

Opportunities and Costs

By Dwight Lee

Audio (8:45 minutes)

Question for thought: As you listen, think about why scarcity forces us to make choices.

Markets work by facilitating social cooperation. They provide people with the information and motivation to pursue their own advantages in ways that best create opportunities for others. My emphasis is on the forest rather than the individual trees of economic understanding. Now I shall begin looking at some of the key concepts essential to applying economic reasoning to all human activity. I begin with opportunity cost.

Limits and Opportunities

Economics has been called the dismal science because it studies the most fundamental of all problems, scarcity. Because of scarcity we all face the dismal reality that there are limits to what we can do. No matter how productive we become, we can never accomplish and enjoy as much as we would like. The only thing we can do without limit is desire more. Because of scarcity, every time we do one thing we necessarily have to forgo doing something else desirable. So there is an opportunity cost to everything we do, and that cost is expressed in terms of the most valuable alternative that is sacrificed.

But the pervasiveness of costs suggests that the dismal reality of limits is only one side of a coin with a brighter side. The limits of scarcity create costs only when there are opportunities. Eliminate the opportunity to choose among alternatives and there are no costs. If, for example, I am forced to live in a particular house, take a particular job, marry a particular woman, and consume a set bundle of goods, I incur no costs when I do those things. So the bright side of costs is the opportunities that create them. Expand our opportunities and the costs of everything we do increase.

Although we commonly see cost as something to avoid, in fact we are better off living in an economy where we are forced to confront the cost of everything we do. I personally might be better off if I could consume products without having to consider their costs because I could shift them to others. But any advantage I could realize would be more than offset if others could ignore the costs of their activities and shift them to me. As a result, we would all lack the information and motivation to choose wisely. Only when the costs of choices are imposed on those who make those choices can we best use the opportunities available.

This is one way of explaining the advantage of market prices. The prices people pay in the marketplace reflect the opportunity costs of their choices. You cannot

generally purchase a good or service in a free market for less than others are willing to pay for it, or for less than the amount spent to make it available, which is an important part of the social cooperation that emerges out of market transactions.

Special Interests Don't Want Costs Considered

Unfortunately, many economic decisions are made not in a market setting in response to market prices, but by government in response to political considerations. This creates opportunities for the politically influential to acquire benefits *paid for by* the general public. Invariably, those seeking political benefits downplay the costs in the hope of justifying larger expenditures; they commonly argue that some things are so important that costs shouldn't even be considered.

Educators argue that education is too important to be considered in terms of costs; environmentalists argue that saving the earth is so imperative that environmental programs should be implemented regardless of the costs; recipients of medical research grants argue that human health trumps any crass consideration of costs; and people supported by the National Endowment for the Arts claim that the value of "art goes to the very soul of what it means to be human" and is "contaminated when compared with dollars and cents." (That's a close paraphrase of a statement on arts funding that I heard on National Public Radio.)

All these statements are best understood as attempts by organized groups to capture more public money. To consider costs has nothing to do with exaggerating the importance of money. Money provides a convenient way of expressing costs, but money is not the cost of anything. When I put down a ten-dollar bill to pay for a meal, the money may appear to be the cost, but the real cost is the opportunity cost—the subjective value I forgo by spending the money on the meal rather than spending it on the most valuable alternative.

Silly Claims

To claim that we shouldn't consider the cost of doing some things is equivalent to claiming that we should do those things without considering the alternatives. That such a transparently silly claim continues to be used in special-interest pleading illustrates the power of deception over logic in political debate. Not considering the alternatives to doing something would make sense only if it were always more valuable than anything else. But this means that we should devote all of our resources to this one thing. If it were really true that fine orchestral music, for example, was so valuable that costs shouldn't be considered, then everyone should go homeless and hungry and spend all of their time listening to orchestras in the nude. This is obviously silly, but not one bit sillier than claiming that something is so important that it is inappropriate to consider its cost.

As soon as two or more groups claim that their program should be funded without considering costs, the relevance of costs should be obvious. Educating our youth and curing our sick cannot both be too important to consider cost, not in a world of scarcity. The cost of doing more to educate our youth is doing less to cure our sick, and vice versa. To ignore the cost of one is to treat the other as unworthy in comparison.

Of course, the realities of scarcity, and the opportunity costs that result, intrude into the political process despite the special-interest rhetoric disparaging considerations of cost. Comparisons have to be made among competing alternatives, so opportunity costs are considered in the political process. Unfortunately, imperfections and biases in the political process prevent the opportunity cost of government action from being adequately considered. The result is what one should expect when alternatives are poorly considered. Waste occurs as decisions direct resources out of more valuable and into less valuable activities, and often into activities counterproductive to the stated objectives.

Market prices do not perfectly reflect opportunity costs, but one can appreciate how close they get by considering the perversities that arise because political decisions often ignore most of the costs of a policy.

Concluding question: Now, what disadvantages are associated with having our government ignore opportunity costs while trying to educate our youth, provide medical benefits to our sick and retirement to our senior population?

Citation

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***Endnote**

Slightly modified for instructors and students using Common Sense Economics (CommonSenseEconomics.com)