

The opportunity cost of college

[Education](#)



The Opportunity Cost of College

What is your opportunity cost of attending college full time this year? What was the best alternative you gave up? If you held a full-time job, you have some idea of the income you gave up to attend college. Suppose you expected to earn \$20, 000 a year, after taxes, from a full-time job. As a full-time college student, you plan to work part time during the academic year and full time during the summer, earning a total of \$10, 000 after taxes. Thus, by attending college this year, you gave up after-tax earnings of \$10, 000 (= \$20, 000 - \$10, 000).

There is also the direct cost of college itself. Suppose you are paying \$6, 000 this year for in-state tuition, fees, and books at a public college (paying out-of-state rates would add another \$6, 000 to that, and attending a private college would add about \$15, 000). The opportunity cost of paying for tuition, fees, and books is what you and your family could otherwise have purchased with that money.

How about room and board? Expenses for room and board are not necessarily an opportunity cost because, even if you were not attending college, you would still need to live somewhere and eat something, though these could cost more in college. Likewise, whether or not you attended college, you would still buy goods such as CDs, clothes, and toiletries, and services such as laundry, haircuts, and DVD rentals . Your spending for such products is not an opportunity cost of attending college but the personal cost that arises regardless of what you do. So for simplicity, assume that room, board, and personal expenses are the same whether or not you attend college. The forgone earnings of \$10, 000 plus the \$6, 000 for tuition, fees, <https://assignbuster.com/the-opportunity-cost-of-college/>

and books yield an opportunity cost of \$16,000 this year for a student paying in-state rates at a public college. Opportunity cost jumps to about \$22,000 for students paying out-of-state rates and to about \$31,000 for those at private colleges. Scholarships, but not loans, would reduce your opportunity cost (why not loans?).

This analysis assumes that other things remain constant. But if, in your view, attending college is more of a pain than you expected your next best alternative to be, then the opportunity cost of attending college is even higher. In other words, if you are one of those people who find college difficult, often boring, and in most ways more unpleasant than a full-time job, then the cost in money terms understates your opportunity cost. Not only are you incurring the expense of college, but you are also forgoing a more pleasant quality of life. If, on the other hand, you believe the wild and crazy life of a college student is more enjoyable than a full-time job would be, then the dollar figures overstate your opportunity cost, because your next best alternative involves a less satisfying quality of life.

Apparently, you view college as a wise investment in your future, even though it's costly and perhaps even painful. College graduates on average earn about twice as much per year as high school graduates, a difference that exceeds \$1 million over a lifetime. These pay gains from college encourage a growing fraction of college students to pile up debts to finance their education.

Still, college is not for everyone. Some find the opportunity cost too high. For example, Bill Gates and Paul Allen dropped out of college to co-found Microsoft (Gates was the richest person on Earth in 2007; Allen ranked 19th). Tiger Woods, once an economics major at Stanford, dropped out after two

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years to earn his fortune in professional golf. And Paula Creamer, who skipped college to play golf, won her first \$1 million sooner than any LPGA player in tour history. High school basketball players who believe they are ready for the pros also skip college, as do most tennis pros. Many actors even drop out of high school to pursue their craft, including Tom Cruise, Johnny Depp, Cameron Diaz, Jim Carey, Robert DeNiro, Colin Farrell, Nicole Kidman, Jude Law, Demi Moore, Keanu Reeves, Kiefer Sutherland, Hilary Swank, Charlize Theron, and Kate Winslet.

SOURCES: "Tuition and Fees, 2006-7," Chronicle of Higher Education Facts and Figures, <http://chronicle.com/stats/tuition/>; Hillary Chura, "Cracking the Books for Financial Aid to College," New York Times, 27 January 2007; "The World's Billionaires," Forbes, 8 March 2007; and "College Board Connect to College Success" at <http://www.collegeboard.com/>.

Rules of the Game and Economic Development

Rules of the game can affect the PPF by either nurturing or discouraging economic development. Businesses supply jobs, tax revenue, and consumer products, but business is risky even in the best of times. How hard is it for an entrepreneur to start a business, import products for sale, comply with tax laws, and settle business disputes? A composite measure developed by the World Bank, a nonprofit international organization, rolls answers to all these questions into a single measure and ranks 175 countries from best to worst in terms of their ease of doing business. Exhibit 3 lists the easiest ten and the worst ten countries. The countries with the friendliest business climate all have a high standard of living and a sophisticated economy. The United States ranks third best, behind Singapore and New Zealand. The ten most difficult countries for doing business all have a low standard of living and a

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poor economy. Nine of the ten are in Africa.

Consider, for example, the burden facing a business that wants to sell an imported product. No business in the African country of Burundi makes bicycles, so a shop selling bicycles there must import them. Bicycles are shipped to Burundi via a port in Tanzania. In all, it takes the shop owner 19 documents, 55 official signatures, and 124 days to get the bicycles from the port in Tanzania to the bicycle shop. Contrast this with 3 documents, 1 official signature, and 5 days needed to import products in Denmark. Burundi is the poorest country on Earth, based on per capita income. Denmark is among the richest, with a per capita income more than fifty times that of Burundi.

How does the burden imposed by business taxes differ across countries? In the Eastern European country of Belarus, a business is subject to 11 different taxes that total 122 percent of profit. So all business profit and more are eaten up by taxes, in the process destroying the main incentive to even open a business. Worse yet, just to comply with tax laws, a Belarus business owner must make 113 tax payments to three government agencies and spend 1,188 hours on tax preparation. The high tax rate and excessive paperwork make Belarus's tax system among the world's most burdensome. Meanwhile, a business in Hong Kong pays only two taxes totaling 14 percent of profit. Complying with business tax laws there requires only one annual electronic filing and about 80 hours of tax preparation.

Another measure of rules of the game is the effectiveness and reliability of the nation's courts in resolving business disputes. The owner of a textiles business in East Timor never uses the court system, nor does any business the owner deals with. To collect a \$1,000 debt through the court system, for

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example, a business owner in East Timor would have to pay \$1, 800 in court and attorney fees, undertake 69 procedures, and wait more than three years. In Denmark, on the other hand, collecting that same debt through the court system costs \$65 dollars, requires only 15 procedures, and take only six months.

Of course, some level of business regulation and taxation is necessary to ensure public health and safety and to nurture market competition. Few would argue, however, the world's most prosperous economies have allowed businesses to go wild. But why would a country impose taxes and regulations so severe as to kill business development, thereby choking off the jobs, taxes, and consumer products that go with it? One possible explanation is that many countries with the worst business climate were once under colonial rule and have not yet developed the administrative cadre to operate government efficiently. Another possibility is that governments in poor countries usually offers the most attractive jobs around. Politicians there create government jobs for friends, relatives, and supporters. Overseeing bureaucratic regulations give all these people something to do, and higher taxes are needed to pay the salaries of all these political cronies.

Perhaps the darkest explanation for the bad business climate in some countries is that business regulations and tax laws provide government bureaucrats with more opportunities for graft and corruption. For example, the more government signatures needed to execute a business transaction, the more opportunities to seek bribes. In other words, obstacles are put in the way of business so that government bureaucrats can demand bribes to circumvent those obstacles. Even Irish rocker Bono, a long-time advocate of aid to Africa, has called for “ advances in fighting the evils of corruption in <https://assignbuster.com/the-opportunity-cost-of-college/>

Africa.” Regardless of the explanation, poor countries are poor in part because they have not yet developed the rules of the game that nurture a prosperous economy.

SOURCE: Doing Business in 2007: Comparing Business Regulations, World Bank Publications, <http://www.doingbusiness.org/>; and Bono, “ A Time for Miracles,” Time, 2 April 2007.

1. (Case Study: The Opportunity Cost of College) During the Vietnam War period, colleges and universities were overflowing with students. Was this bumper crop of students caused by a greater expected return on a college education or by a change in the opportunity cost of attending college?

Explain.

According to a website livinghistoryfarm.org (2009) the reason why colleges were overflowing with enrollment during that period is because a lot of young men didn't want to be drafted for the war. The recruitment started from 1948 to 1973 and one exemption from being drafted then was being in college. Because of this trend, many colleges even in rural areas sprouted all over the country but eventually folded up after the war. This mean that college education was seen as an excuse from being drafted since anti-war sentiments were very popular that time too.

If one is to look at the trend on an economic viewpoint, the reason for this was the change in opportunity cost since it would be more economically advantageous to attend college than get drafted for the war.

Source: http://www.livinghistoryfarm.org/farminginth50s/life_08.html

2. (Case Study: Rules of the Game and Economic Development) Why is the standard of living higher in countries where doing business is easier? Why do governments collect any taxes or impose any regulations at all?

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The standard of living is higher in countries where doing business is easier because there are many investors in such countries. Take the case of Thailand where MNCs thrive because it's easy to operate and labor is cheap. Even on a domestic level, GDP is high in these countries since local businesses are encouraged to make business since business licensing and processing is easier. It is a necessity for governments to collect taxes since it is the lifeblood of a country. Regulations have to be imposed so that free trade would not be abused. An example of abuse would be monopoly. Also, regulations are important to protect the domestic industry of a country.