society.

These ten principles deal with the way individual's decision makers work.

We will look at how consumers make a decision what to buy at what prices.

We will make we will study how companies decide what to produce, what inputs to use, what prices to charge.

How to allocate the production to different parts of the company.
Then we will study how individual companies interact with each other in the market place.

how consumers and producers work with each other and what is the role of the government in the society.

And after we have covered in the decision making of individual consumers, companies, and the governments, we will study what that means in term of performance of industries in the economies and the entire of economies.

So let's look at the ten basic ideas underlying economic analysis.

So in the first set of the principles of how people make decisions, the most important principle is arguably the people face trade-offs.

Because resources scares people can not have everything that they would want to and people have to make decisions on what they obtain what they give up to obtain it.

When making decision what to obtain what to give up, it isnt important to recognize all the costs corresponding to individuals to particular choice.

So it isn't important to measure all of the benefits corresponding to into particular choice and all of the costs we will say that opportunity costs are the costs both explicit and implicit of what we end up choosing.

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We will say that rational people think at the margin.

This principle says that usually individuals make decisions about each units of resources rather than about bigger rumps of the resources.

It is better and more persist if you make a decision about each units of resources you trade-off one unit of one resource for one unit of another resource rather than if you try to make trade-off of larger rumps of commodities.

And we will say that people respond to incentives.

So if people would make particular choice between two commodities and the conditions in the market place change, maybe consumers given more incentive in term of lower price to purchase particular commodity consumers respond to these incentives predictable way.

One side note to this principle is that it is important to structure incentives carefully.

Sometimes governments introduce public programs without thinking carefully about all the consequences.

Think for example of seat belt loss.

Intendant consequence of seat belt loss is that drivers who wear seat belts will be less likely to die if an accident occurs.

The unintendant consequence of these kinds of loss is that consumers or drivers might feel more comfortable driving faster more recklessly and the number of the accidents might increase.

So even if there is the intendant consequence in the event of accident, people are less likely to die.

There is an unintendant consequence that maybe more accident will occur.

The second set of principles is deals is how people interact with each other.

Here the centeral idea is that interaction among people can benefit everybody.

It is an into proposition it says that it's an () think that the only way that people would agree to cooperate each other.

It's if both of them could gain through this interaction.

And it turns out that trade has this property.

Trade between countries or between companies and consumers can benefit both sides of the transactions.

There is a famous economic quote that trade is not a zero sum game which says that trade is not like competition in which one person wins, one person loses.

But it turns out that all participants in trade can benefit and we will study the nuances of this proposition in chapter 3 in the textbook and in some later chapters.

Another proposition is that markets are usually good way to organize economic activity and this proposition says that the decisions that are made in free market without any active coordinations by government are usually the best decisions that can be made.

Individual decision makers compare to benefits and costs of their decisions.

And it turns out that this decision, these choices are the best even for the society over all.

But the next principle that there are situations when previous principle does not hold.

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There are several problematic situations or conditions under which free markets will not allocate scarce's resources to their most advantages's uses.

The market outcomes are not, do not give us the most output or the best kinds of outputs and in those situations the government can interbeing and improve on the outcome.

So we will say that in the present of market failures, and we will say that there are several types of market failures, the government can improve on the situation.

These situations are when there is a externality and externality is an effect of trade between (triple participants 10:24) in the market on third party.

So we will say that if two participants in the trade do not realize all the benefits and the costs of their transaction if there are external affects on other parties who do not participate in the decision making process, the two participants can make an wrong decision.

They can harm other members of society or they can benefit other members of society without being comprehensated for those benefits.

Another market failure is if there is a market power.

Starting in chapter 4, we will study how companies choose their output level prices we will say that through competition between companies and competitions between consumers.

The price level and the output level in the market are somehow desirable but in the present of market power, one member of the society can try to extract more than his fail amount of resources and if this individual tries to redistribute some of the resources in the society to himself, he might incur other external cost on other members in the society.

so monopoly is a... the situation when through market power, companies distore market outcomes away from desirable outcomes.

And another market failure is if there is an uncertainties in the market.
In throughout this semester we will assume that there is a perfect informations among companies and among consumers, all consumers and all producers can make conscious choices but we should think that the market will work well only if markets participants have enough information based on which to make a decision.

So in the present of uncertainties, wrong insistently, wrong market outcomes can happen and if government inter-being improve the amount of the information in the society market outcome could be (13:11).

And finally the final kind of market failure we will mention is if the distribution of the scarces of resources in the society is such that some members of the society would not be able to achieve their potential.

One example of this is if little children are not given educates.

Nutrition education even if they are very bright, they will never be able to cultivate their inner skills.

And the society will lose all the benefits from their future labours.

So if distribution of resources such that all the skills can not be realize all the benefits of the inner resources can not be realized in that case the government could improve on the situation by redistributing existing resources.

We can sure that enough resources are available even to children in disadvantaged family.

And the final set of principles of economics is deals with how the economy ad a whole operate.

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So after we have covered decision making of consumers, households, and companies and individual markets, we will see how that translate into performance of the aggregate level.

We will say that a country's standard of living depends on its ability to produce goods and services.

So this proposition says that the most obeservable differences in the standard of living are due to different productivities of individual people or citizens of various countries.

And if we observe standards of living improving over time, most of those improvements are due to improvement in productivities of individual people.

We will also say that the prices increases when the government prints too much money.

The intuitive meaning of this proposition is that money is just like any other commodity in real world.

The more of commodity is available the less valuable each units of that commodity becomes.

So just like if there is more ice cream available the less people would be willing to pay for additional units of ice cream.

If there is too much money chasing eliminated amount of real commodity, the value of the money will be decreased.

And prices of all real world commodity will rise.

And finally society faces a short-run trade-off between inflation and unemployment.

So this is more advanced principle.

It is not intuitive on its face value but we can explain it using examples.

One way to understand this principle is that if prices in economy increase companies would observe increases of their product and would want to produce more output.

Because each unit of output is worth more amount of money.

Companies have incentive to hire more workers which will end up reducing unemployment in the economy.

Another example through which we can explain this relationship is the other way around.

Suppose that unemployment falls in the economy.

More people are working, earning money that means that people want to spend the earnings in the economy and before companies can adjust and produce more output, there is a limited amount of commodity in the economy.

And there more people with more money chasing this limited amount of goods.

So if people earn more money and if more people are working, then it will result in a more demand for goods in economy and before companies adjust, that will result in a higher prices of commodities.

So these are ten basic principles of our understanding of economic decision making and interactions among participants in real world markets and performance of aggregate economies.

As we move to specific topics in later chapters in the textbook I hope you will recognize these principles at work and I want you to keep them back of your head so that even if we cover very different topics, very different types of markets you will see that there is an underlying common theme between those situations.