Ten Principles of Economics

Enotes World

ECONOMICS

- Economics is all about making rational economic decisions in a state of scarcity
- Economics study how scarce economic resources are allocated.
- And economics also analyzes the forces and trends that affect the economy as a whole, including the growth rate of output, the rate of the population that cannot find work, the rate at which price is increasing, and so on.
- So, Economics is the study of how people, societies, and nations make economic decisions, how they interact with each other, and how the collective system i.e., the economy as a whole works.

ECONOMICS:TEN PRINCIPLES

How People Make Decisions?

- People face trade-offs
- The cost of something is what you give up to get it
- Rational people think at margin
- People respond to incentive

How People Interact?

- Trade can make everyone better off
- Markets are usually good way to organize economic activity
- Government can sometimes improve market outcomes

How Economy as a Whole Work?

- A country's standard of living depends on its ability to produce goods and services
- Price rise when government prints too much money
- Society faces a short-run trade-off between inflation and unemployment

1.People Face Trade-Offs

- Making different decisions by economic entities like individuals, societies, businesses, government at different levels (local, regional, national, and international levels), face trade-offs.
- The ***Trade-off*** is the situation in which one has to give up something to obtain one thing that s/he likes
- The Trade-off occurs due to unlimited wants and limited resources (scarcity of resources)
- This is the most fundamental part of economics and it helps economic entities to choose the best one

Examples

  - *Current consumption VS Future Consumption (Saving)*
  - *Efficiency VS Equality*
  - *Clean environment VS High level of production*

- Understanding these trade-offs makes life easier and we can make good decisions when we understand the opposites are available. Economics shows or acknowledges trade-offs.

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

- Almost all the time people faces trade-offs and so they have to make a comparison between the cost and benefits of alternative course of actions.
- When one spends a year listening to lectures, reading textbooks, and writing papers, he cannot spend the time working at a job. Here earning money from a job is given up for enlarging intellectual ability.
- Therefore, the cost of a decision or a choice is whatever best next alternative courses of action. And this is what we call opportunity cost in economics.
- As the subject matter of economics and following the economic rationality, we should decide with the least opportunity cost.

3. Rational People think at the Margin

- Economics believes that people are rational
- The rationality of people in economics means people are always looking for the best they can do to fulfill their objective and they are self-motivated and guided purposefully.
- So, to get their objective fulfilled they think at the margin or rational people made better decisions by thinking at the margin.
- Every rational decision-maker decisions when the marginal benefit of the decision or action is higher than the marginal cost.

4. People Respond to Incentive

The incentive is the thing (reward or punishment) that induces a person to react. People are rational; they make a comparison between marginal values, so they always respond to incentives.

In economic decisions, incentives play a crucial role as it helps to take decisions to economic entities.

For example, when the price of apples increases, people decide to eat fewer apples. But apple sellers may decide to employ more workforce and produce more apples.

Here rise in price provides an incentive to both participants of the market economy. The incentive for buyers is to consume less and for sellers to produce more.

5. Trade Can Make Every One Better Off

- Trade is the main economic activity through which people interact with each other.
- There is no winner or loser in trade. Trade between the two countries can make each country better off.
- Trade partners are simply looking like competitors but they always contribute in the sense of growth, expansion, and specialization at the individual, national, and international levels.
- With trade from one to another, individuals can purchase greater varieties of goods and services at competitive prices. Countries and families thus can get benefit from the skill and ability to trade with others.
- Trade provides individuals and nations to concentrate on what they do best and to have a greater variety of goods and services.

6. Markets are Usually Good Way to Organize Economic Activity

- Free markets enclose many buyers and sellers of several goods and services, and all of them are focused primarily on their interests.
- Firms are free to make decisions on whom to hire and what is to produce.
- Households decide which firms they have to choose or join in their best interest and what are kinds of stuff to purchase from the free market.
- These firms and households act together in the open market and prices and self-interest direct their actions.
- Adam Smith’s notion of invisible hand and desirable market outcome is the breakthrough of the market economy.
- Most countries that once had centrally planned economies have turned the system and are following the market economy.

7. Government Can Sometimes Improve Market Outcomes

- When the market is failed (improper allocation of resources), presence of imperfections in the market, and if people face negative externalities the government plays its role through policy interventions
- One reason we need government is that the free market can work its magic only if the government enforces the rules and maintains the institutions that are key to the functioning of a market economy.
- Appropriate government intervention through, taxes, subsidies, patent laws, rules, and regulations can make the balance between efficiency and equality in the economy.

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

- There are huge differences in the living standards of people from one country to another. It is due to the productive capacity and productivity of the country. That is the number of goods and services produced from each unit of labor input.
- In nations where workers can produce a large number of goods and services per unit of time, most people enjoy a high standard of living; in nations where workers are less productive, most people suffer from an inadequate existence.
- The expansion rate of a country's productivity also affects the growth rate of its average income.
- China has better living standard than other South Asian countries as the Chinese have a better ability to produce/higher productivity
- To boost living standards, policymakers need to make policies so as to increase productivity.

9. Prices Rise When the Government Prints too Much Money

- Supply of too much money reduces the purchasing power of money (inflation-sustained increase in general price)
- Printing too much money and circulation of it in the economy would make available more money with every one and this leads to an increase in demand
- If the output is not increased to chase such increased demand, the outcome is increasing prices in the economy.
- Considering the economic history of the world, it can be said that all cases of large inflation were the outcome of the growth of the quantity of money supply in the economy.

10. Society Faces a Short-Run Trade-off Between Inflation and Unemployment

- Most economists describe the short-run effects of monetary injections as; increasing the amount of money in the economy stimulates the overall level of spending and thus the demand for goods and services.
- And higher demand may over time cause firms to raise their prices, but in the meantime, it also encourages them to hire more workers and produce a larger quantity of goods and services.
- Here, more hiring means lower unemployment. This leads to one final economy-wide trade-off as a short-run trade-off between inflation and unemployment.
- The Philips curve studies such trade-off between inflation and unemployment