

Paul Krugman • Robin Wells  
**ECONOMICS**

THIRD EDITION



DYNAMIC POWERPOINT™ SLIDES BY SOLINA LINDAHL

CHAPTER  
**1**

**First Principles**

# Food for Thought....



*Some good blogs and other sites to get the juices flowing:*

MARGINAL**REVOLUTION**

**FREAKONOMICS**  
THE HIDDEN SIDE OF EVERYTHING



**The Conscience of a Liberal**

PAUL KRUGMAN

**GREG MANKIW'S BLOG**

Random Observations for Students of Economics

Worth Noting  
Authors in the News and Upcoming Events

 **BUREAU OF LABOR STATISTICS**

 U.S. Department of Commerce  
**Bureau of Economic Analysis**





# Take a look.....

WHAT YOU  
WILL LEARN  
IN THIS  
CHAPTER

- › A set of principles for understanding the economics of how individuals make choices
- › A set of principles for understanding how economies work through the interaction of individual choices
- › A set of principles for understanding economy-wide interactions

[To First  
Active Learning](#)



# Choice: The Heart of Economics.

Interactive

Characteristic

Straight



**She must choose. And her choice affects others.**



# Individual Choice: The Principles

A hand painted in shades of orange and red, holding a globe of the Earth. The background is dark with several stars in red, yellow, and green. The text is overlaid on the hand and globe.

**1. Choices are necessary because resources are scarce.**

# Resources and Scarcity

**Resource:** anything that can be used to produce something else.

**Scarce:** in short supply; a *resource* is scarce when there is not enough of the resource available to satisfy all the various ways a society wants to use it.

# Individual Choice: The Principles

2. The true cost of something is its opportunity cost.

**Opportunity cost:** what you must give up in order to get something.



*Mark Zuckerberg understood the concept of opportunity cost—and dropped out of Harvard.*

# Individual Choice: The Principles

3. “How much” is a decision at the margin.

**Trade-off:** comparison of the costs and the benefits of doing something.

Each bite of the candy bar has costs and benefits.





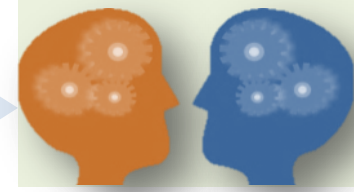
# Individual Choice: The Principles

**Marginal decision:** decision made at the margin of an activity about whether to do a bit more or a bit less of that activity.

**Marginal analysis:** the study of marginal decisions.

**Incentive:** anything that offers rewards to people who change their behavior.

# Active Learning: Discussion



New York City Mayor Michael Bloomberg proposed a ban on the sale of any sugary beverage over 16 ounces in any of the city's restaurants, delis, movie theaters, and street carts.

*“Obesity is a nationwide problem, and all over the United States, public health officials are wringing their hands saying, ‘Oh, this is terrible.’ New York City is not about wringing your hands; it’s about doing something. I think that’s what the public wants the mayor to do,” Bloomberg told The New York Times in making his proposal.*

**Discuss:** Do you agree that soda should be taxed or banned? Why or why not?

# Individual Choice: The Principles

4. People usually respond to incentives, exploiting opportunities to make themselves better off.



*In the United States, restaurant customers have the option of adding a tip to the restaurant bill. In much of Europe a tip is added automatically.*

***Where would you expect waiters to be more attentive?***



# Active Learning: Application

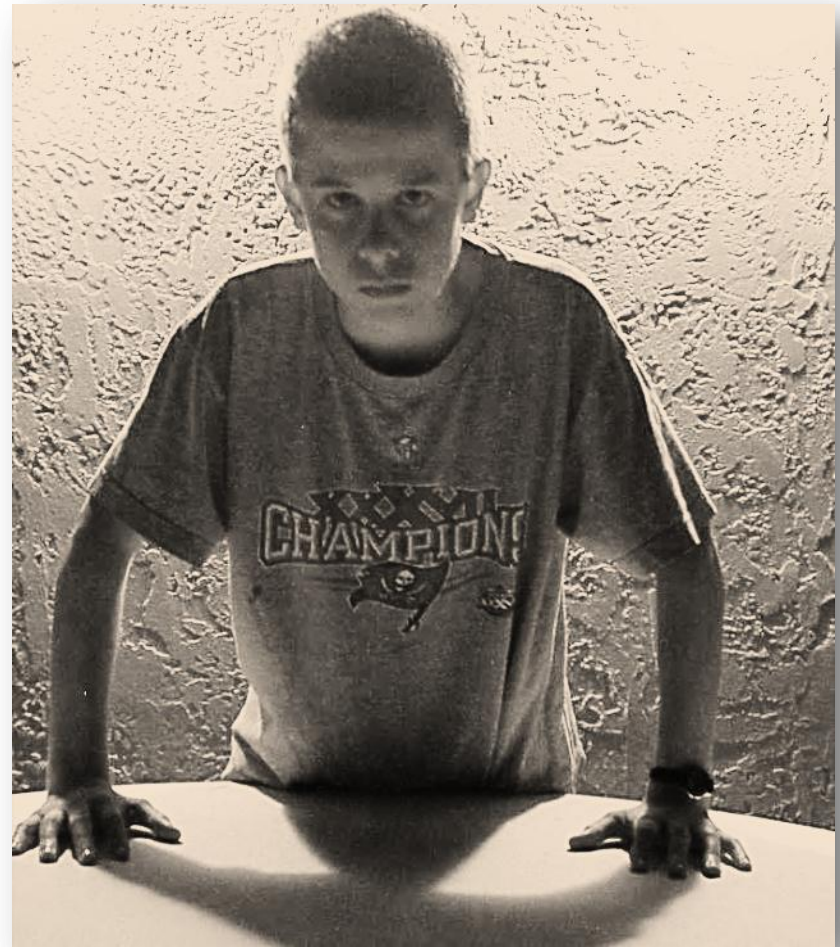
**BUSINESS  
CASE**

*Can you spot the problem with this incentive system?*

**A juvenile prison in Pennsylvania offered judges bribes the more young people they sent to jail.**

**One teen was jailed for a Facebook page that was critical of her high-school principal.**

**Both judges pleaded guilty to accepting \$2.6 million in bribes.**



[To Next  
Active Learning](#)

# Interaction and Individual Choice

## 5. There are gains from trade.



Trade allows us all to consume more than we otherwise could.





# Interaction and Individual Choice



**Specialization:** the situation in which each person specializes in the task that he or she is good at performing.



# Interaction and Individual Choice

## 6. Markets move toward equilibrium.

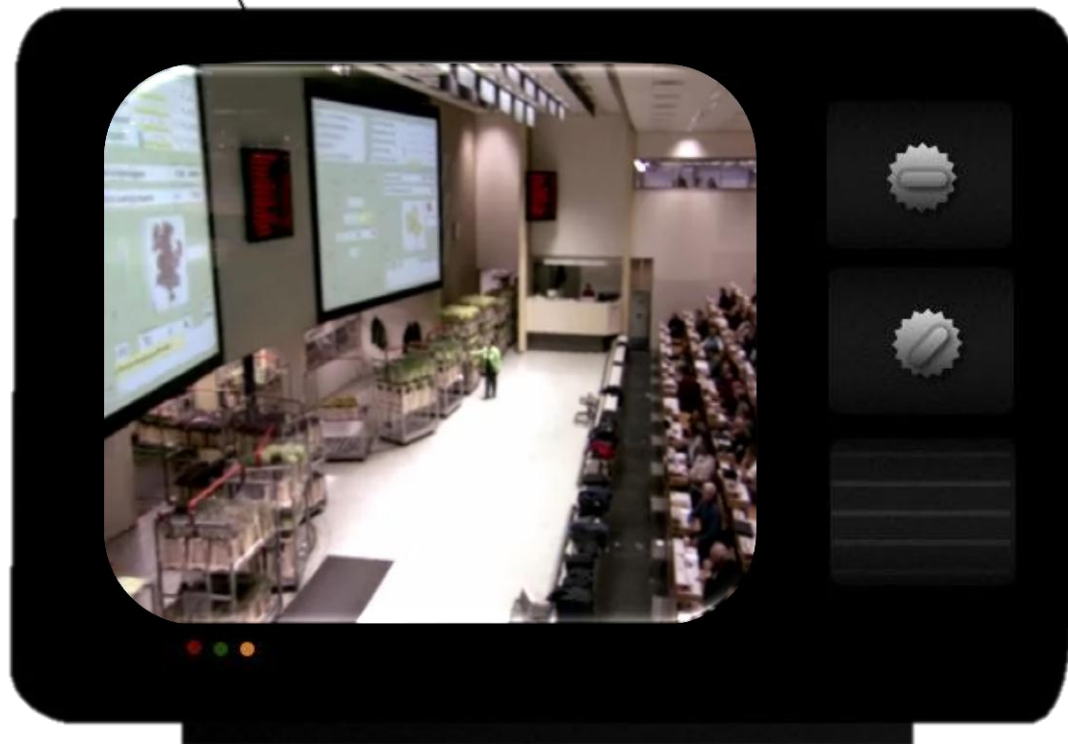
**Equilibrium:** an economic situation in which no individual would be better off doing something different.





# Take a look.....

For a look at a real-world equilibrium, click the picture below to see the Aalsmeer Dutch Tulip auction in action. (3 minutes)



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# Active Learning: Application

## BUSINESS CASE

*Lane speeds reach equilibrium quickly as people respond to incentives.*



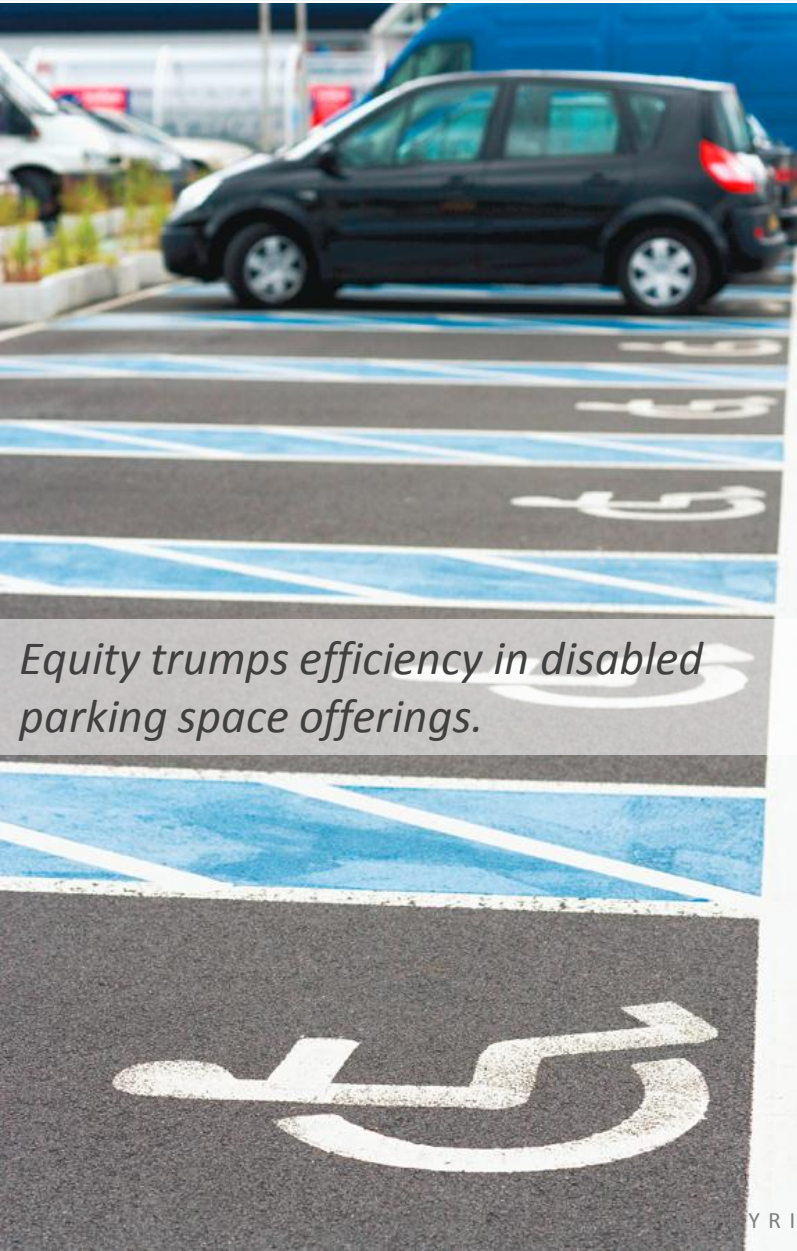


# Interaction and Individual Choice

7. Resources should be used efficiently to achieve society's goals.

**Efficient:** taking all opportunities to make some people better off without making other people worse off.

# Interaction and Individual Choice



*Equity trumps efficiency in disabled parking space offerings.*

**Equity:** a condition in which everyone gets his or her “fair share.”

(There are many definitions of equity.)

**Equity and efficiency are often at odds.**



# Interaction and Individual Choice

## 8. Markets usually lead to efficiency.

People normally take opportunities for mutual gain.





# Interaction and Individual Choice

9. When markets don't achieve efficiency, government intervention can improve society's welfare.

Sometimes **markets fail** and need correction.



# Economy-Wide Interactions

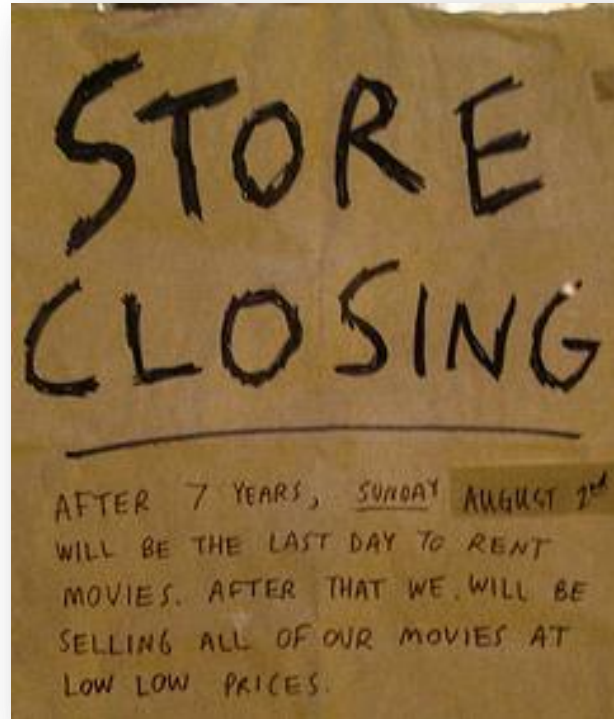
10. One person's spending is another person's income.



# Economy-Wide Interactions

During recessions, a drop in business spending leads to:

Less income,  
less spending...



...and further drops in business spending, layoffs,  
and rising unemployment.



# Economy-Wide Interactions

11. Overall spending sometimes gets out of line with the economy's productive capacity.



# Economy-Wide Interactions

## 12. Government policies can change spending.



*The U.S. government funded the WPA and provided almost 8 million jobs between 1935 and 1943.*