THE TOP 10 THINGS I LEARNED IN PRINCIPLES OF ECONOMICS (ECON 110)

1. **Every economic decision has trade-offs. This is true in all markets and all matters of public policy and government intervention. Common trade-offs include:**
    - Efficiency vs Equality (Taxes for Social Programs)
    - Privacy vs Discrimination (Felony info on job applications)
    - Standard of Living vs Security (National Defense taxes)
    - Quantity vs Quality (ex. Ben & Jerry's vs Blue Bunny)
    - Unemployment vs Minimum Wage

    Understanding the trade-offs behind decisions always leads to better decision making.

2. **It is valuable to think in terms of opportunity costs**
    - **Opportunity costs represent the true cost of something**, which is everything you are giving up in order to get it.
        - Many think the cost of going to see a movie is the $8 ticket. In reality, it also includes the things you could have been doing during those 2 hours. The cost of seeing a movie could have been $108, if at the same time you could have been earning $50 an hour at work.
        - Many think that the cost of college is the price of tuition, books and supplies, housing, and food. In reality, housing and food is not a cost of college because you would be paying for these things whether you go to college or not. More importantly, in going to college you also give up four year of your time, and all the wages or opportunities you would have obtained if you hadn't been going to college during that time.
    - A good understanding of opportunity costs helps you determine the actual costs and benefits of a decision. It helps you better realize how you value family time, vacations, reading a book. Alternatively, it puts into perspective the real cost of watching TV or surfing the internet.
3. **Trade can make everybody better off.**
    - **The ability of trade to benefit both parties depends on *comparative advantage*, not *absolute advantage*.** In other words, it doesn't matter which country can grow the most rice in a year. What matters is who is better at growing rice than at doing other things. Because these countries have the lowest *opportunity cost* for growing rice, they will have a comparative advantage in producing rice. These countries will benefit by making tons of rice and then trading it for other goods. Funny enough, a country that stinks at everything can still benefit others from trade, by trading what they stink the least at. Clearly, thinking in terms of *comparative advantage* instead of *absolute advantage* is non-intuitive at first.
    - **Trade promotes specialization**, which will make the party more skilled at what they do, giving them a higher competitive advantage. This is one reason why the generalists of the 18th century (who did their own, planting, growing, milking, butchering, harvesting, cooking, plumbing, roof repairs, painting, and building) had a lower standard living than we do. Today, we specialize and "trade" by spending all day writing computer programs, and contracting out our plumbing, roof repairs, painting, building, cooking, etc). By using comparative advantages and trade, all parties in the modern society have been made better off.
4. **The free market is usually a great way to organize economic activity**
    - **First, it works like magic**. The kind of timing and coordination it takes to have turkeys in the grocery store in time for thanksgiving is mind-boggling. It's amazing how the free market, made up of farmers, butchers, factory workers, suppliers, distributors, and store owners, all completely

acting in their self-interest, are able to get the right amounts to the right locations at the right times, every time.

- **We use prices to allocate scarce resources**. Because of the way competition drives prices, the scarcer something is, the more expensive it is. This always allows the goods to go to the people who want them the most. Compare this to communist markets where prices are mandated by the government. In these situations something must allocate scarce resources if price cannot. Usually this meant whoever was willing to wait in line the longest for something would get it.
- **Supply and demand runs the show**. Increasing demand raises prices, while increasing supply lowers them. Guided by the principles of supply and demand, the market uses prices to guide the economy to the most desirable outcome, as if by using an "invisible hand".
- **The free market is very efficient.** Because of the concepts above, free market economies are able to get more out of their scarce resources than any other system. Whenever there is a way to get more out of its resources, the market naturally and immediately adopts the method.

5. Governments can sometimes improve market outcomes

- Market failures are when the free market, left alone, fails to allocate resources efficiently. In many cases, government intervention is highly beneficial in improving the outcome.
- **Governments can improve the effects of *externalities***. Externalities exist when one person's choice impacts a bystander. ***Negative externalities*** impact others negatively, for example, when I pollute the river, it harms everyone drinking from it. Because others bear the cost of my pollution, the free-market fails to prevent it. On the other hand, choices that positively impact others (***positive externalities***) aren't made often enough because the chooser doesn't receive the full benefit of his choice (and the benefiters are *free-riders*, having received the benefit without paying for it).
- Government intervention in market failures include: patent and copyright laws, anti-trust legislation, pollution caps, and gas taxes.

6. Information Matters

- In the ideal world of Econ textbooks, all participants in a market have all information. In reality, some people know more than others and markets tend to favor the parties that know more. Used car salesman, job applicants, buyers of health insurance, and doctors are all people who have an advantage because they know more than the parties they are interacting with.
- Brands have value because they convey information. A man driving in an unfamiliar area will choose a McDonalds over a local restaurant, even if they don't particularly like McDonalds. Why? Because those golden arches tells the man a lot about a restaurant which he has never seen before. He knows everything from the quality of its restrooms to how many pickles will be on his hamburger. If he goes anywhere else, he is taking a chance.

7. Incentives Matter

- **Self interest fuels the free market**, thus incentives matter.
- **The free market contains incentives that can have bad consequences**, for example, taking public goods, resulting in the overfishing of harbors or the extinction of Rhinos.
- **Intervention in the free market can change incentives**, resulting in unexpected consequences. Examples include:
    - Seatbelt laws resulting in more pedestrian fatalities
    - The best teachers in public schools end up pursuing other careers
    - CEOs pursuing mergers that reduce company profits
- **Well placed intervention can use incentives to improve outcomes**, like how taxing people to drive in downtown London significantly improves traffic congestion and use of public transport.

8. Financial markets can spread risk

- Risks can be spread in the financial markets, just as the risk of loan default can by spread among individuals by selling bonds representing pieces of the loan. Everything from the risk of changing commodity prices (futures) to the risk of mortgage default (credit default swaps), to the risk of hurricanes, can, and are, sold in the financial markets.
- By spreading risk, one catastrophic event can be weathered. It acts as insurance in our financial system.

9. **Economics can bring great insight into politics**
    - From social programs to education reform, free trade to minimum wage, tax policy to health care reform, immigration to government spending, very few political issues have a clear and definite “best” outcome. In the free market, there is always a trade-off. Wisdom in politics is in understanding the trade-offs and supporting what best fits your principles.

10. **Economics can bring great insight into other aspects of life.**
    - Principles of economics explain how things work (and why they often don’t). It explains if it is worth it to attend an Ivy League school. It explains why you lost your job during the recession. It explains why risky investments are not risky over time. It explains why there are few wealthy nations with tropical climates. It explains why a candy bar doesn’t cost a nickel anymore… and why that’s actually a good thing. Economics develops a rich set of tools for understanding the world around us. There are many awesome books out there that delve into these mysteries by using principles of economics (like Freakonomics, and others). Just read a lot of them! It’s fun and good for you.