Chapter 1: First Principles

Key Learning Objectives

- **Understand the four principles that guide individual choices.**
- **Learn the four principles that govern how individual choices interact.**
- **Identify the three principles that illustrate economy-wide interactions.**

I. Principles of Individual Choice

1. Scarcity and Choice

- **Resources are scarce, meaning there isn't enough to satisfy all wants.**
- **Scarcity forces choices about how resources are allocated.**

2. Opportunity Cost

- **The true cost of something is its opportunity cost (what is given up to get it).**
- **Example: Mark Zuckerberg dropping out of Harvard to start Facebook.**

3. Marginal Analysis

- **"How much" decisions involve comparing marginal benefits vs. marginal costs.**
- **Marginal decision-making means choosing to do a little more or less of an activity.**

4. Incentives Matter

- **People respond to incentives to make themselves better off.**
- **Example: Companies are more likely to reduce pollution if given financial rewards rather than just educational information.**

II. Interaction of Individual Choices

5. Gains from Trade

- **Trade allows individuals to consume more than they otherwise could.**
- **Specialization: People focus on tasks they do best, increasing efficiency.**

6. Markets Move Toward Equilibrium

- **Equilibrium: No individual benefits from changing their behavior because market forces balance supply and demand.**

7. Efficient Resource Use

- **Efficiency occurs when an economy maximizes benefits without making others worse off.**

8. Markets Lead to Efficiency (Most of the Time)

- **Markets tend to allocate resources efficiently.**
- **However, market failures can occur, requiring government intervention.**

Equity vs. Efficiency

- **Equity: Fair distribution of resources (subjective).**
- **Often, achieving greater equity reduces efficiency.**

III. Economy-Wide Interactions

9. Spending Drives the Economy

- **One person's spending is another person's income.**
- **Recessions occur when reduced spending leads to layoffs and declining incomes.**

10. Government Policy Can Influence Spending

- **Recessions occur when overall spending is too low → government may step in.**
- **Inflation happens when spending is too high → government may intervene.**

11. Economic Growth Increases Living Standards

- **Growth comes from technology, resource availability, and productivity improvements.**
- **Growth benefits some more than others, creating winners (e.g., tech industries) and losers (e.g., coal miners).**

Practice Questions

1. **If Costco offers unlimited free samples, do customers who eat them face an opportunity cost?**
   Answer: Yes, they give up alternative food choices or time.
2. **What is happening when workers in a fast-food chain specialize in different tasks?**
   Answer: Specialization.
3. **What is a potential cause of income inequality in a market economy?**
   Answer: Equity concerns—some full-time workers still earn below the poverty line.
4. **What happens during a recession when businesses cut spending?**
   Answer: Less income, less spending, more layoffs.