

OPPORTUNITY COST

KEYPOINTS:

- **Opportunity cost:** Opportunity cost is the best alternative forgone
- **Examples of opportunity costs:**
 - Buying a single branded t-shirt or buying two regular (regular brand) in place of one so that you get an extra t shirt.
 - To continue post-graduation and then take up high paying job or to take up a job immediately after graduation and start earning early in life to lessen financial burden.
 - Buying a villa in the suburbs or a 2 -bed apartment in a prime location.
- **Definition of opportunity cost in decision making of consumers, workers, producers, and governments:**
- **Opportunity cost and consumers**

Example: A local brand selling 1 litre liquid soap for \$x. The other high demand brand sells the same type and quantity of product for \$2x. Choosing the \$2x product means you just end up with half the quantity of liquid soap. So your opportunity cost is the quantity of liquid soap you received less as compared to what you would have received by opting for the local brand at the same price of \$2x

Opportunity cost and workers:

Example: Joining as a research fellow in a prestigious institute in America (a high paying job) against choosing to treating patients which is a dream you always wanted to live. Factors affecting the choice of occupation include: wages paid, promotions offered and the job satisfaction.

Opportunity cost and producers:

Example: If an artist creates a painting of Monalisa, he then cannot use the same canvas to paint Albert Einstein! So before deciding on what to produce with limited resources it is more important to consider the demand and cost of producing the goods. **So the artist could rather paint Monalisa and let the painting of Albert Einstein be his opportunity cost if there is a greater demand for Monalisa!**

Opportunity cost and the government:

Example: Government needs to give a serious thought regarding its expenditure of tax revenue. Spending excessively ;for instance on healthcare might not leave enough to be spent on educational sector. If government chooses to levy higher taxes on its people, then it generates an opportunity cost for them ; who now have to sacrifice saving money or spending on their leisure activities etc. in an effort to pay the increased taxes.

Note: There is no opportunity cost with regards to free goods. But there is an opportunity cost in producing economic goods.

BOARD EXAM QUESTIONS

M/J/17-P-12-Q2

Heavy rain caused floods in an area of a country.

What may be an opportunity cost of repairing the damage caused?

- A** the allocation of government funds to the area instead of on a new airport
- B** the cost of providing shelter for those made homeless
- C** the decline in the tourist industry in the area
- D** the loss of profits from businesses affected by the flood

CORRECT ANSWER AND EXPLANATION

1-A. Heavy rains caused floods in an area of a country. Since the government had to allocate the funds to the area instead of the new airport, this obviously became the opportunity cost, as now the making of the new airport will not be possible till funds become available in the future. The airport that could not be built was the opportunity cost.

M/J/17-P-11-Q2

Helium is a gas that is limited in supply. It takes thousands of years to form from decaying radioactive rocks. The US government holds 35% of the world's supply and has been selling its stocks. Helium is essential in medical scanners. It is also used for party balloons which some say is a wasteful alternative use of a valuable good.

Which concepts can be applied to the above statement?

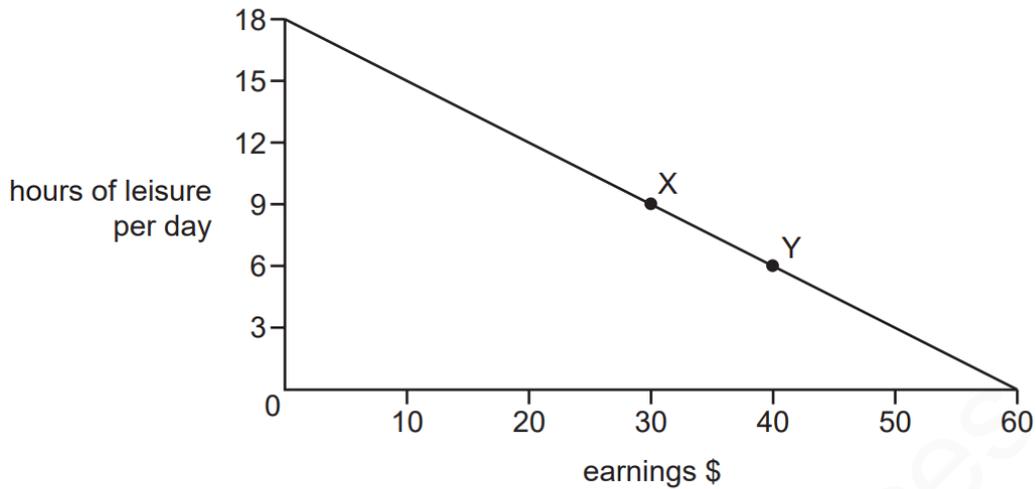
- A** demand and supply, government subsidy
- B** excess demand, resource allocation
- C** factors of production, private monopoly
- D** opportunity cost, public sector

CORRECT ANSWER AND EXPLANATION

2-D. Helium is a gas that is limited in supply. It takes thousands of years to form from decaying radioactive rocks. The US government holds 35% of the world's supply and has been selling its stocks. Helium is essential in medical scanners. It is also used for party balloons which some say is a wasteful alternative use of a valuable good.

M/J/16-P-13-Q3

The diagram shows the choices for an individual between leisure and earnings.



What is the opportunity cost to the individual of the extra earnings when moving from position X to position Y?

- A \$10
- B \$40
- C 3 hours of leisure per day
- D 6 hours of leisure per day

CORRECT ANSWER AND EXPLANATION

The concept of opportunity cost and public sector can be applied to the above information. "Public sector" because, the government is holding the stock and opportunity cost because the stocks of helium are already limited. So if a choice has to be made to use this limited resource in medical scanners , then less will be available for party balloons and vice-versa.