ECONOMIC PRINCIPLE #1
Scarcity Forces Tradeoffs

There are a lot of things we want in life. If you think about it our wants or desires are unlimited. Once we get one thing there always seems to be something else that we “really want” to get. Just think about cell phones. There are always new and better models coming up that can do more than then one we just bought.

The problem is that there are not unlimited resources to go with our unlimited wants. In other words, there are not enough goods and services in the world to ensure that everyone gets what they want. This idea is called scarcity. There will never be enough of everything to satisfy everyone.

Because of scarcity people are forced to make choices. When you choose one item over another you are making a tradeoff. You are trading away – or giving up – one thing that you want so that you can get something that you want even more. Remember, what you gave up (or traded) is your opportunity cost. This first principle is key to moving forward in economics. It continually reminds us that “We Can’t Always Get What We Want.” However, you may think that your parents give you whatever you want – so how does this principle apply to you? The bottom line is that even you are forced to make choices. You can’t have one of everything! And, even if it seems like you get a lot, there are others in the world who do not. This principle is a global principle. Scarcity exists; sometimes it is just hard for us to see. Think of it as the “no-free-lunch principle.” If your lunch was free someone else still had to pay for that food.

Remember also that the choices, or tradeoffs, we make are subjective. In other words, choices are personal. You may look at the costs vs. the benefits of a choice in one way, while someone else looks at it in a different way. The choices you make may not match the choices they make. Knowing and understanding this principle can help us realize how important decision-making really is. Making a decision requires us to evaluate our options, look at the costs and benefits of all alternatives, and make the choice that is right for us.

Now go to your chart and fill in the line for the first principle. When you are thinking of your examples I want you to think about big choices that could be coming up in your future and list two options that you might choose from for these examples. Make sure you come up with some good real-world examples for this principle - put some thought into them. After you have thought of your examples pick one to use throughout this entire exercise. Highlight it or circle it on your chart.

Important: Before you go on to the next principle make sure you get your example choice approved by your teacher. You are going to use this example throughout this lesson so it must be approved.
ECONOMIC PRINCIPLE #2

Costs vs. Benefits

If scarcity is a fact of life and we aren’t going to get everything we want than we need to make the decision that is best for us. This involves weighing the costs of the alternatives against the benefits. Costs aren’t always based on money though. Although money is one cost, there are others, such as time, amount of effort, the effects on ourselves and/or others, other sacrifices you make to get it. Benefits are what you gain from making one choice over another. These include money, time, a good experience, some improvement in your life.

Examining the costs vs. the benefits is called doing a cost-benefit analysis. Sometimes we analyze in our heads because it is a quick decision that does not involves a lot of thought. Other times we spend more time on a decision and may actually write down and compare the costs and benefits, or we may discuss it with friends and family members. Either way, every decision we make should involve an analysis of the costs and benefits.

The Costs vs. Benefits Principle means that people will choose the alternatives that they see as having the greatest benefits at the least costs. Opportunity costs are simply the benefits of the next best alternative we gave up. Remember also that the choices we make are based on what we think will happen in the future. No one knows for certain what the future holds but we look at the expected costs vs. the expected benefits when we make a decision. With small decisions there might be little risk involved. However, when we are making big decisions we don’t always know what the future may hold and how our choices might change that future.

We just do the best we can with the information we have at the time we are making the decision.

Go to your chart and fill in the line for the second principle. Using your chosen example from the first principle do a cost-benefit analysis on that example for the “Real-World Box” in your chart. After weighing your costs and benefits make a decision between the two alternatives and underline it.
ECONOMIC PRINCIPLE #3  
*People Think at the Margin*

All or nothing decisions are pretty rare. Most of our daily decisions involve increments: a little more of this and a little less of that. For example, should I eat two pieces of pizza or three? Deciding whether to eat the third piece of pizza is an **incremental decision**. The decision isn’t all or nothing. We don’t have to choose between eating three pieces of pizza or eating no pizza at all. Each time we choose to eat another piece of pizza we are making a decision at the **margin**. And because we chose to eat three pieces of pizza this time does not mean we have to make that choice every time.

The margin is simply the term for the border or outer edge of something. In the pizza example you could think of the margin as your level or the outer limits of your hunger. Every decision has a margin. When we make a decision at the margin we look at **marginal costs vs. marginal benefits**. Remember, even when it is not an all-or-nothing decision we still weigh the costs and benefits. What are the costs of eating that third piece of pizza? You might be too full and not feel well. What about the calories and fat in each slice of pizza? You might get heartburn later. The third piece just never tastes as good as the first. On the other hand, look at the benefits. Your hunger may be satisfied. It could be a long time until the next meal and it will keep you feeling full. It tastes great and you enjoy it. Once you have weighed the marginal costs vs. the marginal benefits you make your choice on the third piece of pizza.

The **marginal cost** is what you gave up to add the one extra unit, in this case the third slice of pizza. The **marginal benefit** is what you gained.

Now go to your chart and fill in the line for the third principle. Continue using your chosen example. Although you have made your choice it doesn't mean your choices are over. Looking at your example list some of the marginal choices that you will now need to make based on that choice.
ECONOMIC PRINCIPLE #4
Incentives Matter

We know from Principle #2 that weighing the costs against the benefits really matters. We almost always make a decision based on where we see the highest benefits. Benefits are like incentives that help us make our choice. We all know that incentives really do matter. Why do you think I give grades in this class? They are an incentive offered for you to do the best job possible. What about my learning readiness grade? This grade is an incentive for you to show up on time, do your homework, and participate in my class. I want you to succeed so I offer incentives to help you along the way.

Sometimes we encounter negative incentives. Negative incentives are used in the hopes that they will discourage some behavior that we don’t want to see in you. Look in the front of your agenda and you will see some negative incentives. The cell phone policy is a negative incentive. Your phone will get taken away if we see it. If you don’t want your phone taken away than don’t get it out. Two tardies equaling an unexcused absence is also a negative incentive.

So incentives are basically rewards or punishments that influence your decision. We also know that incentives change behavior in very predictable ways; that’s why they are used all the time. Traffic laws have been successful in raising drivers’ safety. Lawmakers know that people will try to follow the rules; that’s why they create these laws – and they work!!

Sometimes negative incentives can be used in conjunction with positive ones. I give you a positive incentive for being on time by offering a good learning readiness grade while the school offers a negative incentive, as stated above with the tardy policy. Why? It’s not hard to figure out. We want you to be on time to class and ready to learn. If you’ve got to be at school than you might as well make the most of it.

Now go to your chart and fill in the line for the fourth principle. Continue using your chosen example. Think about the incentives that were used to get you to make the choice you did. What are some of those incentives? Think of different incentives than those you listed already in your cost-benefit analysis. Make sure you have both positive and negative incentives in your example.
ECONOMIC PRINCIPLE #5
Trade Makes People Better Off

Now we are going to switch our train of thought a little bit. Move your thoughts away from your "big decision" and on to the broader concept of trade. This takes us to our fifth principle: Trade Makes People Better Off.

We can't do everything perfectly. Do you have your own farm and grow all your food? Do you weave the fabric for your clothes and sew them together? Would you even know where to start in order to weave your own clothes? Probably not. That's why we trade. We figure out what we are good at and concentrate our efforts in that area. That's called work specialization. Specialization allows people to produce more because they are concentrating on what they do best. This creates efficiency. We trade our surplus goods or services for someone else's or we trade our efforts for the efforts of someone else. Nowadays, trade is usually done using money for the transactions. The tailor doesn't drive to the farm and trade a pair of jeans for a bushel of apples. They go to the grocery store and use money to pay for their food. In turn, the farmer goes to the mall and picks out a pair of jeans and gives money to the cashier.

Remember, price is a powerful incentive. It can be either a positive or negative incentive depending on the circumstances. When a shirt you've been eyeing goes on sale that is a positive incentive to go the store and buy it because the price is low. On the other hand, when you are shopping for a car and you really want the newest sports model, price can be a negative incentive. That Chevy Corvette is going to cost a lot more than a Chevy Cobalt. Your budget and their price may force you to make a different decision.

Voluntary trade occurs when both parties expect to benefit from the exchange. When that happens everybody wins.

Go to your chart and fill in the line for the fifth principle. Even though it may seem hard, continue using your chosen example. What are the kinds of things you are going to have to trade (think about what you might have to buy or something you might sell)? How did you or your parents get the money needed for these exchanges? How was the money earned? (That's where job specialization comes in.)
ECONOMIC PRINCIPLE #6
Markets Coordinate Trade

How exactly does trade happen? The first thing you might think of is going to a store and buying something. This is one type of market. But economists define a market as any arrangement that allows for the exchange of goods and services. When you go to the bowling alley to have fun with friends and pay for your shoes and a couple of games you have just completed a market transaction. The bowling alley is a market because it brought two different types of people together: buyers and sellers. You were the buyer (you bought games) and the seller was the worker at the bowling alley.

Markets exist online as well. When you buy from Amazon or bid on something up for auction on Ebay you are contributing to a market exchange.

Free markets, or those without many government regulations, are those where buyers and sellers trade until the exchange satisfies both of them. As a buyer, you may wait until the price comes down before you are willing to trade. Meanwhile, the seller may only be willing to go so low on their price. Both parties are weighing their costs and benefits (or marginal costs and marginal benefits) as transactions take place and making decisions based on these analyses. A free market allows both the buyer and seller the freedom to decide. This usually creates an efficient market that serves everyone’s interests.

This principle reminds people that markets do a good job at regulating exchange all on their own. Supply from the sellers and demand from the buyers drives the price of a good or service. Notice above that I said free markets “usually create an efficient market.” There are times when governments can sometimes improve market outcomes. For example, when there is a lack of competition (monopolies) or when they make laws about property rights.

Now go to your chart and fill in the line for the sixth principle. Think about the markets that were (or will be) involved in the choice you made. Record them here. Remember, a market is anywhere there is an exchange of goods or services – it doesn’t have to be an actual store.
**ECONOMIC PRINCIPLE #7**  
*Future Consequences Count*

Many times when you make a decision you are thinking only about your immediate gratification. At the beginning of this lesson I made you think about real-world examples that involve future consequences. This principle is the reason. The decisions you make today can have consequences for your future. Even the decision about what to have for breakfast can have long-term effects on your health.

When we are evaluating the decisions that other people make we should always keep this principle in mind. A good decision-maker, a good economist, will weigh the immediate costs and benefits as well as the long-term costs and benefits before making a decision. However, no one can see into the future (remember this from principle one). You are basing a decision on the *expected* costs and benefits. This involves making educated guesses about the future.

If you eat ice cream for breakfast every day this may have long-term consequences for your health. Your immediate analysis may involve the benefit of how good it will taste and the fact that you are getting some calcium in the ice cream. You are young and have a high metabolism that allows you to work off all those calories too. You may not even see a cost (unless your Mom catches you). Fast forward into the future though. You are 35 years old going in for your yearly physical. All those years of eating ice cream have caught up with you. Your doctor tells you that you need to lose a few pounds (or more than a few). Worse than that, eating all that fat and sugar has given you high cholesterol and high blood pressure. Yikes!! Did you think about that when you chose ice cream for breakfast this morning?

Since no one (at least no one that I know of) has psychic capabilities, the choices we make - based on our guesses about the future - can have outcomes that we never expected. This is called the **Law of Unintended Consequences**. Unintended consequences are those outcomes that you (and economists) did not expect or predict would happen. In fact, some economists spend their entire careers specializing in trying to figure out what the unintended consequences of a decision might be. Certainly the unintended consequences of eating ice cream for breakfast, in the example above, are high cholesterol and high blood pressure.

Go back to your chart for the last time – yeah!! Fill in the line for the seventh principle. Look at the long-term consequences of your chosen example. Think about the long-term costs as well as the long-term benefits. Lastly, try to predict what the unintended consequences might be.

You’re done! You have now learned and applied the economic principles of reasoning. You are on your way to becoming a smart economist!