“The 10 principles of economics”


These are bewildering times. One week Congress passes a 1.3 trillion dollar stimulus bill (including interest), and the next week the administration promises to exercise fiscal responsibility.

Naturally, I'm a little confused.

Science has basic principles, but the question for today is, “Are there basic principles of economics, and if so, what are they?”

Apparently there are. In 1997, N. Gregory Mankiw, a Harvard economics professor, published an introductory economics textbook, “Principles of Economics.” In the forward to the book, he observed: “Economics combines the virtues of politics and science. It is, truly, a social science. Its subject matter is society — how people choose to lead their lives and how they interact with one another. But it approaches the subject with the dispassion of a science…. Economics is a subject in which a little knowledge goes a long way” (www.amazon.com: “Principles of Economics”).

In his book Mankiw presents 10 principles of economics. In order to make it easy, let's discuss these principles as they might apply to a family of five: husband Rick, wife Sally, 17-year-old son Ben, 11-year-old son Jared, and 4-year-old daughter Courtney. Here, then, are Mankiw’s 10 basic principles of economics applied to this family.

1. People face tradeoffs.

When 4-year-old Courtney has been playing with a toy and her 11-year-old brother Jared comes and takes it away from her, she will scream, which alerts their mom Sally. Courtney complains she was playing with the toy first when Jared came and took it away. Sally says for them to work it out, but she will not have screaming in the house.

What can Jared do? He can, of course, just give Sally the toy. Or he can pretend to be having so much fun with another toy that Courtney will decide she wants to play with it. He can then trade toys with her. Courtney, of course, can play with either toy because of her screaming.

Thus, even kids face tradeoffs.

2. The cost of something is what you give up to get it.

Seventeen-year-old Ben wants to take the car Friday night for a date. His parents can just say yes or else they can try to put conditions on using the car, such as: “First you must clean your room, and have your homework done for Monday, and empty the garbage, and …” They can continue with these requirements until Ben complains that using the car isn't worth that much effort, at which time Rick and Sally can back off one or two of their requirements by saying, “OK, you don't really need to clean the garage. Just do everything else and we'll let you have the car tonight.”

Thus the cost of using the car is what work and time Jared is willing to give up for that privilege.

3. Rational people think at the margin.

If money is tight for Rick and Sally, they may decide to make a few small changes, like shopping in Rexburg instead of Idaho Falls to save gas. Or going to a thrift store instead of a more expensive store. They may also decide to convert part of their backyard lawn into a vegetable garden to cut down on food expenses.

This quote is from the Web site smilerz91.blogspot.com/2008/rational‐people‐think‐at‐margin.html:

“When a company is looking for opportunities to become more efficient they don't look at redesigning the whole factory. They look for opportunities to cut a penny here or a couple seconds there. In the long run they add up to real money/productivity…. This is one of the most glaring failures of government programs. They don't look to make incremental improvements. It is big bang or nothing.”

4. People respond to incentives.

If Jared usually gets a C in each of his classes, but could get As with a little more work, Rick might say, “For every A you get, I will reward you with a 5-dollar bill.”
That is incentive. (Actually, that is also how my grades dramatically improved, starting in the sixth grade.)

On the national level, if the federal government were to give a large cash incentive to those who bought a new car, more people would buy new cars. People generally respond to incentives.

5. **Trade can make everyone better off.**

If Rick is a CPA, but it might take him several hours to fix a leaky faucet, it may be more profitable for him to hire a plumber so he can concentrate on what he does best. If the plumber uses the same reasoning, he may decide to have someone else do his taxes. That way everyone does what they do best.

6. **Markets are usually a good way to organize economic activity.**

When Sally goes grocery shopping, if it’s the flu season, she may buy oranges because she wants her kids to have Vitamin C. However, if a killing frost has just wiped out the orange crop in California, forcing the prices to be higher, she may decide to just give them a Vitamin C pill instead.

7. **Governments can sometimes improve market outcomes.**

If a large factory in town is polluting the air and water close by, the company may choose not to improve the situation because it would reduce its profits. But if a city council or if the state government passes a law requiring the factory to clean up, that would improve the community.

In other words, government does have a role in ensuring the safety of its citizens.

8. **A country’s standard of living depends on its ability to produce goods.**

If Rick works for a company that is doing well, he will get bonuses and raises. If he and Sally so choose, they may decide to get a bigger house, remodel their living room or get a new car. That, in turn, provides money for others in the community, who will also increase their spending.

Government by itself cannot produce wealth. It can reallocate money from one economic group to another but it cannot produce it.

9. **Prices rise when government prints too much money.**

Recently while watching TV, I heard a statistic that shocked me. If your ancestors had been given the pleasant assignment of spending a million dollars every day, beginning at 1 A.D. until the present time, they would have spent less money than the 1.3 trillion cost of the second stimulus bill.

It seems quite possible that this may lead to inflation.

10. **Society faces a short-run tradeoff between inflation and unemployment.**

If most people in town have a job, then when a company wants to hire more people, it may have to increase their usual starting salary in order to draw workers from other jobs to come and work for them. This will also force them to charge more for whatever it is they produce. If this happens nationwide, we have the situation we’re in now.

This, then, is my interpretation of Mankiw’s 10 economic principles.

As Mankiw observed in the forward of his book, “I believe that everyone should study the fundamental ideas that economics has to offer. One purpose of general education is to inform people about the world and thereby make them better citizens.... Writing an economics textbook is one way economists can help promote better government and a more prosperous future.”

Since economics is not my field of experience, I especially invite your comments.

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