

A three-minute lecture on opportunity cost

Edward R. Morey

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On the table are 4 items/packages of goods (A, B, C, D)

I will often call them *bundles*.

For example, bundle A might be a used computer and a bottle of wine; B, a used Rolex watch with a green shirt; C, dinner at McDonalds with Jonny Depp and Ann Hathaway; and D, dinner for two at Frasca, a fancy restaurant here in Boulder, wine included, with whoever you want, plus a chess board.

Another item could be none of the above, *na*.

You can have one and only one of these five bundles. (You must choose one of these alternatives.)

Write down your first and second choice

Which alternative/bundle would you rank last?

What is the opportunity cost of your choice?

The opportunity cost of your choice is your second choice

By taking your first choice, you gave up your second choice—you gave up the “opportunity” of having it.

For example, my first choice would have been McDonalds with the kids, my second, the used Rolex wrapped in the green shirt—I think I look good in green.

So, for me, the opportunity cost of acquiring the Big Mac “Special,” is the watch and shirt – I gave up the watch and shirt.

Note that when I made my choice I did not give up my third, fourth, or fifth choice.

Note that there is a cost even though all of the items have a zero monetary cost.

If you ranked the bundles,

D, A, na, C, B

The opportunity cost of acquiring D, is bundle A (your second choice)

Note that even though you prefer A over the status-quo, you are “worse off” with A than with D simply because you choose D over A.

The concept of opportunity remains the same no matter what the alternatives in the choice set represent, no matter the number of alternatives in the choice set, and no matter how you feel about the alternatives relative to the current state.

The **choice** set, is simply the set of things from which you must choose. It represents your constraints.

In the first lecture, the partner set and budget set were both examples of *choice sets*.

If your ranking was

na, C, B, A, D?

You prefer none of them to one of them. So, C, B, A, and D will all make you worse off, in increasing degrees of worseness.

The opportunity cost of choosing none of the above is C, the least of the bads.

For example, C, B, A and D might be increasingly bad dates. By staying home, choosing none of the above, you gave up going out with C.

If your ranking was

D, na, C, B, A?

The opportunity cost of choosing D is “none of the above”

What does that mean?

Think it through: you prefer nothing on the table to C, B, and A, so must consider C, B, and A worse than the current state.

So by choosing D, you have given up getting none of them. By going out with D, you have given up the opportunity to stay home alone.

When determining opportunity cost, need to consider all of the costs

Assume you ranked the computer/wine first and the Rolex/shirt second, knowing that if you came home with the watch your girlfriend would immediately dump you because she hates “posers,” and wearing the watch would prove to her that you are a poser. (Economists assume you know the implications of what you do.)

But you rank the Rolex over the Frasca dinner with a chess board.

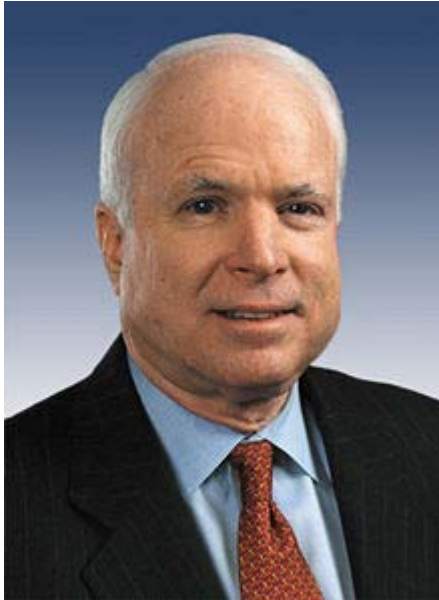
For you, the opportunity cost of taking the computer/wine is a world with the Rolex but no girlfriend. (Your second choice implies no girlfriend.)

In addition, you prefer a world with a Rolex but no girlfriend, to taking her to dinner at Frasca.

Is the opportunity cost of blatantly cheating on your rich wife simply yelling, screaming and less money?

Consider the last election.

Consider the Presidential candidate, John McCain. What would have been the cost to John McCain have been if he had pulled a “John Edwards” on his wife, Cindy, right before the election?



What is included in the opportunity cost to John Edwards of pulling a “John Edwards”?

It is the life he would be living if he had not pulled a “John Edward”. This includes stuff he would have bought that he cannot buy now because of child-care expenses for the new kid, money spent maintaining the new-kid’s mother, the money costs of breaking up with the wife, etc.

Does it include other stuff as well? He recently got arrested for breaking campaign-finance laws (campaign contribution were funneled to the “new family”). So, the opportunity cost includes not being arrested (a life “arrest-free”)

Mark (the former governor of S.C.), with wife, before



Mark after hiking the [Appalachian](#) trail with Maria





Maria Belen Shapur

Maybe part of the opportunity costs of choosing Maria, is being President of the U.S. That is, he might have been our next President if he had not done what he did.

Why do star football and basketball players often drop out of college?

Or, in the case of basketball players, not even start college.

Is the opportunity cost of going to college simply the cost of tuition?

No, the opportunity cost includes what they gave up, including the possibility of playing pro and making zillions of dollars, and funding a dog-fighting business.

By staying in college, these guys give up a rich lifestyle.

The textbook uses the example of Tiger Woods, who went to Stanford for a while, but did not graduate.

How about elite college field-hockey players?

Why are elite male basketball players more likely to drop out of college than elite female players?

The only kind of “cost” important to economists is opportunity cost

The same should be true for you.

Note that opportunity cost and monetary cost are often very different.

What if John Edward had made his decision to cheat on his dying wife solely on the basis of the monetary costs?

He would have grossly underestimated the cost.

So, I just searched the old exams on the course web page using the word “opportunity”, assuming it would pull up all the questions I have asked about “opportunity cost.” It pulled up many questions. You should now find and study those questions, to make sure you understand the concept for the quizzes and for the first midterm.

Two questions.

I have a debit card with \$20 left in the account, and for some reason the \$20 will disappear from the account by tomorrow morning if it is not spent today. My first choice is to hit the bars tonight and spend the \$20 on drinks. My second choice is to stay home, veg, and buy nothing.

It seems that the money cost of hitting the bars is \$20.

Is that \$20 part of the opportunity cost?

Is the opportunity cost necessarily \$20 or more?

and

An alternative scenario: I have \$20 in my pocket and it will still be there in the morning if I do not spend it tonight. My first choice is to spend the \$20 tonight at the movies (ticket and snack). I know if I go to the movies, I will not get in a fist fight with my roommate. I know we will fight if I stay home. My second choice is to stay home, spend the \$20 on pizza and some music downloads, and fight my roommate.

What is the opportunity cost of my going to the movies?

One more thought: consider the cost of taking a stressful job rather than your second choice, a relaxed life of poverty. How would you express the “stress component” of the opportunity cost? It would be incorrect to say that “stress is part of the opportunity cost.” It would be correct to say that “relaxation (no stress) is part of the opportunity cost of taking the job. Don’t say it backwards.