

## A Guide to Economic Reasoning

*Human behavior is influenced by choices, costs, future consequences, incentives, rules and voluntary exchange.*

Life is about tradeoffs, and so is economics. In everyday life, people engage in economic reasoning. Whether consciously or unconsciously, they weigh the relative costs and benefits of each alternative when faced with a choice and then choose the one that provides them with the greatest anticipated benefits. While some decisions are obviously more important than others, the study of economics emphasizes that no decision is cost-free. Economists consider the real cost of any decision to be the best alternative not chosen.



The introduction to economic reasoning below is a decision-making model that provides a framework for making rational choices about issues affecting our everyday lives as well as broader social issues. Human behavior is influenced by choices, costs, future consequences, incentives, rules and voluntary exchange.

Here are the 6 steps in the guide to economic reasoning:

1. **People choose.** Most situations involve making choices. People evaluate the costs and benefits of different alternatives and choose the alternative that seems best to them.
2. **People's choices involve costs.** Costs do not necessarily involve money. The most important type of cost is opportunity cost: the next best alternative that people give up when they make a choice.
3. **People's choices have consequences that lie in the future.** The important costs and benefits in economic decision making are those that will appear in the future. The study of economics stresses the importance of making decisions about the future because we can influence only the future; we cannot influence things that happened in the past.
4. **People respond to incentives in predictable ways.** Incentives are actions or rewards that encourage people to act in a certain way. Incentives can be either positive or negative. When incentives change, people's behavior changes in predictable ways.
5. **People create economic systems, or rules, that influence individual choices and incentives.** How people cooperate is governed by written and unwritten rules. As the rules change, incentives – and consequently people's behaviors – change.
6. **People gain when they trade voluntarily.** People can produce goods and services at lower opportunity costs when they specialize in what they do best. Then they can trade what they produce for goods or services that would be more costly for them to produce. In this way, both sides gain.