**Using Economic Decision-Making Models**

**to Become Informed Decision-Makers**

**Skill (1h) in 2015 History/Social Science (Virginia SOL)**

The decision model you use depends on your question/issue and how many options you are trying to consider. See three examples below.

1. **Cost-Benefit Decision Model.** To decide whether or not to do something—when the choice is, “yes” or “no”

For example, Should I buy this particular house?

|  |  |
| --- | --- |
| **Costs**  A cost is what you give up when you decide to do something | **Benefits**  A benefit is what satisfies your wants |
| * It will cost $250,000 * The location isn’t as close to shopping and restaurants as I would like. * The kitchen and bathrooms need to be modernized * It doesn’t have a garage | * $250,000 is less than many of the houses I have looked at * I really like the floor plan * I believe it is a good value that will appreciate * There are good schools in the area |

1. **Cost-Benefit Decision Tree**. To help you decide between two choices. In essence, it combines two Cost-Benefit models.

For example, Should I buy a house in the country or a house in the city? [Or, should I buy the house on Elm Avenue or the house on Mulberry Street?]

|  |  |
| --- | --- |
| GOAL: Buy a house | |
| Choice 1 – Buy a house in the country | Choice 2 – Buy a house in the city |
| |  |  | | --- | --- | | Costs | Benefits | | * It is a long commute to work * Most of my friends live in the city | * I love the open land and have room for a garden * I can get a nicer house for the same money | | |  |  | | --- | --- | | Costs | Benefits | | * Houses are generally more expensive in the neighborhoods I like. * Taxes are higher. | * It is closer to work * I’m closer to shopping and restaurants | |

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| Final Choice |

1. **PACED Decision Model**. A more advanced model used when you have various options/alternatives but also certain things/criteria that are important to you.

Below is an example applying the PACED Decision Making Model

1. **State the problem.** Where should I live? OR Should I buy, rent, build or live with my parents?
2. **List the alternatives.** In this example, more precision regarding the alternatives would be helpful, e.g. some specific locations after some initial research; estimated cost/rent for the desired home
3. **Identify the criteria important to the person making the decision.** List them in the chart.
   1. If one or more criteria is more important than others, it can be given more weight by giving it a number above the scale. For example, if location is more important, you can double the rate you give it (e.g. a rate of 3 becomes 6 because 2 x 3 = 6)
4. **Evaluate the alternatives against the criteria.** Several methods can be used: a scale of numbers such as that below or plus (+) or minus (--)

3 = alternative meets criteria very well2 = alternative meets criteria satisfactorily  
 1 = alternative does not meet criteria satisfactorily  
 0 = alternative does not meet criteria at all

1. **Make a decision.** And, identify the opportunity cost.

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| --- | --- | --- | --- | --- | --- | --- |
| **3. Criteria**  **2. Alternatives** | best investment in the long run | monthly payment that fits my budget | flexibility to change courses | desirable location I like | three bedrooms, two baths, a garage. | **Totals** |
| **Buy a house** |  |  |  |  |  |  |
| **Rent a house** |  |  |  |  |  |  |
| **Buy land and build a house** |  |  |  |  |  |  |
| **Live with parents** |  |  |  |  |  |  |

1. **Decision \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_**

**Identify the Opportunity Cost** (i.e. second best alternative; that which was given up by making the choice that was made.)

**In each model, there is no “right” answer.** The decision made depends on the person making it, but using an appropriate decision-making model should lead to making a more informed and better choice.