

The Economic Way of Thinking

“Making Good Decisions”

The economic way of thinking can help you make good choices. Very simply, all you need to do is to consider the costs and the benefits of each choice before you make a decision! By doing this, you can be confident in your choices and avoid negative consequences in the future. That is what economics and the economic way of thinking is all about!

People Make Choices

- Resources are limited
- Wants and needs are unlimited
- People have to choose
- Every choice has an opportunity cost



Opportunity Cost



You have already learned that due to scarcity there are not enough resources for everyone to have everything they want and need. Time, space, and money are limited but our wants and needs are unlimited. Suppose you have saved two thousand dollars for a car. After searching the Internet and local car lots, you have found two cars that meet your needs. You must choose between the two cars because you only have enough money for one of them and you can only drive one car at a time anyway. You have to decide which of the two cars best fits your needs and has the features you want. The car that you choose not to purchase is your opportunity cost, the second best alternative that you give up in order to purchase the other car.

How Do Incentives Affect Our Choices?

- Incentives – benefits that affect your choices
 - Rewards
- Disincentives – costs that affect your choices
 - Penalties



Opportunity Cost

An incentive is something positive that you get when you make a choice. Incentives can affect our choices. Let's say that your mom says she will give you twenty dollars if you ace your finance test tomorrow. The twenty dollars is a monetary incentive. Suppose several of your friends are going to the movies tonight, but you have the test in finance class tomorrow. You decide to stay home and study for the test. Going to the movies with your friends is your opportunity cost. Your mom's incentive probably influenced your decision to stay home instead of going to the movies.

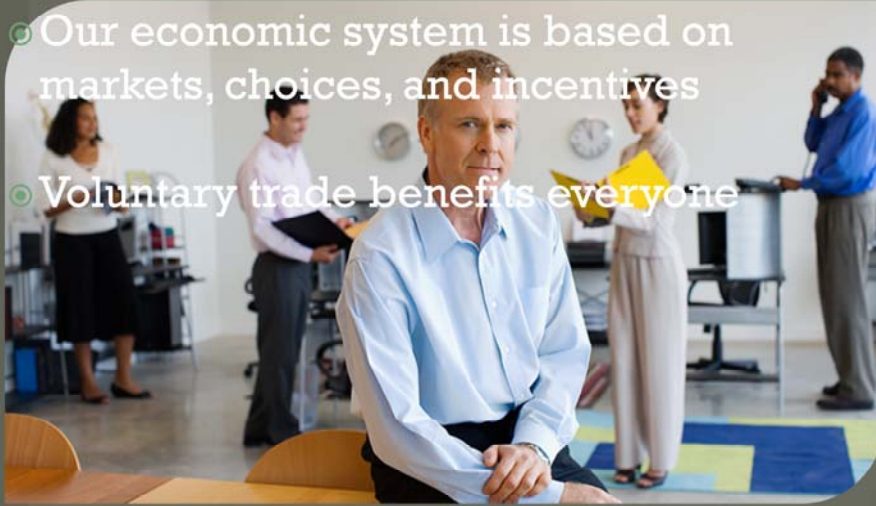
Incentives can be non-monetary as well. Suppose instead of twenty dollars, your mom said she will let you stay out one hour later than usual on Friday night if you ace the test. This is a non-monetary reward or incentive.

A disincentive is something negative that affects your choices. For example, suppose your mom says that if you don't get an "A" on the finance test, you will be grounded for the weekend. This penalty or disincentive will probably make you study harder for the test so you won't get grounded!

Incentives and disincentives work the same way in economics. They encourage or discourage people to make certain choices.

How Does our Economic System Influence our Choices?

- Our economic system is based on markets, choices, and incentives
- Voluntary trade benefits everyone



Our economic system was established by people who wanted more freedom and opportunities. Americans are free to make choices about many things. You can choose to start your own business or work for someone else. You can also choose to buy from a huge variety of goods and services. You can even choose to buy with cash or credit. You have all of these choices because the United States is a free market economy.

Supply and demand is influenced by incentives too. Businesses decide what to produce and sell based largely on the profit they will make. That profit is their incentive to produce what we will buy. The purchases you choose to make are also influenced by incentives – what you will gain from the purchase! So, our economic system is based on people's choices and the incentives that influence those choices.

Another key element of our economic system is voluntary trade. Voluntary means that you do something because you want to, not because someone tells you that you must do it. Americans trade every day. You trade cash for a Whopper at Burger King. You trade your time and effort for a paycheck. Free trade is a huge part of our economic system. Businesses benefit from trade because they get your money. The economy benefits from trade because people are spending money which stimulates growth. However, if you don't make good choices when you trade, you may not be as happy with your choices as you thought you would be. That is why it is important to use the economic way of thinking and carefully evaluate each alternative for its costs and benefits to you!

How Do Consequences Affect Our Choices?

- Consequences – the positive or negative results of behaviors and/or choices



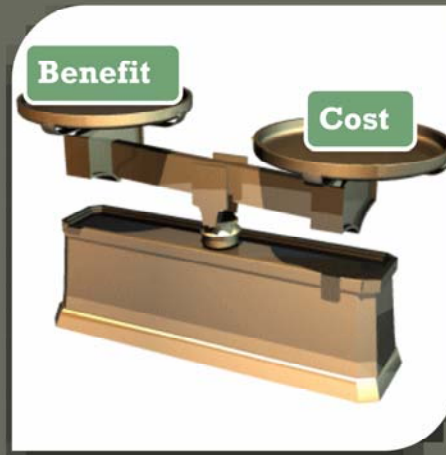
Before you make a choice, you need to consider the results or consequences that may occur because of your choice. For example, you decide not to study for that finance test. The consequence of that choice could be a bad grade on the test, which will also affect your overall grade in the class. It could also affect you in other ways, such as disappointing your parents.

Some consequences are fairly easy to predict, but others may not be so obvious. Suppose you put some questionable pictures of yourself on your Facebook page. The obvious consequence might be that your parents ground you and take away your Internet privileges. They might also lose trust in you. What you may not know is that many colleges and businesses are looking at the Facebook pages of their prospective students and employees. Those pictures might prevent you from getting into the college of your choice or from getting the job you want.

When you make choices, you have to decide if the consequences are worth the rewards you get from your choice. In other words, the choices you make today will affect your future. So, it is important that you make good choices!

Marginal Benefit/Marginal Cost Rule

- If the marginal benefit of an action is greater than the marginal cost, **go for it!**
- If the marginal cost of an action is greater than the marginal benefit, **don't do it!**



Remember, in economics, marginal simply means additional. Economists have a rule called the marginal benefit/marginal cost rule. To use this rule when making decisions, all you have to do is analyze each choice for its costs and benefits. If the benefits outweigh the costs, it is a good choice. If the costs are higher than the benefits, it is probably not a good choice and you may want to consider other options.

Let's go back to the earlier example about the two thousand dollars you saved for a car. Remember, you had two very similar cars to choose from. Let's say that the first car is one thousand eight hundred dollars but you will have to wait two weeks before you can actually take it home. Suppose the second car is two thousand dollars but you can drive it home today. With the first car you have the benefit of keeping two hundred dollars in your pocket, but you have the cost of waiting two weeks to get your car. With the second car you have the benefit of taking the car home today, but you have the cost of an extra two hundred dollars. You may think, I already saved the two thousand dollars, I want my car *now*. Suppose the first car has a sunroof but the second car doesn't. That one marginal or additional benefit may make you decide to wait two weeks for the first car!

You can see that there is a lot to consider when making choices – especially economic ones. If you use the economic way of thinking, you will make better choices because you have considered the incentives (benefits) and the consequences (costs) for each alternative and picked the option that best meets your wants and needs.

Scenario

Let's look at a real-world example to see how the Economic Way of Thinking helps to explain people's actions.

If you go to the movies a lot, I'm sure you experience this situation all the time.



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Scenario:


Every time I walk out of a movie theater, I have to step over empty soda cups, popcorn buckets, and discarded candy wrappers. Most people feel comfortable just leaving this garbage on the floor instead of throwing it away in the trash cans at the exits. People don't treat their own homes this way – they don't leave popcorn and soda containers all over their living room floors.

So why don't people throw their trash out at the movie theater? Let's use The Economic Way of Thinking principles to help us with this mystery.

So why don't people throw their trash out at the movie theater?

Introduction

Let's use The Economic Way of Thinking principles to help us with this mystery:



People choose.

People's choices involve costs.

People respond to incentives in predictable ways.

People gain when they trade voluntarily.

People create economic systems that influence decisions.

PROPERTIES
Allow user to leave interaction:
Show 'Next Slide' Button:
Completion Button Label:

After viewing all the steps
Show upon completion
Next Slide

Properties...

Edit in Engage