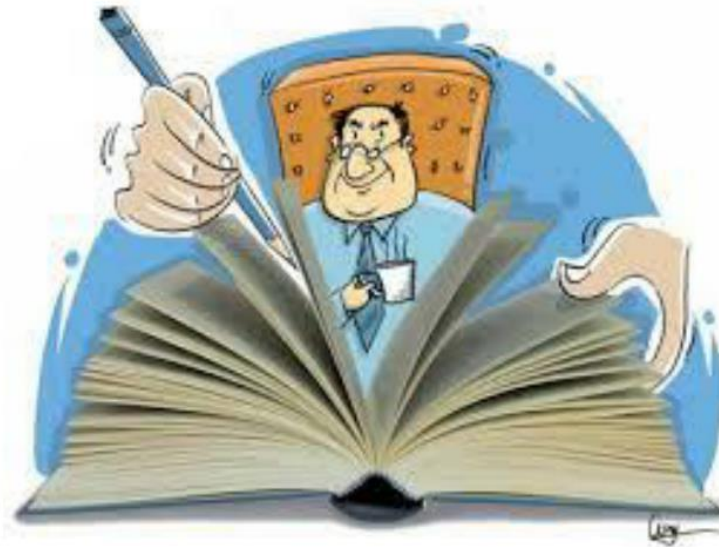




# Ten Principles of Economics



**Dr. Omnia Elmahdy**

**How people make decisions**

**How people interact with each other**

**The forces and trends that affect how the economy as a whole works.**

# How people make decisions

- People face **tradeoffs**. يواجه الناس المفاضلات.
- The **cost** of something is what you **give up** to get it.  
تكلفة الشيء هي ما تتخلى عنه لتحصل عليه.
- **Rational** people think at the **margin**. العقلاء يفكرون في الهامش.
- People **respond** to **incentives**. الناس يستجيبون للحوافز.

# How people interact with each other

- **Trade** can make everyone **better** off. التجارة يمكن أن تجعل الجميع أفضل حالاً.
- **Markets** are usually a good way to **organize economic activity**. عادة ما تكون الأسواق وسيلة جيدة لتنظيم النشاط الاقتصادي.
- **Governments** can sometimes **improve economic outcomes**. يمكن للحكومات في بعض الأحيان تحسين النتائج الاقتصادية.

# 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**

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

- Food v. clothing
- Leisure time v. work

Making decisions requires **trading**  
**off one goal against another**

How do you spend your time ?

How does a family spend its income ?



Recognizing that tradeoffs exist does not indicate what decisions should be made



## Principle #2:

### The Cost of Something Is What You Give Up to Get It

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

## Opportunity Cost



or



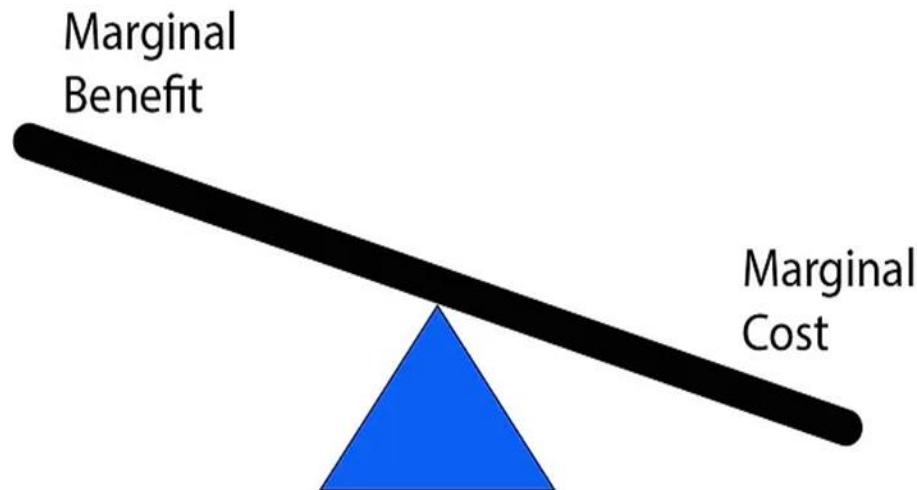


## Principle #3:

### Rational People Think at the Margin

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

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



# Thinking at the Margin

- o In addition to looking at opportunity costs, economists also look at the cost and benefits of adding or subtracting one more unit.
- o In economics, marginal means additional
  - o Marginal costs – extra cost of adding one more unit
  - o Marginal benefits – the extra benefit of adding the same unit
  - o \*\*\*As long as the marginal benefit is greater than the marginal cost, it pays to add one more unit

*Example: Try to decide how many years you should stay in school.*

Decide whether or not to remain in school for an additional year or two.

Thus, you need to compare the additional benefits of another year in school (the marginal benefit) with the additional cost of staying in school for another year (the marginal cost)

## 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**!

#### Marginal Cost v. Marginal Benefit

- People make decisions based on costs and benefits.
- The benefits must **always** outweigh the costs.
- When rational decisions occur, marginal benefit outweighs marginal cost. \*\*\*\*\*



## *Example*

- When the price of a good rises, consumers will buy less of it because its cost has risen
- When the price of a good rises, producers will allocate more resources to the production of the good because the benefit from producing the good has risen

## Principle #5:

### Trade Can Make Everyone Better Off

- Trade is not like a sports competition where one side gains and the other side loses
- People gain from their ability to trade with one another.
- Trade allows people to specialize in what they do best
- Just like families benefit from trading with one another so do **countries**

# Types of Economic Systems

- Market

Economy

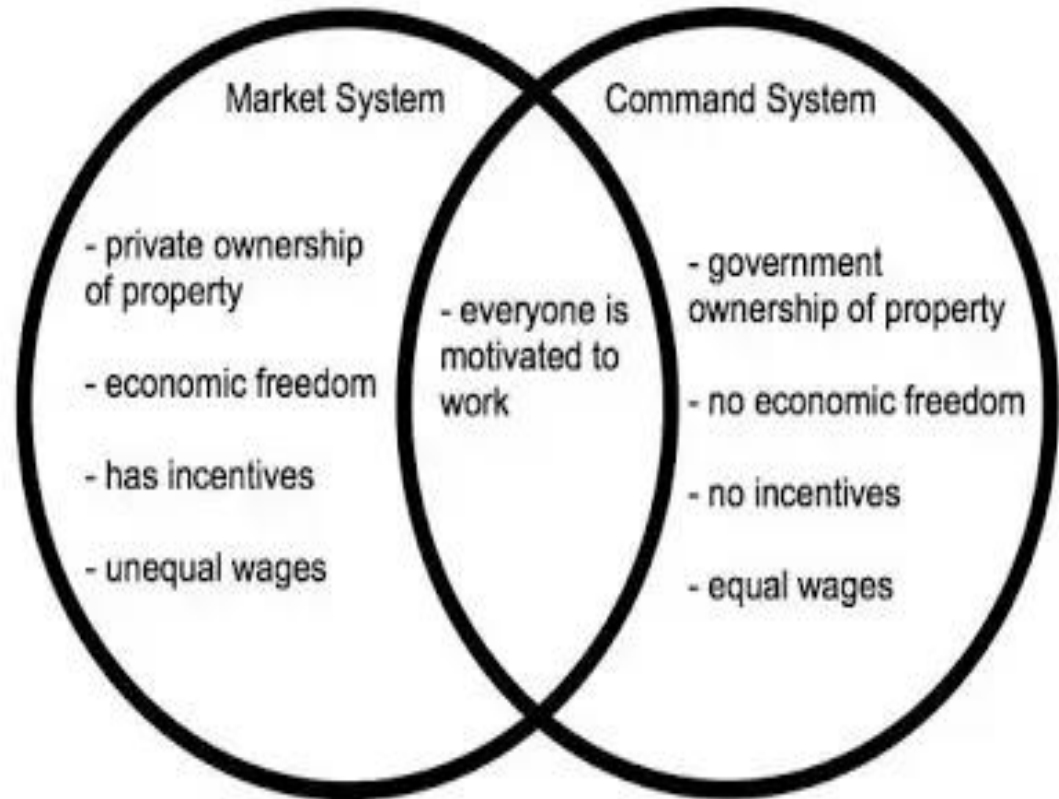
اقتصاد السوق

- Command

Economy

الاقتصاد الموجه

## Market System vs. Command System





## 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 القرارات اللامركزية للعديد من الشركات والأسر 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.

# Market Economy

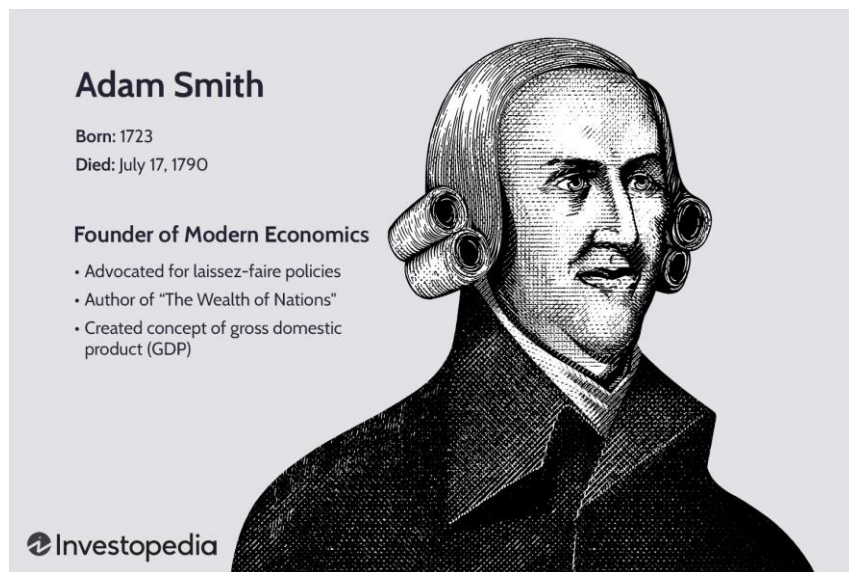
- A market is defined as the sum of interaction between buyers and sellers

A perfectly competitive market has the following characteristics:

- 1- There are many buyers and sellers and no one is large enough to **influence the price**
- 2- Buyers and sellers act independently
- 3- Buyers and sellers are free to enter or leave the market at any time
- 4- There is perfect information of the buyers (consumer sovereignty) سيادة المستهلك

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.



# Invisible Hand

Government does not get involved

Needs of society automatically met

Profit-seeking producers will make more

Competition keeps quality high

Competition keeps prices low

Competition & self-interest act as an invisible hand that regulates the free market



- **The role of government in a market economy is minimal**
- Government maintains order and competition by insuring that basic conditions of a market are observed



The illustration shows a stylized building with a striped awning. A person is sitting inside the building, handing a box to another person standing outside. A dashed line connects the box to a larger box on the ground. Next to the larger box are several coins, including one with a dollar sign and one with a cent sign. The background is a light blue gradient.

# Market Economy

*['mär-kat i-'kä-nə-mē]*

An economic system in which economic decisions and the pricing of goods and services are guided by the interactions of a country's individual citizens and businesses.

 Investopedia

# Command Economy اقتصاد موجه

- This is done by centralized planning of economic life
- Allocation choices are made by the government rather than the consumer
- Socially desirable goals can be achieved through planning
- Government prevents any economic **failure**



## Command Economy

[kə-'mand i-'kɑ-nə-mē]

An economic system in which a central government dictates permissible levels of production and prices.



- When a government interferes in a market and restricts price from adjusting, decisions that households and firms make are not based on the proper information.
- Thus, these **decisions may be inefficient**
- **Centrally-planned economies have FAILED** because they did not allow the market to work



# Centrally Planned Economy

*['sen-trə-lē 'pland i- 'kă-nə-mē]*

An economic system in which decisions are made by a central authority rather than by market participants.



## Principle #7:

### Governments Can Sometimes Improve Market Outcomes

- *There are two broad reasons for the government to interfere with the economy: **the promotion of efficiency and equity.***
- ***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.

- 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. متفرج ، أحد الحضور
  - Market power, which is the ability of a single person or firm to unduly influence market prices. بلا مبرر

Because a **market economy rewards** people for their ability to produce things that other people are willing to pay for, there will be an unequal distribution of economic prosperity ازدهار.

## Principle #8:

### The Standard of Living Depends on a Country's Production

1. Differences in living standards from one country to another are quite large.

2. Changes in living standards over time are also great.

3. The explanation for **differences** in **living standards** lies in **differences** in **productivity**.

- **Productivity** إنتاجية is the amount of goods and services produced from **each hour of a worker's time**.
- **High productivity** implies يدل على a **high standard** of living.
- **Policymakers** must understand the **impact** of any **policy** on our **ability to produce** goods and services.



# Productivity

*[,prō-dək-'ti-və-tē]*

Measuring output per unit of input to gauge the efficiency of production.

## Principle #9:

# Prices Rise When the Government Prints Too Much Money

- Inflation التضخم 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.



## Inflation

[in-'flā-shən]

A rise in prices, which can be translated as the decline of purchasing power over time.

## Principle #10:

### Society Faces a Short-run Tradeoff Between Inflation and Unemployment

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

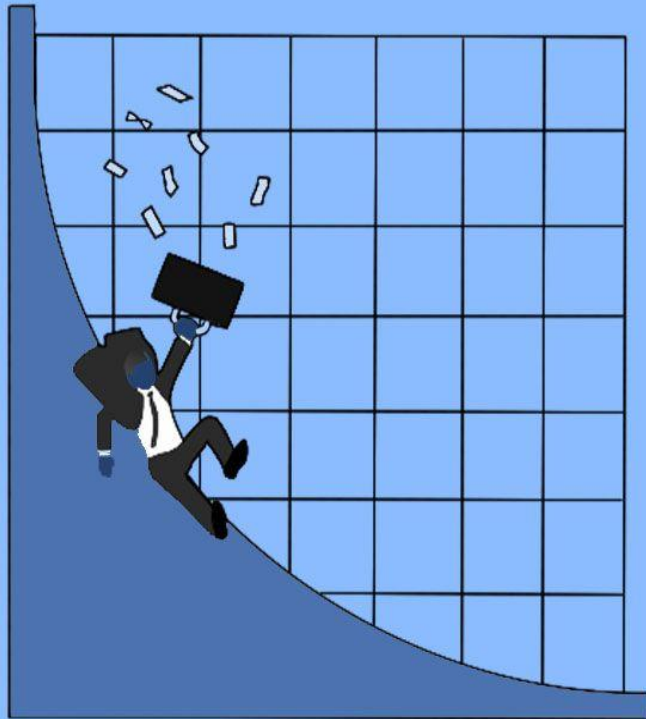
↓ Inflation ⇔ ↑ Unemployment

It's a short-run tradeoff! (temporary)

- The Phillips curve is important for understanding the **business cycle**.

**Business cycle: are fluctuations in economic activity, such as employment and production.**





# Phillips Curve

[;fi-leps 'kerv]

An economic concept developed by A. W. Phillips stating that inflation and unemployment have a stable and inverse relationship.

