



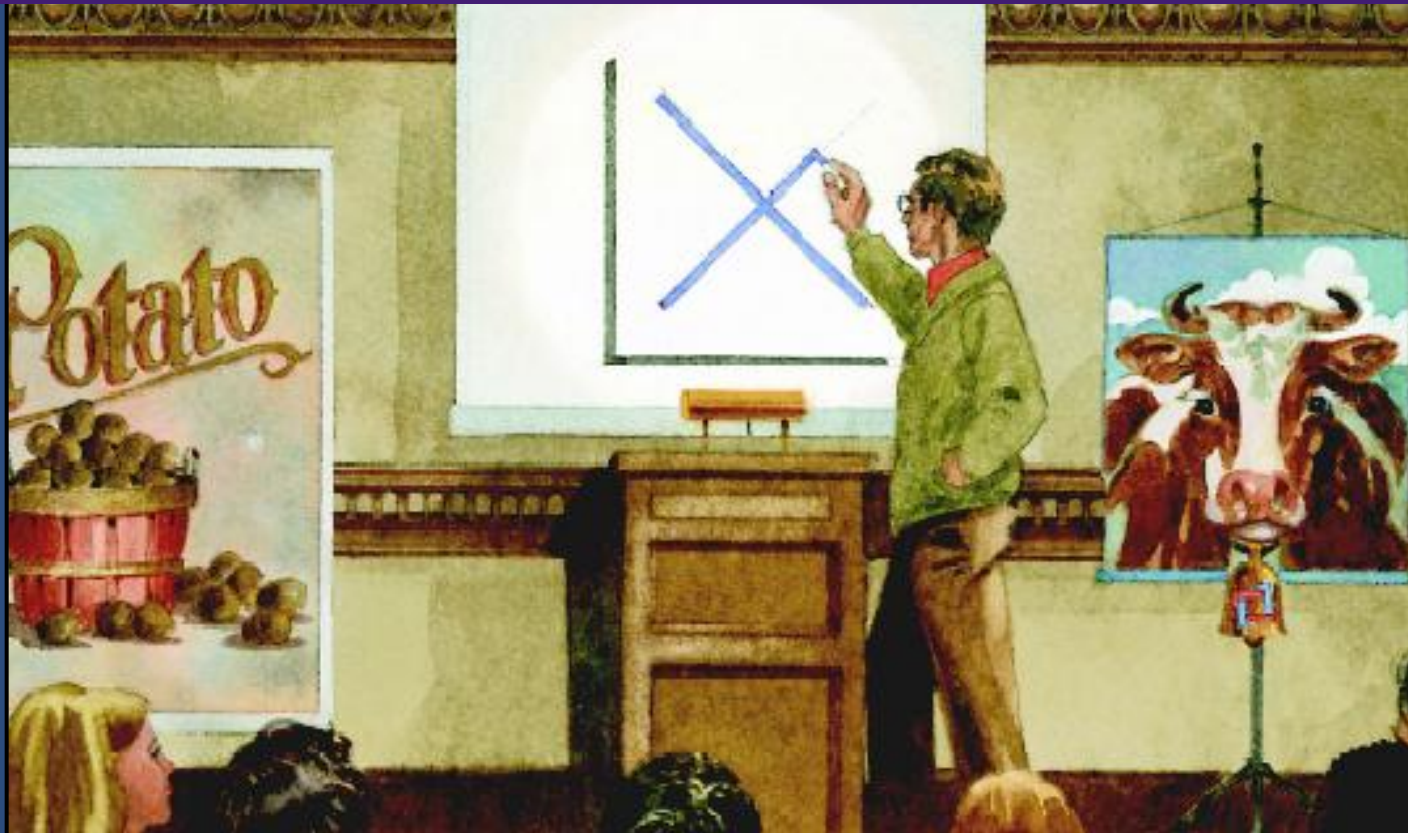
PowerPoint® Lecture Presentation
to accompany
Principles of Economics, Third Edition
N. Gregory Mankiw

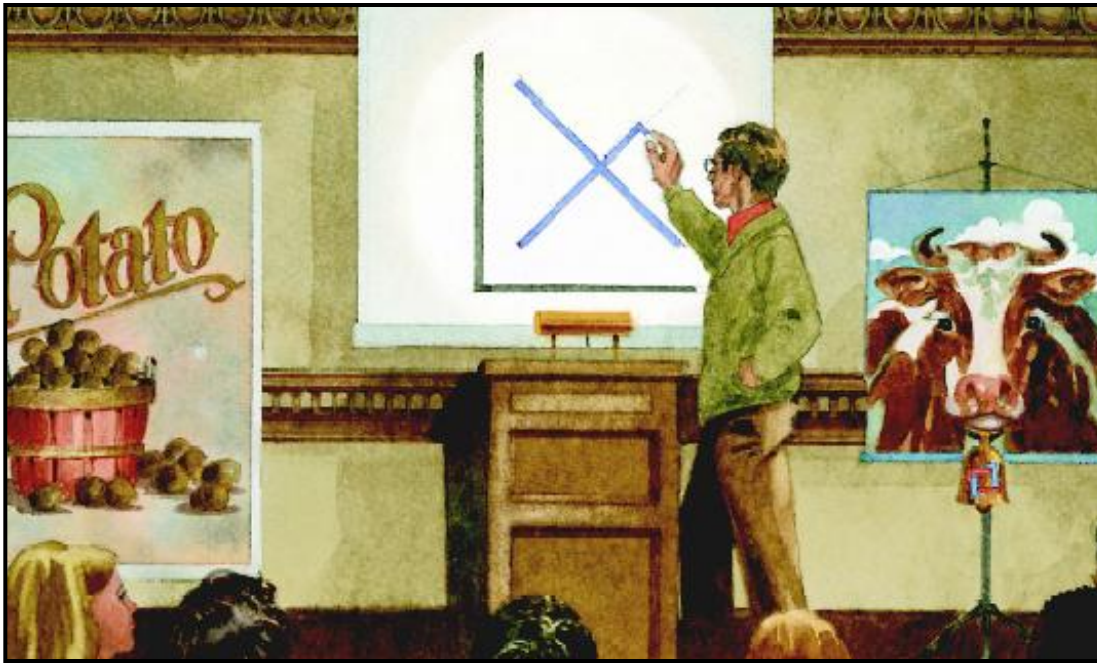
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INTRODUCTION





Ten Principles of Economics

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Economy. . .

. . . The word *economy* comes from a Greek word for “one who manages a household.”

TEN PRINCIPLES OF ECONOMICS

- A household and an economy face many decisions:
 - Who will work?
 - What goods and how many of them should be produced?
 - What resources should be used in production?
 - At what price should the goods be sold?

TEN PRINCIPLES OF ECONOMICS

Society and Scarce Resources:

- The management of society's resources is important because resources are scarce.
- *Scarcity*. . . means that society has limited resources and therefore cannot produce all the goods and services people wish to have.

TEN PRINCIPLES OF ECONOMICS

Economics is the study of how society manages
its scarce resources.

TEN PRINCIPLES OF ECONOMICS

- How people make decisions.
 - People face tradeoffs.
 - The cost of something is what you give up to get it.
 - Rational people think at the margin.
 - People respond to incentives.

TEN PRINCIPLES OF ECONOMICS

- How people interact with each other.
 - Trade can make everyone better off.
 - Markets are usually a good way to organize economic activity.
 - Governments can sometimes improve economic outcomes.

TEN PRINCIPLES OF ECONOMICS

- The forces and trends that affect how the economy as a whole works.
 - The standard of living depends on a country's production.
 - Prices rise when the government prints too much money.
 - Society faces a short-run tradeoff between inflation and unemployment.

Principle #1: People Face Tradeoffs.

“There is no such thing as a free lunch!”



Principle #1: People Face Tradeoffs.

To get one thing, we usually have to give up another thing.

- Guns v. butter
- Food v. clothing
- Leisure time v. work
- Efficiency v. equity

Making decisions requires trading off one goal against another.

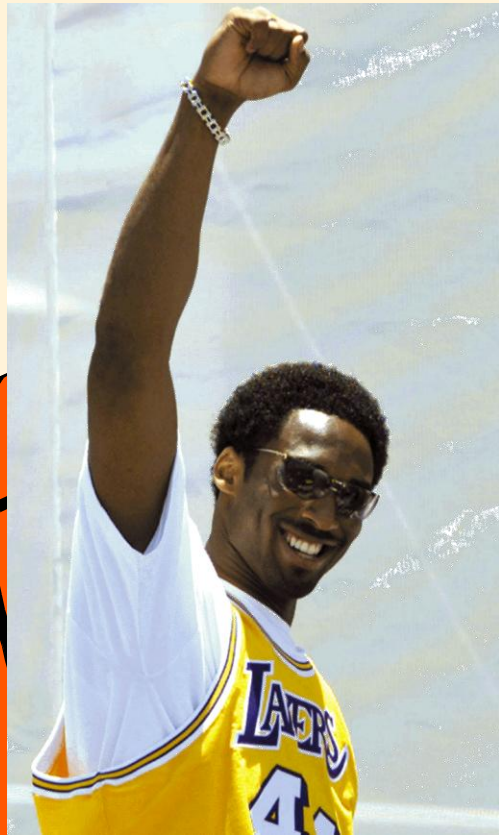
Principle #1: People Face Tradeoffs

- Efficiency v. Equity
 - *Efficiency* means society gets the most that it can from its scarce resources.
 - *Equity* means the benefits of those resources are distributed fairly among the members of society.

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

- Decisions require comparing costs and benefits of alternatives.
 - Whether to go to college or to work?
 - Whether to study or go out on a date?
 - Whether to go to class or sleep in?
- The *opportunity cost* of an item is what you give up to obtain that item.

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



LA Laker basketball star Kobe Bryant chose to skip college and go straight from high school to the pros where he has earned millions of dollars.

Principle #3: Rational People Think at the Margin.

- *Marginal changes* are small, incremental adjustments to an existing plan of action.

People make decisions by comparing costs and benefits at the margin.

Principle #4: People Respond to Incentives.

- Marginal changes in costs or benefits motivate people to respond.
- The decision to choose one alternative over another occurs when that alternative's marginal benefits exceed its marginal costs!

Principle #5: Trade Can Make Everyone Better Off.

- People gain from their ability to trade with one another.
- Competition results in gains from trading.
- Trade allows people to specialize in what they do best.

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

- A *market economy* is an economy that allocates resources through the decentralized decisions of many firms and households as they interact in markets for goods and services.
 - Households decide what to buy and who to work for.
 - Firms decide who to hire and what to produce.

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

- Adam Smith made the observation that households and firms interacting in markets act as if guided by an “invisible hand.”
 - Because households and firms look at prices when deciding what to buy and sell, they unknowingly take into account the social costs of their actions.
 - As a result, prices guide decision makers to reach outcomes that tend to maximize the welfare of society as a whole.

Principle #7: Governments Can Sometimes Improve Market Outcomes.

- *Market failure* occurs when the market fails to allocate resources efficiently.
- When the market fails (breaks down) government can intervene to promote efficiency and equity.

Principle #7: Governments Can Sometimes Improve Market Outcomes.

- Market failure may be caused by
 - an *externality*, which is the impact of one person or firm's actions on the well-being of a bystander.
 - *market power*, which is the ability of a single person or firm to unduly influence market prices.

Principle #8: The Standard of Living Depends on a Country's Production.

- Standard of living may be measured in different ways:
 - By comparing personal incomes.
 - By comparing the total market value of a nation's production.

Principle #8: The Standard of Living Depends on a Country's Production.

- Almost all variations in living standards are explained by differences in countries' productivities.
- *Productivity* is the amount of goods and services produced from each hour of a worker's time.

Principle #8: The Standard of Living Depends on a Country's Production.

- Standard of living may be measured in different ways:
 - By comparing personal incomes.
 - By comparing the total market value of a nation's production.

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

- Inflation is an increase in the overall level of prices in the economy.
- One cause of inflation is the growth in the quantity of money.
- When the government creates large quantities of money, the value of the money falls.

Principle #10: Society Faces a Short-run Tradeoff Between Inflation and Unemployment.

- The Phillips Curve illustrates the tradeoff between inflation and unemployment:

↓ Inflation \Rightarrow ↑ Unemployment

It's a short-run tradeoff!

Summary

- When individuals make decisions, they face tradeoffs among alternative goals.
- The cost of any action is measured in terms of foregone opportunities.
- Rational people make decisions by comparing marginal costs and marginal benefits.
- People change their behavior in response to the incentives they face.

Summary

- Trade can be mutually beneficial.
- Markets are usually a good way of coordinating trade among people.
- Government can potentially improve market outcomes if there is some market failure or if the market outcome is inequitable.

Summary

- Productivity is the ultimate source of living standards.
- Money growth is the ultimate source of inflation.
- Society faces a short-run tradeoff between inflation and unemployment.