Opportunity Cost Versus Choice

Learning Objectives

In this chapter, you will learn to:

1. Define the study of microeconomics
2. Describe the difference between positive and normative statements
3. Assess if an exchange will happen
4. Identify and describe how three factors of production form the basis of the circular flow of income
5. Describe how households and firms interact in two markets
6. Describe the concept of opportunity costs using the examples of guns and butter
7. Plot a production possibility curve using two examples of scarce resources
8. Describe the differences between public goods and private goods

RWE Video 1.2 Opportunity Cost Versus Choice - Tamara Woroby - 3 min 11 s

Dr. Woroby explains how scarcity leads to a problem of choice, where economists calculate the extent of sacrifice of one good made to attain one unit of another. She explains this in the context of an allocation of the government budget between "guns," representing military expenditure, and "butter," representing nonmilitary expenditure. Every additional dollar spent on guns is a dollar less spent on butter. This decision-making process demonstrates the concept of opportunity cost.

OPPORTUNITY COST VERSUS CHOICE

Opportunity cost is a very important principle in economics. Economics is how we try to satisfy unlimited wants with limited or scarce resources. We cannot have everything we want, and that means we need to make choices. A simpler definition of economics is that economics is the study of choice.

When you choose something, you get to enjoy what you chose. Economists tend to look at what you gave up. We call that opportunity cost.

Businesses, people and government make many choices every day. Corporations make profits. They can choose to share some of those profits with their workers as higher wages or the corporation can invest in capital and machinery. Every dollar spent as a worker's wage increase is one dollar less that can be invested in machinery.

Governments have to decide how to spend taxpayers' money. Economists call this a choice between guns and butter. Guns represent the expenditures that governments make on military, and butter represents all the nonmilitary expenditures, like investments in the environment, health benefits, roads and education.

How much a nation spends on guns and how much it spends on butter is a decision best left to politicians and the public. In this decision-making process, economists observe that every dollar spent on guns is a dollar that cannot be spent on butter, or on nonmilitary expenditures like butter. Every dollar spent on nonmilitary expenditures is one dollar less that can be spent on defense.

Economics is the study of choice.

Consumers face the same choices as firms and governments. When a consumer decides to go see a music concert, the money spent on the ticket is money that cannot be spent on other things, like food or clothes.

More importantly, the cost of attending that concert is not just the cost of the ticket, transportation to the concert, parking and a babysitter; it is also the cost of not doing other things during the time of the concert.

A millionaire might be able to buy every seat in the concert hall, but that millionaire cannot be in the concert hall watching the concert and, at the same time, visit a museum or attend a business conference. A person cannot be in two places at once.

The most precious commodity for any consumer is time. An hour spent reading is an hour that cannot be spent watching television. Consumers have to make choices how to budget their money and their time, and how to allocate their scarce resources in a world of unlimited desires.

These decisions by consumers, firms and governments demonstrate the concept of opportunity cost.