

Cost Types Comparison Reference

Quick reference for opportunity cost formulas, cost types, and incentives

The Opportunity Cost Formula

$$\text{Total Economic Cost} = \text{Explicit Costs} + \text{Implicit Costs}$$

Opportunity Cost = Value of the Next Best Alternative Forgone

Explicit Costs: Direct, out-of-pocket payments (money you spend)

Implicit Costs: Opportunity costs (value of what you give up)

Explicit vs. Implicit Costs

Explicit Costs

Definition: Direct, out-of-pocket payments. Money that actually leaves your wallet or bank account.

Characteristics:

- Easy to measure and track
- Shows up in bank statements
- Appears on receipts
- Visible and obvious

Examples:

College tuition

Rent or mortgage

Car payments

Groceries

Gas

Implicit Costs (Opportunity Costs)

Definition: The value of what you give up when you make a choice. Money you COULD have earned or saved.

Characteristics:

- Harder to measure
- Invisible in bank accounts
- Often LARGER than explicit
- Includes time value

Examples:

Forgone earnings

Lost investment returns

Time spent elsewhere

Interest not earned

Inflation losses

Real-World Scenario Examples

Scenario	Explicit Cost	Implicit Cost	Total Economic Cost
4-Year College	\$120,000 (tuition, books, room)	\$140,000 (4 yrs x \$35k salary)	\$260,000

Scenario	Explicit Cost	Implicit Cost	Total Economic Cost
Buy \$25,000 Car	\$25,000 (purchase price)	\$29,000 (lost investment growth)	\$54,000
\$10k in Checking (1 yr)	\$0 (no fees)	\$700 (lost interest + inflation)	\$700
Study 4 Hours	\$0 (studying is free)	\$60 (4 hrs x \$15/hr wages)	\$60

Types of Incentives

Positive Incentives

Rewards that encourage a behavior

Examples: Tax credits, bonuses, discounts, rewards for savings milestones

Negative Incentives

Penalties that discourage a behavior

Examples: Fines, taxes, penalties, late fees, missing out on rewards

Structural Incentives

Systems that make behaviors easier or harder

Examples: Automatic savings, app blockers, separate accounts, default settings

Social Incentives

Peer pressure and accountability

Examples: Public commitments, accountability partners, friendly competition

Key Insights to Remember

- **Implicit costs are often larger** than explicit costs, but people ignore them because they're invisible.
- **Your time has value** - every hour spent on one thing is an hour not spent on something else.
- **The "free" option usually isn't free** - it has implicit costs (your time, forgone opportunities).
- **To make smart decisions**, calculate BOTH types of costs, not just money spent.
- **Design incentives** that align with your values to achieve financial goals.

PFL Academy - L-49: Scarcity, Opportunity Cost, and Incentives | Reference Sheet