

FINANCIAL UNIVERSITY
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Opporunity costs.

FK1-18(u)s

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Presentation plan

- 1) What is opportunity costs?
- 2) About opportunity costs.
- 3) Examples of opportunity costs.
- 4) Tasks
- 5) Conclusion

Opportunity cost is the cost of any activity measured in terms of the value of the next best alternative forgone.

Opportunity Cost



Since resources are limited and human wants are unlimited, people and societies must make choices about what they want most.



Examples of opportunity costs

Example #1: Masha has \$10 and has the option of either buying a music CD or a pair of shorts. If she goes for the pair of shorts, she does so by giving up on the opportunity of buying the CD and, hence, in this case her opportunity cost would be the CD. However, if she opts for the CD, she does so by giving up on the opportunity of buying the shorts and, hence, here her opportunity cost is the pair of shorts. In this example, the choice is not among several but only between two mutually exclusive items. However, in case of more than two mutually exclusive items also, the opportunity cost is the value of just one item and not the rest of them as only one alternative - the next best - is considered for calculating opportunity cost.

Example #2: Misha holds stocks worth \$10. He has the option of either selling them for \$15 at present or to wait for 3 months by which time the prices are expected to go further up. Being the cautious person he is, Misha decides to sell them for \$15 today as he is of the opinion that if, instead of rising the stock prices fall then he might incur a loss. By giving up on the opportunity to sell his \$10 worth stocks in future for a price higher than \$15, he is incurring an opportunity cost, the value of which would be decided 3 months later. Therefore, his opportunity cost is the future price of his stocks which may be more or less than \$15 or even lesser than \$10. From this opportunity cost example, we can see that the next best alternative need not belong to the same time frame as the selected alternative.

Calculating Opportunity Cost :)

Problem: Misha has just graduated from medical college and he has been offered a job at one of the most prestigious hospitals in town. The job would pay him \$45, 000 a year. However, his uncle, who runs a health care and fitness center, has also offered him a position for \$35, 000 a year. However, Misha wishes to enroll for a medical research program at a foreign university, which would cost him \$38, 000, and eventually does so. *Calculate his opportunity cost.*

Conclusion

Society must decide what it wants and what it is willing to give up to get it.

The same applies to you individually.

Since every economic decision requires a choice, economics is a study of trade-offs.

When you analyse each side of a trade-off, you can make better decisions.

