Economics and Choice

Teacher Guide

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Abstract

The purpose of the "Economics and Choice" PowerPoint lecture is to highlight two fundamental economic concepts: scarcity and opportunity cost. This lesson can be used by high school teachers in an economics course or by college instructors in an economic principles or microeconomics course.

Overview

Economics, in the simplest terms, is the study of scarcity. It is important to understand that humans, and hence society as a whole, have unlimited wants but only limited means. As such, we cannot each "have it all," and instead must make difficult choices. Whenever one choice is made, we necessarily give-up or forgo other choices. For example, if I choose to read a book, I cannot take a nap. I can do one or the other, but not both *simultaneously*. Once a choice is made, I cannot go back in time and make another choice. Therefore something is given-up or forsaken every time a decision is made. Understanding this, economists often study choices taken at the margin – i.e., how making small changes in a behavior affects overall satisfaction. If I am allocating my resources (time and money) in the best possible way, it should be impossible for me to reduce one behavior and use/spend the freed up resources in a way that makes me better off. To drive home these points, the lecture concludes with an in-class exercise.

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Detailed Notes

Defining Economics (slide 3)

The slide provides a definition of economics: *a social science that examines how people choose among the alternatives available to them*. This definition makes it clear that without scarcity, there is no need for economics (we would all have everything that we want). Because we cannot have it all, we must make hard choices.

Economic Approach to Decision Making (slide 4)

This slide is a sneak-peak/preview of the main concepts that will follow, namely that scarcity implores people to 1) make choices, 2) consider opportunity cost (a concept introduced in slide 7), and 3) pursue their self-interest. The latter concept (self-interest) is just asserted, but can be justified as a natural human response to an environment with competition for survival.

Scarcity Forces People to Make Choices (slide 5)

This slide defines scarcity and contrasts two important concepts: *scarce goods and free goods*. Basically, scarce goods, as their name implies, are limited in availability and hence scarce. If scarce goods didn't cost anything (i.e. their price was $0), people would demand more of the good than could possibly be produced. Free goods, by contrast, are not scarce and are available in (effectively) unlimited supply. Economists sometimes refer to such goods as "non-rival" – i.e. if you consume some of this good, it doesn't interfere or prevent me from consuming it. Therefore, these goods are free. The classic example is the air we breathe. Unfortunately, most goods are scarce and not free.

Scarcity ←→ Choice (slide 6)

This slide highlights the fact that scarcity necessitates that choices be made, and furthermore the nature of these choices varies with who/what is making these choices. Society must make choices concerning taxes (who pays and how much), spending programs (what to build), etc., while individuals and households make more familiar choices like what to purchase, where to live, how much to save, etc.

Finally, businesses decide what to produce, how to produce it, and how to price it (in more competitive markets, like commodities, this last point is not applicable).

Scarcity Makes Opportunity Cost Important (slide 7)

This slide defines the critical concept of opportunity cost: *the value of the best alternative that is given up when making a choice*. The concept is powerful and is used in many areas of economics, but the underlying idea is pretty straightforward: once you make a choice, you give-up your other options. For example, if I drive my car to Chicago, I give up the choice of *simultaneously* driving my car to Cincinnati. I could always turn my car around and drive to Cincinnati *after* I drive to Chicago, but life does not provide a reset button that allows me to go back in time, reclaim the time I already spent (and fuel already burned) driving to Chicago. Once those resources are gone, there is no going back.

Scarcity, Self-Interest, and Society (slide 8)

This slide talks a bit about Adam Smith, the father of modern economics. Smith was the first person to recognize the connection between scarcity, choice, and the well being of society. As a professor of moral philosophy, Smith made an amazing discovery: self-interested behavior promotes economic and social well-being. This seems odd, given that most people instinctively feel that altruism rather than greed promotes a better society. To understand how this works, you must first understand that all voluntary transactions involve a buyer and a seller, wherein the buyer is paying *less* than what she thinks something is worth (otherwise she wouldn't buy) and the seller is receiving *more* than what he thinks the item is worth (or he wouldn't sell). The *difference* between what you think something is worth and what you receive (or pay) for it is called *surplus*. Therefore, buyers and sellers, mindful of opportunity cost and not wasting scarce resources, will enter into voluntary transactions that maximize both consumers' surplus and producers' surplus.

Choices on the Margin (slides 10 and 11)

These two slides introduce the concept of marginal choices: *choosing to do a little bit more (or less) of something*. This simple concept is used in many economic models, where the small changes are measured mathematically by way of derivatives. For the purposes of this lecture, we won't go there. Instead, the concept of small/marginal changes is important in the context of determining if someone is making good choices –i.e. maximizing their personal well being by appropriately allocating their scarce resources (and thereby minimizing the opportunity costs of their decisions). The test is simple: if someone is allocating their resources (time and money) in the best possible way, it should be impossible for them to reduce one behavior and use these freed-up resources in a way that makes them better off.

<u>You Try It! (slides 12 and 13)</u>

These two slides are an in class exercise for your students. This is basically a budgeting exercise, and students have to reshuffle their scarce, take home income in order to maximize their well being and save enough money for the down payment on their first home. Opportunity cost abounds. Clearly, there are no "right" answers to this problem, as people with differing preferences will necessarily have different spending priorities. Nonetheless, the act of creating a budget drives home the concept that every dollar spent, is one less dollar that can be saved or spent on anything else. You may find it best for students to break into small groups to complete this exercise.