

Business Economics and Law Seminar 1

10 Key Principles of Economics





Principle 1

 **Incentives matter. The main incentive is to maximise output (profit, utility, wealth) from the available resources.**

a. When you go to the mall, do you try to get the most value from your spending? Why or why not?

b. Why do individuals have a strong incentive to attempt to get the most out of the resources that they own?





Principle 2

 **There is no such thing as a free lunch.**

Sellers often advertise that a product is “free”, i.e. “buy one, get one free” or “free car wash with fill-up.”

a. Does this mean that there is no cost of providing the “free” product?

b. If there is a cost of providing the product, why would the seller advertise it as “free”?

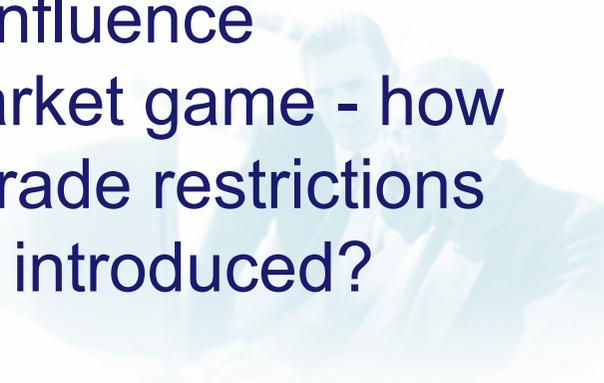
Can government provide goods and services such as housing, education or health care for free to its citizens?





Principle 3

 **Trade increases economic welfare.**

- a. Why do people trade?
 - b. Explain the principle of specialisation and economies of scale in your own words (as you understand them).
 - c. How do you think the opportunities for specialisation, economy of scale and trade affect welfare of the society?
 - d. How do you think trade restrictions influence economic welfare? Think about the market game - how would it go and what would happen if trade restrictions (say, 20% tax on all deals made) were introduced?
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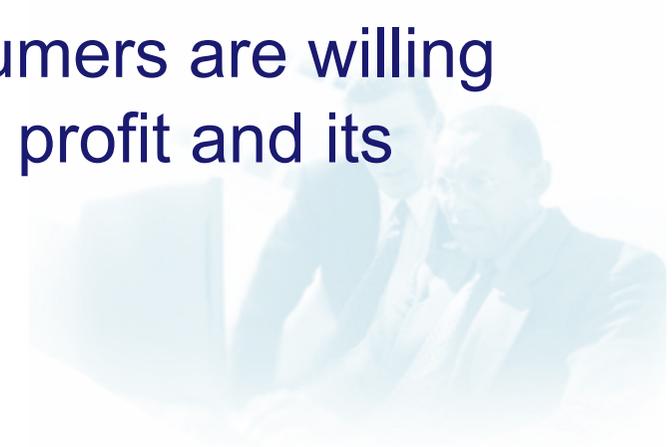


Principle 4

 **Prices bring the choices of buyers and sellers into balance.**

a. If producers are supplying more of a good than consumers are willing to purchase at the current price, what will happen to the market price in the future?

b. If the price set is higher than consumers are willing to pay, how will this affect the seller's profit and its future strategy?





Principle 5

Evaluate the statement: “Production should be for people and not for profit.” Think about the following:

- a. If production is profitable, are consumers helped or hurt?
 - b. Would consumers be helped more if production resulted in a loss?
 - c. To what extent is there a conflict between the incentives of producers and the incentives of consumers?
 - d. If producer is making profit how will it affect its personal spending and consumption pattern?
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Principle 5

 **Profit direct businesses toward activities that increase wealth.**

Economists believe that even though business failures are often painful for the investors and employees involved, there is a positive side.

- a. What is the positive side?
- b. Why do many economists stress that the role played by losses is just as important as the role of profits?





Principle 6

 **People earn income by helping others.**

a. If an individual is motivated primarily by the desire to make money, will he or she have an incentive to be helpful to others?

b. Will he or she have an incentive to develop skills or produce goods that others value highly? Why or why not?





Principle 7

- a. What does the term “self-interest” mean to you? Is it the same thing as selfishness and greed?

- b. In a market economy, when individuals pursue their own self-interest, how will their actions influence the well-being of others?





Principle 7

 **The “invisible hand” of market forces directs buyers and sellers toward activities that promote the general welfare.**

...every individual... intends only his own gain, and he is in this... led by an invisible hand to promote an end which was no part of his intention... By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it.

"The Wealth of Nations" (1776), Adam Smith - the father of modern economics and capitalism.





Principle 8

- a. Why are the living standards so much higher today than was true 200 years ago?
- b. What do you think are the primary sources of high per capita income?
- c. Describe the role of the entrepreneur in a market economy. What must an individual do in order to undertake an entrepreneurial venture? What role does the entrepreneur play in achieving economic progress?





Principle 8

 **Economic progress comes primarily through trade, investment, better ways of doing things (technology), and sound economic institutions.**

d. If people were altruists, not greedy and selfish, how would this affect economic progress?

e. Do the legal institutions of a country matter? What are some of the characteristics of legal institutions that would help promote economic progress?





Principle 9



Transaction costs are an obstacle to free trade

- a. Do middlemen add value to trade, or do they merely add to the cost of obtaining the good?

- b. Would you prefer to buy a product with the help of a middleman or directly? Why?





Principle 10

 **Decisions are made at the margin.**

How do you make decisions about:

a. whether to attend an extra (non-compulsory) tutorial?

b. or have a 5th hamburger?

c. or work overtime for another hour after you have already worked for 60 hours this week?





Source

adapted from:

Gwartney, Stroup, Lee, and Ferrarini. *Common Sense Economics: What Everyone Should Know About Wealth and Prosperity*. St. Martin's Press, 2010

