Economic Interaction
Interaction: How Economies work
Chapters One and Two?

- Interaction of choices—my choices affect your choices, and vice versa—is a feature of most economic situations.
- In economics we will quickly see that end results sometimes comes out different from what was intended.

Principles that underlie the interaction of individual choices:
- 1. There are gains from trade.
- 3. Resources should be used as efficiently as possible to achieve society's goals.
- 4. Markets usually lead to efficiency.
- 5. When markets don't achieve efficiency, government intervention can improve society's welfare.
There are gains from trade

- In a market economy, individuals engage in trade. They provide goods and services to others and receive goods and services in return.

- There are gains from trade: people can get more of what they want through trade than they could if they tried to be self-sufficient.

This increase in output is due to specialization. Each person specializes in the task that he or she is good at performing.

Follow your bliss!

Markets move to equilibrium

- An economic situation is in equilibrium when no individual would be better off doing something different.
• Anytime there is a change, the economy will move to a new equilibrium.

  * Ex.: What happens when a new checkout line opens at a busy supermarket?

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**Resources should be used as efficiently as possible to achieve societies goals.**

• An economy is efficient if it takes all opportunities to make some people better off without making other people worse off.

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• Should economic policy makers always strive to achieve economic efficiency?
• Equity means that everyone gets his or her fair share. Since people can disagree about what’s “fair,” equity isn’t as well-defined a concept as efficiency.

Parking example in the book
• equity, making life “fairer” for handicapped people, and
• efficiency, making sure that all opportunities to make people better off have been fully exploited by never letting parking spaces go unused.

Markets usually lead to efficiency.
• The incentives built into a market economy already ensure that resources are usually put to good use.
• Opportunities to make people better off are not wasted.
When markets don’t achieve efficiency, government intervention can improve society’s welfare

- **market failure**, the individual pursuit of self-interest found in markets makes society worse off.

- Why do markets fail?
  - Individual actions have side effects not taken into account by the market externalities.
  - One party prevents mutually beneficial trades from occurring in the attempt to capture a greater share of resources for itself.

**Cartoon**: (Image of a cartoon showing a conversation between two characters. One character says, “Hey, you know how we try to make sure nobody does anything that they can’t afford? We do that with our security motives.” The other responds, “What if we just made it easier?”)