As we know that human wants are unlimited and resources are limited.

The word economy comes from the Greek word **oikonomos,** which means “one who manages a household.” Like a household, a society faces many decisions.

***At Micro level:*** *individual/ household*  think that how much he works, what he buys, how much he saves, and how he invests his savings

***At Macro level:*** Society think that how much they work, what they buy, how much they save, and how they invest their savings

Both have limited resources. The management of society’s resources is important because resources are ***scarce***.

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

**Ten Principles of Economics**

An economy is just a group of people dealing with one another as they go about their lives. Because the behavior of an economy reflects the behavior of the individuals who make up the economy, we begin our study of economics with four principles of individual decision making.

***The first four principles discussed how individuals make decisions.***

**PRINCIPLE 1: PEOPLE FACE TRADE-OFFS**

As we hear the old saying, “There ain’t no such thing as a free lunch.” To get one thing that we like, we usually have to give up another thing that we like. Making decisions requires trading off one goal against another.

**Examples**

1. Student time either for study or games (individual)
2. Parents decision of spending or saving income (individual)
3. Gun vs Butter (national defense or development) (society)

Another trade-off society faces is between ***efficiency (***society is getting the maximum benefits from its scarce resources) and ***equality (***those benefits are distributed uniformly among society’s members). Example if government support to unemployed workers then they are not willing to work again. This thing will reduce their efficiency.

**PRINCIPLE 2: THE COST OF SOMETHING IS WHAT YOU GIVE UP TO GET IT**

Because people face trade-offs, making decisions requires comparing the costs and benefits of alternative courses of action.

**Example**

1. Decision to go to college

* **benefits** are intellectual enrichment and a lifetime of better job opportunities
* But what are the ***costs***? To answer this question, you might be tempted to add up the money you spend on tuition, books, room, and board. Yet this total does not truly represent what you give up to spend a year in college.

There are two problems with this calculation.

**First,** it includes some things that are not really costs of going to college. Even if you quit school, you need a place to sleep and food to eat. Room and board are costs of going to college only to the extent that they are more expensive at college than elsewhere.

**Second,** this calculation ignores the largest cost of going to college—your time. When you spend a year listening to lectures, reading textbooks, and writing papers, you cannot spend that time working at a job. For most students, the earnings given up to attend school are the largest single cost of their education.

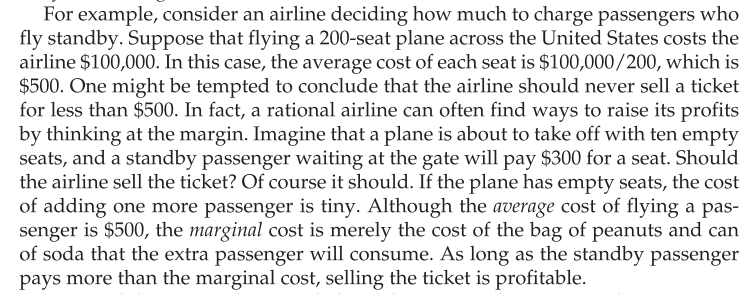
The ***opportunity cost*** of an item is what you give up to get that item. When making any decision, decision makers should be aware of the opportunity costs that accompany each possible action. In fact, they usually are. College sportspersons who can earn millions if they drop out of school and play professional sports are well aware that their opportunity cost of college is very high. It is not surprising that they often decide that the benefit is not worth the cost.

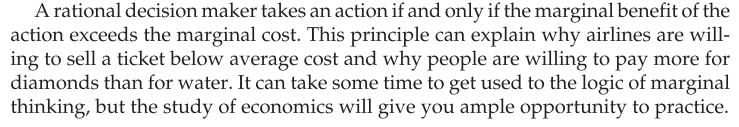
**PRINCIPLE 3: RATIONAL PEOPLE THINK AT THE MARGIN**

Economists normally assume that people are rational (sensible person who make decisions based on intelligent thinking rather than emotion). ***Rational people*** systematically/scientifically and purposefully do the best they can to achieve their objectives, given the available opportunities.

When exams roll around, your decision is not between blowing them off or studying 24 hours a day but whether to spend an extra hour reviewing your notes instead of watching TV.

Economists use the term ***marginal changes*** to describe small incremental adjustments to an existing plan of action. Keep in mind that margin means “edge,” so marginal changes are adjustments around the edges of what you are doing. Rational people often make decisions by comparing marginal benefits and marginal costs.

***Example:*** 



**PRINCIPLE 4: PEOPLE RESPOND TO INCENTIVES**

An incentive is something that encourages a person to act, such as the prospect of a punishment or a reward. Because rational people make decisions by comparing costs and benefits, they respond to incentives.

* Incentives are essential to analyzing how markets work. For example, when the price of an apple rises, people decide to eat fewer apples. At the same time, apple orchards decide to hire more workers and harvest more apples. In other words, a higher price in a market provides an incentive for buyers to consume less and an incentive for sellers to produce more. As we will see, the influence/impact of prices on the behavior of consumers and producers is essential for how a market economy allocates scarce resources.

***The next three principles concern how people interact with one another.***

**PRINCIPLE 5: TRADE CAN MAKE EVERYONE BETTER OFF**

American and Japanese firms produce many of the same goods. Ford and Toyota compete for the same customers in the market for automobiles. Apple and Sony compete for the same customers in the market for digital music players.

Trade between the United States and Japan is not like a sports competition in which one side wins and the other side loses. In fact, the opposite is true: Trade between two countries can make each country **better off**.

Countries as well as families benefit from the ability to trade with one another. Trade allows countries to specialize in what they do best and to enjoy a greater variety of goods and services.

**PRINCIPLE 6: MARKETS ARE USUALLY A GOOD WAY TO ORGANIZE ECONOMIC ACTIVITY**

The collapse/failure of communism in the Soviet Union and Eastern Europe in the 1980s may be the most important change in the world during the past half century.

Most countries that once had centrally planned economies have uncontrolled the system and are instead developing market economies. In a market economy, the decisions of a central planner are replaced by the decisions of millions of firms and households. Firms decide whom to hire and what to make. Households decide which firms to work for and what to buy with their incomes. These firms and households interact in the marketplace, where prices and self-interest guide their decisions.

At first glance, the success of market economies is puzzling. In a market economy, no one is looking out for the economic well-being of society as a whole. But Adam Smith made the most famous observation in all of economics: Households and firms interacting in markets act as if they are guided by an “invisible hand” that leads them to desirable market outcomes.

**PRINCIPLE 7: GOVERNMENTS CAN SOMETIMES IMPROVE MARKET OUTCOMES**

If the invisible hand of the market is so great, why do we need government? One purpose of studying economics is to refine your view about the proper ***role and scope of government policy***.

One reason we need government is that the invisible hand can work its magic only if the government enforces the rules and maintains the institutions that are key to a market economy. Most important, market economies need institutions to enforce ***property rights*** so individuals can own and control scarce resources. A farmer won’t grow food if he expects his crop to be stolen; a restaurant won’t serve meals unless it is assured that customers will pay before they leave.

***The last three principles concern the workings of the economy as a whole.***

**PRINCIPLE 8: A COUNTRY’S STANDARD OF LIVING DEPENDS ON ITS ABILITY TO PRODUCE GOODS AND SERVICES**

Changes in living standards over time are also large. Almost all variation in living standards is attributable to differences in countries’ productivity—that is, the amount of goods and services produced from each unit of labor input. In nations where workers can produce a large quantity 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 endure a more meager existence.

**PRINCIPLE 9:** **PRICES RISE WHEN THE GOVERNMENT PRINTS TOO MUCH MONEY**

What causes inflation?

In almost all cases of large or persistent inflation, the culprit is growth in the quantity of money. When a government creates large quantities of the nation’s money, the value of the money falls.

**PRINCIPLE 10: SOCIETY FACES A SHORT-RUN TRADE-OFF BETWEEN INFLATION AND UNEMPLOYMENT**

Although a higher level of prices is, in the long run, the primary effect of increasing the quantity of money, the short-run story is more complex and controversial. Most economists describe the short-run effects of monetary injections as follows:

• Increasing the amount of money in the economy stimulates/encourages the overall level of spending and thus the demand for goods and services.

• 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.

• More hiring means lower unemployment. This line of reasoning leads to one final economy-wide trade-off: a short-run trade-off between inflation and unemployment.