

Economic Reasoning Principles

How People Make Decisions

1. People Face Tradeoffs
 - We Exist in a State of Scarcity
 - Because Resources are Limited, People Must Make Choices
2. People Economize
 - People Choose Alternatives That *They Perceive* to Offer the Greatest Difference Between the Benefit + the Cost
3. All Choices Involve Costs
 - The Opportunity Cost of a Choice is the Benefit of the Foregone Alternative
 - Don't ask: "What *Could* I have done?" Ask: "What *Would* I Have Done?"
 - i. It's only the "next-best" alternative that matters!!!
 - Decisions are made in Light of an Unknown Future, based on *Expected Costs and Expected Benefits*
4. Rational Decisions Occur at the Margin
 - All of Nothing Decisions are Extremely Rare. Most Decisions are Best Made by Weighing the Expected Benefits + Expected Costs of the Next Increment.
5. People Respond to Incentives
 - When Incentives Change, People's Behavior Changes in *Predictable Ways*.
 - Incentives are Shaped by Society's Institutions, the Formal + Informal "Rules of the Game."
6. Prices are Extremely Powerful Incentives
 - Prices Change as the Relative Demand for and Supplies of Goods, Services, + Resources Change
 - Changing Prices Change People's Opportunity Costs + thus, the Choices They Make

How People Interact

7. Trade Can Make Everyone Better Off
 - Voluntary Trade Occurs when Both Parties Expect to Benefit From the Exchange.
 - Giving up Things of Lesser Value for Things of Greater Value Makes all Parties to the Exchange Better Off
 - Specialization Allows People to Produce More by Concentrating on what They do Best + Trading their Surplus Goods or Services to Obtain Other Goods + Services
8. Markets are Usually a Good Way to Organize Economic Activity
 - Market Institutions Which Govern Exchange in the Economy Enhance Personal Freedom by Allowing People to Make Decisions in Light of Their Perceptions of the Expected Costs + Benefits that They Face
9. Governments can Sometimes Improve Market Outcomes
 - Defining + Enforcing Property Rights, Correcting for Externalities, Maintaining Competition, Free-Rider Problems, + the Desire to Promote Social Goals like Equity, + Security, are Areas in Which Government is involved in the Economy. The Pertinent Question when Considering Government Action is "Do the Benefits of the Action Outweigh the Costs?"

How the Economy Works as a Whole

10. Individual + National Standards of Living Depend on the Ability to Produce Goods + Services
 - Increased Labor Productivity Raises Incomes + Standard of Living. Productivity Levels are Dependent upon Education, Technology, and Investment in Capital Goods.