

THEME

1



There Is No Such Thing as a Free Lunch

OVERVIEW

Student Letter

You probably don't know much about managing your money. And what you don't know could hurt you. All your life you will be spending, borrowing, saving, and investing. You will be making economic decisions as a consumer, a worker, an investor, and a citizen. You will make choices today that will have major consequences for your future.

"What occupation should I pursue?" "Should I go to college?" "Should I get a credit card?" "Are all credit cards alike?" "Should I start saving now or wait until I have more of what I need?" "Should I invest in the stock market?" "What stocks or mutual funds should I invest in?"

The evidence is that most of you are not ready to make these choices. The average score on a recent national test on personal finance given to 12th graders was 51.9 percent. That's an "F" in any class. High school students received an even lower "F" on a national test about economics. The average score was only 48 percent. Your parents didn't do much better. Adults scored 57 percent on that same economics test. At least, they almost passed.

By now you may be thinking, "So what? Get off my case. How will understanding economics and personal finance help me? It's just more stuff people want me to learn in high school."

For openers, this information might make you rich. Achieving personal wealth involves planning and making sound financial choices, such as getting an education, saving early and often, comparison shopping, developing a money-management plan, and shopping for the best loan. You might be surprised to know that most millionaires in this country did not get rich quick by winning the lottery or inheriting money from a relative. They became rich by making sound choices, including these:

- Getting a good education.
- Working long, hard, and smart.
- Learning money-management skills.
- Living below their means.
- Investing in the stock market for the long term.
- Gathering information, developing criteria, and considering the alternatives before making decisions.

Learning to make smart choices is not rocket science. It might take some work, but you can learn this stuff. Your efforts now can have a big payoff later. How about starting on your first million bucks right now?

Questions

1. How much do high school students know about personal finance and economics?

2. What is personal finance?

3. Is there a payoff for learning personal finance?



ABOUT THERE IS NO SUCH THING AS A FREE LUNCH

1. What is an FAQ? *A Frequently Asked Question!*

2. Why is there no such thing as a free lunch?

Because of scarcity, we can't have everything we want—whether it's clothes, cars, or lunches. Every time we choose something, we have to give up something else. In other words, everything has a cost.

3. Why do some people have more money than others?

They have made wiser decisions regarding education, money management, and lifestyle.

4. How will studying personal finance improve my life?

This information will help you make better choices; better choices can lead to greater wealth and a more satisfying life.

5. What is an economic way of thinking?

A reasoning process that involves considering costs as well as benefits in making decisions.

6. Why do we have to make so many decisions?

Because of scarcity, we can't have everything we want.

7. Are things getting better or worse in the United States?

Things are definitely getting better. Here are a few examples. In 1970, the average size of a new home was 1,500 square feet, and by the late 1990s, the average size was 2,150 square feet. Only 34 percent of new homes had central heat and air conditioning in 1970, while 81 percent of new homes were so equipped in the late 1990s. In 1970, 20 percent of households had no car, and only 29 percent had two or more. By the late 1990s, only eight percent of households had no car, and 62 percent had two or more. The average net worth of a household in 1970 was \$27,938, and in the late 1990s it was \$59,398. You will probably live better than your parents as long as you get a good education and make sound financial decisions. Go for it!

EXERCISE 1.1

The Millionaire Game Score Sheet

1.	True or False (circle one)	Score (-5 or +5) (Millionaire card -10 or +10)	_____
2.	True or False (circle one)	Score (-5 or +5) (Millionaire card -10 or +10)	_____
3.	True or False (circle one)	Score (-5 or +5) (Millionaire card -10 or +10)	_____
4.	True or False (circle one)	Score (-5 or +5) (Millionaire card -10 or +10)	_____
5.	True or False (circle one)	Score (-5 or +5) (Millionaire card -10 or +10)	_____
6.	True or False (circle one)	Score (-5 or +5) (Millionaire card -10 or +10)	_____
7.	True or False (circle one)	Score (-5 or +5) (Millionaire card -10 or +10)	_____
8.	True or False (circle one)	Score (-5 or +5) (Millionaire card -10 or +10)	_____
9.	True or False (circle one)	Score (-5 or +5) (Millionaire card -10 or +10)	_____
10.	True or False (circle one)	Score (-5 or +5) (Millionaire card -10 or +10)	_____
11.	True or False (circle one)	Score (-5 or +5) (Millionaire card -10 or +10)	_____
12.	True or False (circle one)	Score (-5 or +5) (Millionaire card -10 or +10)	_____
13.	True or False (circle one)	Score (-5 or +5) (Millionaire card -10 or +10)	_____
14.	True or False (circle one)	Score (-5 or +5) (Millionaire card -10 or +10)	_____
15.	True or False (circle one)	Score (-5 or +5) (Millionaire card -10 or +10)	_____

EXERCISE 2.1

A Mystery of Two Families

The Robinsons and the Meltons are two families that earn the same income, live in the same neighborhood, are of the same age, and have two children each. Yet the Robinsons are six times wealthier than the Meltons. Why is this?

The Robinsons spend time managing their money but not worrying about it. Although they never inherited a dime, Mr. and Mrs. Robinson feel they can easily send their children to college. The \$250,000 they have saved is also a good start for their retirement. Both

are working to improve their future income. Mr. Robinson is completing a college degree at night, and Mrs. Robinson has been taking weekend seminars offered at no cost by her employer. Both are hoping for promotions.

The Meltons are very worried about money. Their credit card balance keeps increasing every month. They have neither the time nor money to improve their education. Although they could sell their house for more than they owe on the mortgage, they have no savings. They hope their children will get scholarships to pay for college.



The Handy Dandy Guide

To solve the mystery of the two families, let's learn some basic points of economic reasoning that will help you make better choices. We summarize this approach to economic reasoning through the *Handy Dandy Guide*. It is based on six main ideas.

1. People choose.

This may seem obvious, but think for a minute about how many people say they "have no choice." In fact, we ALWAYS have a choice.

The Robinsons spend a few hours every week managing their money. They have a budget, record their expenses, and adjust their spending if they are "over budget." Their goal is to save 10 percent of their income each month. They investigate how to invest their savings, comparing rates of return and risks.

The Meltons feel they don't have time for this. They are thankful for their two credit cards because without them they could never get the things they want. The Meltons do spend a lot of time watching television; relaxing is important.

2. All choices involve costs.

Choices come with costs. Because the Robinsons spend time managing their money, they must give something up. Economists say there is an opportunity cost for every choice. The opportunity cost is the most valued option that you gave up because you chose what you did. The opportunity cost is your next best option.

For the Robinsons, the opportunity cost of managing their money is the television they give up. For the Meltons, the opportunity cost of watching television is managing their money.

Making good choices involves comparing the benefits and costs of any decision. The Robinsons are wealthier than the Meltons because of the choices they made.

3. People respond to incentives in predictable ways.

An incentive is a benefit or cost that influences a person's decisions.

One powerful incentive is money. Money is important because of the stuff we can buy with it and the freedom it gives us to make more choices. People work to earn money, but they also work to accomplish their goals and have a satisfying career. By managing your money more carefully, you can keep more of the benefits of your hard work by having the money to accomplish other goals.

Another incentive is interest on savings. Most people would rather have something today than tomorrow. This is why people pay interest when they borrow money and earn interest when they save it.

The incentive for the Robinsons to save is that they will have more goods and services in the future. They will also be able to achieve other goals because they can help others, spend money on recreation, and have a greater variety of choices. This is also an incentive for getting a good education. With a good education, you will earn much more in the future, understand more about the world, and have more control over your life.

4. People create economic systems that influence choices and incentives.

The American economic system relies on markets, choices, and incentives.

Americans are free to start a business, get an education, choose an occupation, and buy or not buy an incredible variety of goods and services. Americans may save or not save, rent an apartment or buy a house, buy a new car, a used car or no car, and use credit cards or pay cash. Every decision has costs and benefits. The system creates incentives that guide our behavior.

The American private-enterprise system has made the United States a land of choices and opportunities. These opportunities involve ever-present tradeoffs and choices. Of course, every choice has an opportunity cost.

The Robinsons take better advantage of the opportunities available to them. They do not view themselves as victims of too little income or of businesses that charge too high prices. Instead, they make choices to increase their future income and spend that income wisely.

5. People gain when they trade voluntarily.

"Voluntary" refers to doing something because you want to, not because someone forced you. Neither the Robinsons nor the Meltons are forced to buy goods and services. They are not forced to work for their employers. They do these things because the benefits are greater than the costs.

Of course, things can go wrong when people trade. If you don't trade carefully and gather sound information, you may find you don't benefit as much from the trade as you expected. The Robinsons take more time than the Meltons before making such decisions.

6. People's choices have consequences that lie in the future.

If you watch television and read newspaper and magazine advertisements, you may think everyone lives for today. Most people, however, also live for tomorrow. Otherwise, why would we conserve, save, and invest?

Life is not a lottery. Sound decision making—not luck—will affect your future. The choices you make today will affect your future.

The Robinsons have more wealth because they saved more and spent less than the Meltons, even though the Meltons work more. The Robinsons also get more for their income because they compare costs, benefits, and alternatives before making major purchases. Their past decisions have affected their present wealth and lifestyle.

Questions

1. What is an opportunity cost?

2. Why is opportunity cost important when you make choices?

3. Why do people want to be wealthy?

4. What difference does it make if the United States is viewed as a land of victims or a land of opportunities?

5. What is the incentive for saving?

6. Why are the Robinsons wealthier than the Meltons?

EXERCISE 2.2

The Boring School Mystery

Most high school students believe school is boring. Yet most students graduate from high school. Why do students stay in school if school is so boring? Can the Handy Dandy Guide provide the answer to this mystery?

There are many reasons to stay in school and many reasons to drop out. Yet many more students stay in school than drop out. For each of the following clues, put “S” for “stay in school” or “D” for “drop out of school.” Then use the *Handy Dandy Guide* to explain why more people stay in school than drop out.

1. _____ High school dropouts can help their families earn more money for food, shelter, and transportation than their friends in high school.
2. _____ High school graduates have higher future incomes than high school dropouts.
3. _____ High school graduates can go to college.
4. _____ High school students must follow school rules, which limit freedom.
5. _____ High school dropouts can work full-time and have a better car, clothes, and social life than their friends in high school.
6. _____ Parents want their children to stay in school.
7. _____ School activities, such as sports and music, are fun for many students.
8. _____ Increased knowledge opens up increased choices.

Questions

1. What is the cost of staying in school?

2. What is the cost of dropping out of school?

Questions (continued)

3. What is the incentive for staying in school?

4. How does the American economic system encourage people to graduate from high school?

5. Is going to high school voluntary or do you have no choice?

6. Why do some students choose to drop out of school?

7. Why do most students choose to stay in high school and graduate?

8. What are the future consequences of a decision to drop out of school or stay in school?

EXERCISE

3.1

Decision Making

A fundamental law of economics states that there is no such thing as a free lunch. There is no such thing as a free lunch because individuals, businesses, governments, and economic systems all face scarcity. Therefore, we must make decisions at the personal, business, and government levels. A wise decision involves weighing the benefits and costs of the alternatives. There is a cost to every decision.

Scarcity occurs because our resources are limited and our wants are unlimited. Scarcity exists because human wants always outstrip the limited resources available to satisfy them.

People's **wants** are never satisfied. No matter what we already have, we would like to have more. The United States is one of the richest nations in the world, but poverty still exists. Even wealthy individuals desire more. Few of us are satisfied with our education, health care, and standard of living. Many people would also like to have more income. Our wants are limited only by our imagination. Wants also change over time. Twenty years ago, few Americans had CD players, DVD players, cell phones, or computers. No one wanted a faster Internet connection.

Unfortunately, our **resources** are limited. We have only so many human resources, natural resources, and capital resources. **Human resources** are the physical, intellectual, and creative talents of people. When you get a better education, you improve your human resources. When a nation is better educated, it has more human resources—and a higher standard of living.

Natural resources are gifts of nature. Natural resources include water, forests, natural gas, oil, and climate. Natural resources are not the only resources a nation needs to become rich.

Capital resources include all the resources made and used by people to produce and distribute goods and services. Tools, factories, and office buildings are examples of capital resources. In economics, capital refers to items used to produce something else, not money. Money is just a medium of exchange used to make the buying and selling of goods and services easier. People like more money because they can use it to buy more stuff. It's the stuff that is important.

Because of scarcity, we must make choices. Every choice involves an **opportunity cost**. The opportunity cost of a decision is the next best alternative that is not chosen. It is the value of what you give up in order to get what you want.

Questions

1. Why is there no such thing as a free lunch?

2. Give some examples of natural resources, human resources, and capital resources.

A. Natural resources

B. Human resources

C. Capital resources

3. What is capital?

4. Why do economists NOT view capital as money?

5. What is an opportunity cost?

EXERCISE 3.2

Personal Decision Making

This exercise focuses on personal decision making. Our personal resources include time, money, and skills that we use to satisfy our wants. We use our personal resources to purchase goods and services. Goods are things we can touch, such as cars, houses, computers, and cell phones. Services are activities such as rock concerts, educa-

tion, movies, insurance, loans, vacations, and health care. Of course, we cannot have all the goods and services we want because of scarcity. But we can have more goods and services if we choose wisely. By carefully considering the costs and benefits of our decisions, we can improve our lives.

A College for Maria

Maria Delgado will graduate from high school this spring. She plans to attend college, but she does not know which college to attend. She is using a decision-making model in order to make a better choice. Let's work through Maria's decision using the five-step decision-making model.

STEP 1: *Define the Problem*

Maria must recognize the problem. She knows all colleges and universities are not alike, and she must choose the one that is right for her. She plans to major in marketing.

STEP 2: *List the Alternatives*

Maria has found three main alternatives. State U is a big university with 30,000 students, and it offers both undergraduate and graduate programs. Many undergraduate classes are very large; some have more than 300 students. The tuition is reasonable. The business school and the marketing program are highly ranked nationally. State U is located 150 miles from Maria's hometown.

Local Community College is a two-year college only a few miles away from Maria's house. Its classes are smaller than State U's, averaging about 40 students. There are marketing classes. While some faculty members are outstanding, Maria has heard that most do not have Ph.D.s like they do at State U. The tuition for LCC is low, and if she decides on LCC, Maria could keep her part-time job.

Private College, which has only 3,000 students, is located 200 miles from Maria's hometown in a neighboring state. The classes are small, and the students get a lot of individual attention and help. The college offers marketing courses. Its admission standards are high, but Maria is an outstanding student and thinks she has a good chance of being accepted. Tuition is expensive. Private College gives scholarships and loans, but the cost would still be higher than at State U.

STEP 3: *Identify Your Criteria*

Your criteria are personal goals you feel are important. Every person has different criteria. Maria's most important criteria are these:

- Low-cost tuition because her family is not wealthy.
- High quality education, particularly in marketing.
- Small class size and personal attention.
- Close location to home because she feels she would miss her friends.

STEP 4: *Evaluate Your Alternatives*

Maria must now evaluate her alternatives against her criteria. She has decided to use the decision-making grid shown on page 14. She will use a "+" and "-" system to evaluate each alternative. One plus sign is positive and two plus signs are even better—very positive. A minus sign is negative. Complete the grid before going to Step 5.

STEP 5: *Make a Decision*

Maria decided to attend Local Community College for two years. Cost is very important to her. By attending the community college while working part-time, she might even be able to save some money. She felt the private college had the best program for her, but it is too expensive and too far from home. The community college had the most pluses. Low cost and closeness to home were very important to her, and the community college did best on these criteria.



Maria's Decision-Making Grid

Based on the information in this exercise, use the grid to help Maria make a decision. Then answer the questions that follow.

What is the problem? _____

Fill in the boxes with + , ++ , or – , as you think Maria might have decided.

ALTERNATIVES	CRITERIA			
	Low Cost	Quality Program	Personal Attention	Close to Home
State U				
Local Community College				
Private College				

What choice do you recommend for Maria based on her criteria?

Questions

1. Why is the decision-making model important?

2. Are there any additional criteria that Maria did not consider that you feel are important in choosing a college?

3. Do you agree with Maria? Why or why not?

EXERCISE
3.3

Buying a New PC

You can use the decision-making model and grid for any consumer decision. Assume you want to buy a personal computer. Fill out the decision-making grid that follows and decide which PC to buy. Find the alternative models at electronics superstores, computer stores, or online computer

services. Develop your criteria, which could include memory, hard disk capacity, modem speed, audio and video capabilities, and processing speed. Choose the criteria that are most important to you; fill out the grid; make a choice; and justify it.

PC Decision-Making Grid

The Problem: _____

<div> <div>CRITERIA</div> <div>ALTERNATIVES</div> </div>				

The Decision: _____