The Three Basic Concepts to Economic Success.

These three concepts – scarcity, choice, and opportunity cost – help form the foundation for economic thinking and reasoning.

Scarcity

The study of economics begins with the concept of scarcity. Scarcity describes the condition in which our wants are greater than the resources available to satisfy those wants. We face the problem of scarcity every day whether we think about it or not. It might be nice to dream about a world without scarcity, but the sad reality is that the things we want are scarce because the resources that are needed to produce them are scarce. If you want a new skateboard, it takes wood, tools, and labor (all of which are resources) to produce that skateboard. The people who own the wood, the tools, and the labor want something in return for their use because they have other ways they could be used. If the wood were not used for skateboards, it might be used to build windows or baseball bats. Economist Thomas Sowell says it this way: “The first lesson of economics is scarcity: There is never enough of anything to satisfy all those who want it.”

Choice

This condition of limited resources to meet unlimited wants leaves us in a situation in which we must constantly choose which of our wants we will seek to satisfy. For example, because time is scarce you must choose whether you will sleep away the morning or go to school. You must choose whether to spend your allowance or save your allowance. Scarcity prohibits you from saving and spending the same dollar, you must choose. If you decide to spend it, you must choose whether you want to buy a video game or a DVD of your favorite movie. If you save your allowance, will you save it for a car or for college? On a broader level, scarcity forces society to choose how to use resources as well. Will a piece of land be used as a park or for a housing development? Will tax revenue be used for healthcare or for education?

Opportunity Cost

The next logical step is that when making choices people incur a cost. If you choose to buy a video game instead of a movie, you incur an opportunity cost. Economists define an opportunity cost as the most highly valued opportunity given up when you make a choice. So the opportunity cost of buying the video game is that you cannot buy the DVD. The opportunity cost is the opportunity lost. The opportunity cost of spending money is the lost opportunity to save the money. On a social level, the opportunity cost of using land for parks is land not available for building houses. The opportunity cost of tax revenues spent on healthcare is the lost opportunity to spend the money on education. Keep in mind that the opportunity cost is the most highly valued opportunity given up. Think about this: when your alarm clock went off this morning, you had a number of options open to you. Assuming you first chose to get out of bed, you could have chosen to:

Go to school
Watch TV, or
Go to the mall

Now, what is the opportunity cost of going to school? Is it watching TV and going to the mall? No. Because of the scarcity problem, you would have only been able to do one of those options if you weren't at school, so you are only giving up the opportunity to do one of them, more specifically the one you were most likely to do. So if you were to place a value on your choices you would choose the activity you valued most, which was go to school, your opportunity cost would be the one on which you placed the next highest value, watching television.

There is no free lunch!

This brings us to our last lesson. Nobel Laureate Milton Friedman was fond of saying, "There is no such thing as a free lunch." Imagine that the friendly neighborhood pizza restaurant set up a table full of pizza boxes outside your school about lunchtime and put up a sign that said Pizza and soda $0.00. Why wouldn't that be a free lunch? It didn't cost you anything right? Well, it may not have cost you in terms of money, but any situation which forces you to make a choice results in an opportunity cost. Or consider this: you may spend several hours this evening tweeting and texting friends at no additional monetary cost to your phone plan. You may think of this as free, but there is a cost. What opportunity did you give up? In his famous quote, Milton Friedman was reminding us of the lessons we have learned today: because of scarcity we must choose and choice means that there is an opportunity cost. So the reason there is no free lunch is that your choice to eat pizza out on the sidewalk in front of your school means that you are giving up the opportunity to dine elsewhere, such as a local burger stand. Perhaps your evening spent tweeting and texting at home was an evening not spent with other friends at a football game. These three concepts – scarcity, choice, and opportunity cost – help form the foundation for economic thinking and reasoning.

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