بسمه تعالی

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Ten Principles of Economics

- **Resources are scarce**
- **Scarcity:** the limited nature of society's resources
  - Society has limited resources
    - Cannot produce all the goods and services people wish to have
- **Economics**
  - The study of how society manages its scarce resources

Ten Principles of Economics

- **Economists study:**
  - How people decide what to buy,
    how much to work, save, and spend
  - How firms decide how much to produce,
    how many workers to hire
  - How society decides how to divide its resources between national defense, consumer goods, protecting the environment, and other needs

How People Make Decisions?

Principle 1: People face trade-offs

Principle 2: The cost of something is what you give up to get it

Principle 3: Rational people think at the margin

Principle 4: People respond to incentives

Principle 1: People Face Trade-offs

- **Trade-off:**

  To get something that we like, we have to give up something else that we also like

  - Going to a party the night before an exam
    - Less time for studying
  - Having more money to buy stuff
    - Working longer hours, less time for leisure
  - Protecting the environment
    - Resources could be used to produce consumer goods

Principle 1: People Face Trade-offs

- **Society faces trade-offs:**
  - The more it spends on national defense (guns) to protect its shores
    - The less it can spend on consumer goods (butter) to raise the standard of living at home
  - Pollution regulations: cleaner environment and improved health
    - But at the cost of reducing the incomes of the firms’ owners, workers, and customers

Principle 1: People Face Trade-offs

- **Efficiency:** society gets the most from its scarce resources
- **Equality:** prosperity is distributed uniformly among society’s members
- **Tradeoff:**
    - To achieve greater equality, we should redistribute income from wealthy to poor
    - But this reduces incentive to work and produce, shrinks the size of the economic “pie”

Principle 1: People Face Trade-offs

Individual (choosing economics course)	• Students' decision to choose an economics course means not choosing another course.
Individual (continuing to study for a master's degree)	• On the other hand, this decision is not to enter the labor market. A person ignores the income from work.
firm (decision to allocate resources)	• When a firm buys new machines for production, it's decided to allocate more resources to that purpose, rather than to hire more labor.

Source: prof. nili slides

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

- **Making decisions**
  - Compare costs with benefits of alternatives
  - Need to include opportunity costs
- **Opportunity cost**
  - Whatever must be given up to obtain some item

➢ **Examples:**

The opportunity cost of:

- Going to college for a year
  - Tuition, books, and fees
  - PLUS foregone wages
- Going to the movies
  - The price of the movie ticket
  - PLUS the value of the time you spend in the theater

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

- Given that football players can receive high salaries for a limited number of years, the cost of education is high for them.

Principle 3: Rational People Think at the Margin

- **Rational people**
  - Systematically and purposefully do the best they can to achieve their objectives
  - Given the available opportunities
  - Make decisions by evaluating costs and benefits of marginal changes
    - Small incremental adjustments to a plan of action

- **Examples:**
  - Cell phone users with unlimited minutes (the minutes are free at the margin)
    - Are often prone to making long/frivolous calls
    - Marginal benefit of the call > 0
  - A manager considers whether to increase output
    - Compares the cost of the needed labor and materials to the extra revenue
  - Eating another piece of pizza
    - Its cost of eating (☺)

Principle 3: Rational People Think at the Margin

- Suppose the total cost of a 100-person plane to fly from Tehran to Mashhad is 50 million. Therefore, the average cost of each seat is equal to 500 thousand tomans.
- Imagine a few hours before the flight, there are several empty seats, and people are ready to buy a ticket for 400 thousand tomans.
- In this case, if the airline sells the ticket, it will receive 400 thousand tomans, and if it does not sell the ticket and flies with an empty seat, there will be no profit.

Principle 4: People Respond to Incentives

- **Incentive**
  - Something that induces a person to act
- **Examples**:
  - When gas prices rise, consumers buy more hybrid cars and fewer gas guzzling SUVs
  - When cigarette taxes increase,
    teen smoking falls

Active Learning 1 — Applying the principles

You are selling your 1392 Pride. You have already spent 10 million tomans on repairs. At the last minute, the transmission dies. You can pay 5 million tomans to have it repaired, or sell the car “as is.”

In each of the following scenarios, should you have the transmission repaired? Explain.

A. Market value (what you could get for the car) is 75 MT if transmission works, 62 MT if it doesn’t.
B. Market value is 63 MT if transmission works, 55 MT if it doesn’t.

Principle 4: People Respond to Incentives

- In Tehran, it is observed that some taxi drivers sleep in their cars. They come to Tehran from other provinces to work in taxis.(e.g. snapp-tap30).
- The incentives of these people to earn money is so high, that they are willing to endure such hardships.

How People Interact?

Principle 5: Trade can make everyone better off

Principle 6: Markets are usually a good way to organize economic activity

Principle 7: Governments can sometimes improve market outcomes

Principle 5: Trade Can Make Everyone Better Off

- **People benefit from trade:**
  - People can buy a greater variety of goods and services at lower cost
- Countries benefit from trade and specialization
  - Get a better price abroad for goods they produce
  - Buy other goods more cheaply from abroad than could be produced at home

Principle 5: Trade Can Make Everyone Better Off

- North Korea and South Korea are close to each other, but their quality of life is very different.
- North Korea has no foreign trade, and it produces the goods and services it needs.
- South Korea enjoys the benefits of trade and specialization in interacting with other countries.

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

- **Market**
  - A group of buyers and sellers (need not be in a single location)
- "***Organize economic activity***" means determining
  - What goods and services to produce
  - How much of each to produce
  - Who produced and consumed these
- **A market economy allocates resources**
  - Decentralized decisions of many firms and households – as they interact in markets
- Famous insight by Adam Smith in *The Wealth of Nations* (1776):
  - Each of these households and firms acts as if "led by an **invisible hand**" to promote general economic well-being

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

- **Prices**:
  - Determined: interaction of buyers and sellers
  - Reflect the good’s value to buyers
  - Reflect the cost of producing the good
- **Invisible hand:**
  - Prices guide self-interested households and firms to make decisions that maximize society’s economic well-being

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

➢ **An example of distortion in the mechanism of prices and market performance**

- The government buys wheat, distributes flour at low prices, and sets prices for them. It distorts the price signaling mechanism.
- As a result, bakeries have no incentive to improve their quality (and, for example, its packaging). And people do not consume bread properly.

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

➢ **An example of the correct result of a market mechanism**

- Unlike bread, for saffron, no effort is made to manage and consume it.
- Naturally, it is well consumed by the people. And has no waste.
- The way it is distributed and packaged has also always been improved.

Principle 7: Governments Can Sometimes Improve Market Outcomes

- **Government - enforce property rights**
  - Enforce rules and maintain institutions that are key to a market economy
    - People are less inclined to work, produce, invest, or purchase if large risk of their property being stolen
- **Government - promote efficiency**
  - Avoid market failures: market left on its own fails to allocate resources efficiently
  - Externality – source of market failure
    - Production or consumption of a good affects bystanders (e.g. pollution)
  - Market power – source of market failure
    - A single buyer or seller has substantial influence on market price (e.g. monopoly)
- **Government - promote equality**
  - Avoid disparities in economic wellbeing
  - Use tax or welfare policies to change how the economic “pie” is divided

Active Learning 2 Discussion Question

In each of the following situations, what is the government's role?

Does the government's intervention improve the outcome?

a. Public schools for K-12
b. Workplace safety regulations
c. Public highways
d. Patent laws, which allow drug companies to charge high prices for life-saving drugs

How the economy as a whole works?

Principle 8: A country's standard of living depends on its ability to produce goods and services

Principle 9: Prices rise when the government prints too much money

Principle 10: Society faces a short-run trade-off between inflation and unemployment

Principle 8: Country's Standard of Living Depends on Its Ability to Produce Goods and Services

- **Huge variation in living standards**
  - Across countries and over time
  - Average income in rich countries
    - Is more than ten times average income in poor countries
  - The U.S. standard of living today
    - Is about eight times larger than 100 years ago
- **Productivity:** most important determinant of living standards
  - Quantity of goods and services produced from each unit of labor input
  - Depends on the equipment, skills, and technology available to workers
    - Other factors (e.g., labor unions, competition from abroad) have far less impact on living standards

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

- **Inflation**
  - An increase in the overall level of prices in the economy
- **In the long run:**
  - Inflation is almost always caused by excessive growth in the quantity of money, which causes the value of money to fall
  - The faster the government creates money,
    the greater the inflation rate

Principle 10: Society Faces a Short-run Trade-off between Inflation and Unemployment

- **Short-run trade-off between unemployment and inflation**
  - Over a period of a year or two, many economic policies push inflation and unemployment in opposite directions
  - Other factors can make this tradeoff more or less favorable, but the tradeoff is always present

Ten principles of economics: individual decision making

1. **People Face Trade-offs**
   - To get something that we like, we usually have to give up something else that we also like.
2. **The Cost of Something Is What You Give Up to Get It**
   - Monetary vs. non-monetary cost
3. **Rational People Think at the Margin**
   - Incremental reasoning
4. **People Respond to Incentives**
   - Carrots and sticks!

- ***Class activity***: Describe an important trade-off you recently faced.

Ten principles of economics: people interaction

5. **Trade Can Make Everyone Better Off**
    - How does Iran-China trade affects the two countries?
6. **Markets Are Usually a Good Way to Organize Economic Activity**
    - Collapse of the Soviet Union
    - Chinese post Mao reforms
    - The invisible hand of Adam Smith
7. **Governments Can Sometimes Improve Market Outcomes**
    - Role of governments: property rights, security
    - Improve efficiency (market failures) / equity (social justice)
    - Government failure

Ten principles of economics: the economy as a whole

8. **A Country's Standard of Living Depends on Its Ability to Produce Goods and Services**
   - Average income: US $55,000, Nigeria $6,000, China $13,000
   - Produce more, eat more!
9. **Prices Rise When the Government Prints Too Much Money**
   - Financing the government: taxes vs. inflation
10. **Society Faces a Short-Run Trade-off between Inflation and Unemployment**
    - More money stimulates demand, incentivizes firms to produce more, requiring more labor
    - But in the long-run, cost of production goes up and prices increase, no impact on unemployment.

منابع

- اسلایدهای کتاب مبانی اقتصاد منکیو
- اسلاید های درس مبانی اقتصاد دکتر نیلی
- اسلایدهای درس مبانی اقتصاد دکتر وصال

با تشکر