Three Basic Questions Every Society Must Answer

1. What Goods and Services Will Be Produced?
2. How Will Goods and Services Be Produced?
3. Who Will Consume the Goods and Services?

Opportunity Cost: There's No Such Thing as a Free Lunch!

Because of scarcity, any time a choice is made, there are alternatives that are *not* chosen. More precisely, there is always one *next best* alternative that is not chosen. In economics, the value of the next best alternative is called **opportunity cost**.

Both **producers** (those who provide goods and services) and **consumers** (those who use goods and services) incur opportunity costs when making decisions. For example, the business person who uses a building to operate an insurance business cannot use the same building to produce pizzas. The consumer who uses scarce income to purchase a new carpet will have to forgo saving the money or purchasing something else. Because there are always alternative uses for limited resources, every economic decision has an opportunity cost.

A major goal of economics instruction is teaching students to recognize and evaluate opportunity costs when making decisions. As consumers, students should realize that the "cost" of buying an item is not really its price; rather, it is the most valued item that now *cannot* be bought. For producers, the opportunity cost is the next most valuable good or service that is *not* produced as a result of the decision to produce something else.

The concept of opportunity cost also relates to the use of **time**. Since time is scarce, the time spent doing one activity cannot be spent doing another. Thus, the real "cost" of watching television is not the time itself, but the most valuable other activity that could be done during that time.

The inescapable conclusion to this discussion is that there is, as the economists tell us, "no such thing as a free lunch." All resources are limited and have alternative uses. Every economic choice has an opportunity cost.

THE GUIDE TO ECONOMIC THINKING

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 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.

4. **People create *economic systems* 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.

5. **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.

6. **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.