

NAME: _____



OPPORTUNITY COSTS AND DEMAND¹

NO NEEDS!

We have already disposed of the faulty notion that needs exist. There are, after all, substitutes for everything, even life. “Needs” turn out to be “wants” when we inspect them closely. The next question is “How urgently are these things wanted?”

Ask yourself the following questions: How many records do you want to own? What grade do you want from this course?

If you can answer any of those questions, it is because you have assumed some cost in each case. Suppose you said you want an A from this course and plan to get one. What difference would it make if the price of an A went up? The teacher isn’t taking bribes; the price of an A to you (that’s what counts) is the sacrifice you must make to get it—the opportunity cost.

Would you still want an A if it required 20 hours of study per week, whereas a B could be had for just one hour per week? You might still want it, but perhaps you would not be willing to buy it at such a high price when a fairly good substitute, a B, is so much cheaper. And that is what counts. Human wants seem to be insatiable. But when a want can only be satisfied by failing to satisfy other wants, we all moderate our desires and accept less than we would like to have.

Economists state the relationship between the amount of something people will purchase and its opportunity cost as a law. The **LAW OF DEMAND** is one of the most important doctrines in economics. It says there is a negative relationship between the quantity of a thing which people will demand and the opportunity cost of the thing. When applied to goods or services with a money price, records for instance, it goes like this: price and quantity demanded vary inversely. When the price of something goes up, the quantity of that thing which will be demanded will go down. And vice versa.

PRICE RATIONING

Scarcity exists. Because it does, societies have to make choices about who gets what. This is a political decision. In fact, politics has been defined as “the authoritative allocation of societal goods and services.” Usually, in a capitalist society (like ours), scarce goods are rationed by price. Higher prices discourage consumption because of the law of demand. Low opportunity cost uses of things are given up first.

Sometimes, even in America, people want to use some method other than price to ration scarce goods. Houston often has summer water shortages. Is raising the price of water a good way to ration scarce water? Politicians invariably say no, because water is a necessity. Uh-oh! There’s that word again. So we beg and plead, with high-cost advertising campaigns. We pass laws against watering lawns or washing cars. What do you think? Is this a good idea, or should we allow the market to allocate scarce water with the price system?

¹ This exercise is adapted from *The Economic Way of Thinking* by Dr. Paul Heyne. Chapter Four is entitled “Substitutes Everywhere: The Law of Demand.”

1. What things do people use water for?
2. Rank the things which you listed in order on the basis of the quantity of water used for each thing.
 - (1)
 - (2)
 - (3)
 - (4)
 - (5)
3. Rank the things which you listed in order on the basis of the importance the average person would impute to this use. In other words, which things are most likely to be perceived as “necessaries.”
 - (1)
 - (2)
 - (3)
 - (4)
 - (5)
4. Next to each use listed in number three (3) above, please list at least one substitute for water when used for this purpose.
5. If the price of water were increased to ten (10) times its present level, which use would be the first to be given up? _____ Which use would be the last use to be given up?

6. Propose an alternative method of allocating scarce water (that is, an alternative to price rationing) which the City of Houston could use in a draught.
7. If your scheme (from #6) limits lawn watering, would you make an exception for someone with an expensive, award-winning Bermuda grass lawn? _____ Would you allow that homeowner to “buy” lawn-watering time from his neighbors, who won’t “waste money” watering their lawn anyway? _____ If you said no, why not?

If you said yes, you have just created a valuable property right in lawn-watering time. Are you bothered by some people gaining a “windfall profit” from the misfortune of the draught?

Is there any way for the water department to get this extra profit so that it may spend it on providing more dependable water service in the future? _____ How?

8. Which method do you think would be cheaper to police (enforce), the price rationing method or your proposed alternative?
9. If price rationing keeps some people from getting “needed” water, is there some way to correct this while keeping the system? _____ What is it?
10. Texas has laws against “price gouging” in a crisis situation. In 1988, during the hurricane, several people were arrested in Galveston for violating this statute. One was a lumber yard owner who increased the price he charged for plywood when the storm was approaching. Is this OK?

Why or why not?

The lumber yard owner had offered his supplier a premium price for more plywood which his customers “needed” to board up their homes. The supplier complied, but he had to ship existing supplies of plywood from elsewhere in Texas in order to meet the demand. This was expensive. Does this change your perspective on “price-gouging?” _____

Why or why not?

Is plywood in ordinary times and for ordinary purposes exactly the same product as plywood for boarding up homes when a hurricane threatens? Why not?

What is the likely consequence (opportunity cost) of Texas’ statute against “price gouging?” In other words, what is likely to happen, or not happen, next time a hurricane approaches the Texas Gulf Coast?