

OPPORTUNITY COSTS (I)

1. The cost of the **most desirable** alternative choice given up as a result of a decision.

How is **most desirable** determined?

2. When resources are used to make a product, the opportunity cost is what those resources could have also made.

Or

The cost of making a product is the value of the other products not produced.

OPPORTUNITY COSTS (II)

1. COST/BENEFITS

ALL COSTS

ALL BENEFITS

2. WHOSE COSTS AND BENEFITS

AN INDIVIDUAL – THE
INDIVIDUAL

A BUSINESS FIRM – SINGLE FIRM

A SOCIETY OR GROUP OF
INDIVIDUALS – THE DECISION-MAKING
PROCESS

3. SITUATIONAL

4. CONSEQUENCES

OPPORTUNITY COSTS (III)

COMPARATIVE ADVANTAGE – A COUNTRY SHOULD PRODUCE THE GOOD WITH THE LOWEST OPPORTUNITY COST, EVEN IF THAT COUNTRY HAS AN ABSOLUTE ADVANTAGE OVER OTHER PRODUCERS.

FROM THE SAME RESOURCES A COUNTRY CAN EITHER PRODUCE 4 GUNS OR 12 TONS OF BUTTER.

A SECOND COUNTRY CAN WITH THE SAME RESOURCES CAN EITHER PRODUCE 2 GUN OR 2 TONS OF BUTTER.

THE FIRST COUNTRY HAS THE ABSOLUTE ADVANTAGE IN PRODUCING BOTH PRODUCTS. IT IS MORE PRODUCTIVE IN PRODUCING BOTH PRODUCTS

THE OPPORTUNITY COSTS ARE:

FIRST COUNTRY : FOR A GUN, 3 TONS OF BUTTER

FOR A TON OF BUTTER, $\frac{1}{3}$ A GUN (LOWER OC)

SECOND COUNTRY: FOR A GUN, A TON OF BUTTER (LOWER OC)

FOR A TON OF BUTTER, A GUN

THE FIRST COUNTRY PRODUCES BUTTER AND THE SECOND COUNTRY PRODUCES GUNS. WHY? LOWER OPPORTUNITY COSTS.

SUPPOSED IF THE TWO COUNTRIES AGREED TO TRADE 2 TONS OF BUTTER FOR ONE GUN.

IF SPECIALIZATION, THEN THE SECOND COUNTRY CAN MAKE 2 GUNS AND TRADE ONE FOR 2 TONS OF BUTTER – 1 GUN AND 2 TONS OF BUTTER, A GAIN OF A TON OF BUTTER.

THE FIRST COUNTRY CAN MAKE 12 TONS OF BUTTER AND TRADE 2 TONS FOR A GUN – ONE GUN AND 10 TONS OF BUTTER, A GAIN OF A $\frac{1}{3}$ GUN

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Can save \$50 by buying a car in Concord, but getting to Concord from Exeter will cost \$10 in gasoline? A good buy? Consequences