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.**
- **2. Markets move toward equilibrium.**
- **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?

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.

- **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.**

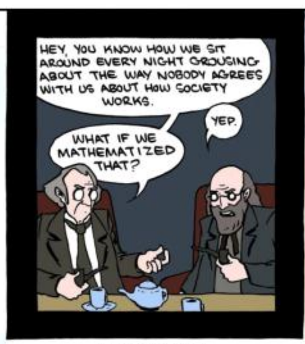
Markets usually lead to efficiency.

- **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.**



Before Economics.