Friday, January 22

In the first 15 minutes, work with your group to complete the activities for Principles 1-5 in your packet.
Thinking in Terms of Costs and Benefits

A person will want to do a particular activity only if the **benefits** are greater than the **costs**. Weighing the costs and benefits of a decision is a process called **cost-benefit analysis**.

The word **marginal**, in economics, means **additional**.

- Suppose that your lunch costs $5, and that you are considering buying a soda to go with your lunch. This soda will have a cost that is in addition to your $5 meal. The additional cost is called the **marginal cost**.
Thinking in Terms of Incentives

Economists use the word incentive to describe something that encourages or motivates a person to take action.

- For example, if your parents offer you $10 to mow the lawn, the incentive, the $10, may motivate or encourage you to mow the lawn.
Thinking in Terms of Trade-Offs

- Individuals face trade-offs. More of one thing necessarily means less of something else. Often you make decisions between something you like and something you dislike. What trade-offs have you faced today?

- Societies also face trade-offs.
  - For example, the federal government has only so much money from tax revenues. If more of its tax dollars go to education, fewer are available to be spent on road and highway maintenance. What other types of trade-offs might the government consider when determining if more tax dollars should be spent on education?
    - Answers: health care, defense, etc.
Thinking in Terms of What Would Have Been

When you think in terms of “what would have been,” you begin to understand the opportunity costs for “what is.”

It takes a certain kind of vision to see what would have been, using your mind, and not your eyes.

- For example, suppose the federal government sets aside funds for a new interstate highway system. Thousands of people are hired to work on the project, and the benefits are easy to see—more jobs and better roads.

- However, there is more than meets the eye in this scenario. The taxpayers had to pay for the new highway system. What did the taxpayers give up by paying taxes to fund the new highway? They gave up the opportunity to buy goods for themselves, such as clothes, computers, and books.

- What would have been produced and consumed had the highway not been built? If more computers had been produced instead of highways, more people would have worked in the computer industry and fewer would have worked in highway construction.
Thinking in Terms of Unintended Effects

Economists often look for the unintended effects of actions that people have taken.

- If a store owner increases prices, will he necessarily make more money? Often an attempt to increase sales, by increasing prices, can lead to the unintended effect of fewer sales.
Thinking in Terms of the Small and the Big

Economics is divided into two branches: microeconomics and macroeconomics.

Microeconomics is the study of the small picture, such as the behavior and choices of individuals or a single business or industry. For example, in microeconomics, an economist would study and discuss the unemployment that exists within an industry, such as the auto industry.

Macroeconomics is the study of the big picture. Economists studying macroeconomics may look at the behavior and choices of the entire economy. To continue our example, in macroeconomics, an economist would study the unemployment that exists in the entire nation.
Two Major Branches of Economics

**ECONOMICS**

- **Microeconomics**
  - The study of small economic units such as an individual or single business firm

- **Macroeconomics**
  - The study of the “big picture,” the entire economy

<table>
<thead>
<tr>
<th>Microeconomics examples</th>
<th>Macroeconomics examples</th>
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<tr>
<td>Housing prices in your hometown</td>
<td>Housing prices nationwide</td>
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Thinking in Terms of Theories

Why is the crime rate higher in some countries than in other countries? What causes some nations to be rich and others to be poor? These questions do not have easy, obvious answers. To answer them, economists build theories.

- A **theory** is an **explanation** of how something works, designed to answer a question for which there is no obvious answer.

- Theories may not always seem **reasonable**.
  - Suppose you lived during the period of the Roman Empire and someone proposed to you that the Earth was round. At that time many would have thought this was an unreasonable theory, but today most everyone would agree that the Earth is indeed round.

- Scientists believe that we should evaluate theories based not on how they sound to us, or whether they seem right, but on how well they **predict**. If they predict well, then we should accept them.
Most of economics can be summarized in four words: People respond to incentives.

-Steven Landsburg, economist

Governments use economic incentives to influence the behavior of citizens in a way that benefits society. They create incentives through laws and through taxes.

For example, a government could pass a law prohibiting children from purchasing a product meant for use by adults. Such a law would make it difficult for children to obtain the product.

A government could also place a tax on a certain good to discourage its use. Such a tax would increase the cost of the good. For some people, the cost would then be greater than the benefit, and these people would decrease their consumption of the good.

A government could give tax benefits to encourage an activity. For example, it might provide a credit by giving taxpayers back a portion of a tax, or it might provide a deduction by allowing taxpayers to subtract a certain amount from their income before calculating their taxes. Such a credit or deduction would reduce the cost of the activity. For some people, the benefit will then be greater than the cost, and these people would increase their participation in the activity.
For each of the goals in questions 16-21, think of a government incentive that accomplishes the goal.

**EXAMPLE**

**Goal:** Decrease the consumption of alcohol.

**Incentive:**
The government taxes the manufacture and sale of alcohol. Such taxation increases the cost of alcohol. For some people, the cost is now greater than the benefit, and these people have decreased their consumption of alcohol.

16. **Goal:** Decrease smoking.

**Incentive:**
The government has passed a law that requires people to be 18 years old to purchase cigarettes. Many cities have passed laws that restrict smoking in public areas. The government uses taxes to discourage smoking.

17. **Goal:** Increase the level of education.

**Incentive:**
The government requires children to attend school and subsidizes the cost of education. The government gives tax benefits to help pay for education.

18. **Goal:** Increase the rate of private home ownership.

**Incentive:**
The government allows homeowners to deduct the interest on home (mortgage) loans from their income before calculating their income tax. The government regulates many aspects of the buying process to protect consumers.
19. **Goal:** Decrease the consumption of fuel oil.

*Incentive:*
The government taxes gasoline at a higher rate than it taxes most other goods. The government gives tax incentives for the purchase of efficient hybrid vehicles, which use less gasoline.

20. **Goal:** Increase the rate of personal spending.

*Incentive:*
The government offers various retirement savings plans that allow income to be exempt from taxation if it is saved until after the taxpayer retires.

21. **Goal:** Increase donation to charities.

*Incentive:*
The government allows givers to deduct from their income taxes at least some of what they donate to charities.
Refer to the goals and incentives in questions 16-21 as you answer questions 22 and 23.

22. What is the trade-off of using tax benefits as incentives?

   Tax benefits could reduce tax revenues and that reduction can lead to higher taxes in other areas, fewer services in other areas, or budget deficits.

23. Could any of these incentives have unintended effects? Give a specific example.

   An increase in taxes on alcohol or cigarettes could create or expand black (prohibited) markets for those goods. Also, as the number of tax loopholes increases, the tax code becomes increasingly complex and the opportunity for tax cheating increases.