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Topic :: Personal Budgeting and opportunity cost

Individuals face constraints when deciding how to spend limited income. In the example: a student receives \$ 100 per month to spend on gas (\$2 per gallon) and DVDS (\$10 each). The entertainment of these two, goods that can be purchased are shown on a budget line, which represents all possible ways of spending the full income.

On the budget line: you spend all \$100 on gas and DVDs.

Below the budget line: you spend less than \$100, leaving money for savings or other items.

Above the budget line: combinations are unattainable with the current income.

Changes in the income or prices shift the budget line:

Higher income → shift outward (more goods affordable)

Lower income → or higher income → shifts inward (fewer good affordable)

Lower prices (with same income) → shifts outward (more goods affordable)

opportunity cost is the value of alternative you give up.

At current prices, each DVD (\$10) costs the opportunity of 5 gallons of gas (\$2 each)

conversely, each gallon of gas costs one-fifth of a DVD

opportunity costs depends on relative prices, not just money prices

Even if prices rise equally (eg: DVDs \$20 & gas \$4), the trade-off remains the same (1 DVD = 5 gallons of gas)