

World Markets Vs. Economy

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Although economics has many facets, the field is unified by several central ideas. In this article, we will take a closer look at Ten Principles of Economics. There is no question as to what an economy is. Whether we are talking about the economy of Los Angeles, England, or Australia, a healthy economy is based on several distinct variables. Because the behaviour of an economy reflects the behaviour of the individuals who make up the economy.

Principle 1: People Face Trade-offs

"There is no such thing as a free lunch." To get one thing that we like, we usually have to give up another thing that we like. Nonetheless, acknowledging life's trade-offs is important because people are likely to make good decisions only if they understand the options that they have available.

Principle 2: The Cost of Something Is What You Give Up to Get It.

Because people face trade-offs, making decisions requires comparing the costs and benefits of alternative courses of action. In many cases, however, the cost of some action is not as obvious as it might first appear.

Principle 3: Rational People Think at the Margin

Economists normally assume that people are rational. Rational people systematically and purposefully do the best they can to achieve their objectives, with the opportunities they have.

Michael Leary of Apex Investment Services says that rational people know that decisions in life are rarely black and white but usually involve shades of gray. Economists use the term marginal changes to describe small incremental adjustments to an existing plan of action.

Principle 4: People Respond to Incentives

An incentive is something that induces a person to act. Because rational people make decisions by comparing costs and benefits, they respond to incentives. You will see that incentives play a central role in economics.

Incentives are crucial to analyzing how markets work. For example, when the price of an apple rises, people decide to eat more pears and fewer apples because the cost of buying an

apple is higher. At the same time, apple orchards decide to hire more workers and harvest more apples because the benefit of selling an apple is also higher.

When analyzing any policy, we must consider not only the direct effects but also the indirect and sometimes less obvious effects that work through incentives. If the policy changes incentives, it will cause people to alter their behaviour.

As we go about our lives, many of our decisions affect not only ourselves but other people as well. Now we will discuss the next three principles which examine with how people interact with one another.

Principle 5: Trade Can Make Everyone Better Off

It is easy to be misled when thinking about competition among countries. Trade between the United States and Japan is not like a sports contest in which one side wins and the other side loses. In fact, the opposite is true: Trade between two countries can make each country better off.

By trading with others, people can buy a greater variety of goods and services at lower cost. Countries benefit from the ability to trade with one another. Trade allows countries to specialize in what they do best and to enjoy a greater variety of goods and services. The Japanese, as well as the French and the Egyptians and the Brazilians, are as much our partners in the world economy as they are our competitors.

Principle 6: Markets Are Usually a Good Way to Organize Economic Activity

At first glance, the success of market economies is puzzling. After all, in a market economy, no one is looking out for the economic well-being of society as a whole. Free markets contain many buyers and sellers of numerous goods and services, and all of them are interested primarily in their own well-being. Yet despite decentralized decision making and self-interested decision makers, market economies have proven remarkably successful in organizing economic activity in a way that promotes overall economic well-being.

Principle 7: Governments Can Sometimes Improve Market Outcomes

If the invisible hand of the market is so great, why do we need government?

One reason we need government is that the invisible hand can work its magic only if the government enforces the rules and maintains the institutions that are key to a healthy economy. Most important, markets work only if property rights are enforced. A farmer won't grow food if he expects his crop to be stolen; a restaurant won't serve meals unless it is assured that customers will pay before they leave; and a music company won't produce CDs if too many potential customers avoid paying by making illegal copies. We all rely on government provided police and courts to enforce our rights over the things we produce - and the invisible hand counts on our ability to enforce our rights.

How individuals make decisions, and how people interact with one another make up the many variables of "The Economy."

Principle 8: A Country's Standard of Living Depends on Its Ability to Produce Goods and Services

The differences in living standards around the world are staggering. In 2007, the average American had an income of about \$37,500. In the same year, the average Mexican earned \$8,950, and the average Nigerian earned \$900. Not surprisingly, this large variation in average income is reflected in the quality of life. Citizens of high-income countries have more TV sets, more cars, better nutrition, better healthcare, and a longer life expectancy than citizens of low-income countries.

What explains these large differences in living standards among countries and over time? The answer is surprisingly simple. Almost all variation in living standards is attributable to differences in countries' productivity- the amount of goods and services produced from an employee's time. In nations where workers can produce a large quantity of goods and services per unit of time, most people enjoy a high standard of living. Similarly, the growth rate of a nation's productivity determines the growth rate of its average income.

Principle 9: Prices Rise When the Government Prints Too Much Money

In Germany in January 1921, a daily newspaper cost 0.30 marks. Less than 2 years later, in November 1922, the same newspaper cost 70,000,000 marks. All other prices in the economy rose by similar amounts. This instance is one of history's most stunning examples of inflation.

What causes inflation? In almost all cases of large or persistent inflation, the culprit is growth in the quantity of money. When a government creates large quantities of the nation's money, the value of the money falls. In Germany in the early 1920s, when prices were on average tripling every month, the quantity of money was also tripling every month. Although less dramatic, the economic history of the United States points to a similar conclusion: The high inflation of the 1970s was associated with rapid growth in the quantity of money, and the low inflation of the 1990s was associated with slow growth in the quantity of money.

Principle 10: Society Faces a Short-Run Trade-off between Inflation and Unemployment

Although a higher level of prices is, in the long run, the primary effect of increasing the quantity of money, the short-run story is more complex and more controversial. Most economists describe the short-run effects of monetary injections as follows:

- * Increasing the amount of money in the economy stimulates the overall level of spending and thus the demand for goods and services.
- * Higher demand may over time cause firms to raise their prices, but in the meantime, it also encourages them to increase the quantity of goods and services they produce and to hire more workers to produce those goods and services.
- * More hiring means lower unemployment.

This line of reasoning leads to one final economy wide trade-off: a short-run trade-off between inflation and unemployment. Although some economists still question these ideas, most accept that society faces a short-run trade-off between inflation and unemployment. This simply means that, over a period of a year or two, many economic policies push inflation and unemployment in opposite directions. This short-run trade-off plays a key role in the analysis of the business cycle—the irregular and largely unpredictable fluctuations in economic activity, as measured by the production of goods and services or the number of people employed.

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