The Concept Of Opportunity Cost: Benefits And Challenges

The opportunity cost is the best alternative you give up to get that item (Principles Of economics, 7th Edition, 2018). In other words, it is a benefit that an individual could have enjoyed but gave up for something else. In order to understand the concept of opportunity cost, economists have made some basic assumptions:

- Human wants are unlimited in number.
- The resources required to attain these wants are limited.
- Individuals behave rationally. Individuals always make the most logical decision that gives them maximum personal utility.
- The wants of an individual differ in intensity and importance. The wants that are more important are satisfied earlier while other less important wants can be satisfied later.

Assumptions are important to economists because they make the economic processes more comprehensible and easier to understand and study. Economists use different assumptions to solve different issues. Assumptions assist in the classification of complex procedures in order to develop theory and models. These theories can then be applied to more complex circumstances for further study. To study the effects of international trade, for example, we may assume that the world consists of only two countries and that each country produces only two goods. Of course, the real world consists of dozens of countries, each of which produces thousands of different types of goods. But considering a world with only two countries and two goods, we can focus our thinking. Once we understand international trade in an imaginary world with two countries and two goods, we are in a better position to understand international trade in the more complex world in which we live (Principles Of economics, 7th Edition, 2018).

Contrary to the model of decision-making adopted by modern economic theory, in real life, humans don’t make rational decisions based on an outcome, but instead, they think in terms of gains and losses using mental heuristics that often lead them to sub-optimal choices. (Daniel Kahneman and Amos Tversky Prospect Theory in 1979). The reasons for this are:

- Firstly, it is not always possible to know the consequences of the actions. Even though an individual may learn from experience, but the circumstances usually change, and the result of a decision may vary.
- Secondly, individuals are not good at deliberating all the available opportunity costs. They tend to think in a superficial way and often fail to address all the accessible opportunity costs.
- Thirdly, we succumb to peer pressure. This is true in case of youngster who often make decisions in a hurry. However, we might be able consider the available opportunity costs and make more rational decisions as we grow older.

Economics is the study about the management of scarce resources by the society. There are unlimited needs but resources to fulfill them are limited. Therefore, people often face difficulties in making a decision because to get something they like, usually involves giving up something else that they also like. The agent does not have a superior or better method of allocating resources for any available choice (Mankiw. & Parthenakis., 2014).

Such situations are called trade-offs. So how do people make decisions in situations of trade-offs? The answer is simple: they compare the costs and benefits of alternative courses of action and make the choice which gives them the maximum satisfaction(utility). Any rational individual will choose an action that will give him the maximum net benefit and will lower his net costs. I

The concept of opportunity cost is one of the most rational approaches to decision making. However, it may not work in practise. It is impossible to consider the cost-benefit criteria in every situation that we face. Moreover, an individual may not behave rationally all the time and is prone to succumb to different societal pressures. But the it does encourage us to contemplate the choices at hand so that we are able to maximise our benefit and behave in the most rational way whenever possible in order to avoid making irrational decisions that we are likely to regret later.

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