

BANKNOTES

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Opportunity Cost

By L. Carlos Lara

In his book, “Becoming Your Own Banker,” author R. Nelson Nash walks the reader methodically through several important concepts that are instrumental in understanding the process of privatized banking. These concepts, he insists, are quite simple to comprehend if you will make use of your imagination, reason and logic. Regretfully, this is the beginning point of many of our difficulties. We simply lack practice in the use of one or all three of these mental disciplines. For this reason, rereading his book or attending one of his seminars is always beneficial. What we want most is a clear understanding of these concepts because, as he tells us, “*if you understand what’s happening, you’ll know what to do.*”¹

We must not overlook Nelson Nash’s expectation that we read and study, not only his book, but also the books of other great thinkers. He wants us to become great thinkers, too. Just glance at the extensive reading list in the appendix of his book. Texts cited there are all complementary readings and support the wisdom contained in his book. More importantly, let’s not miss the fact that many of these books are based on Austrian economics, a significant clue to understanding Nash’s concepts. Notice that on the back cover of the book, “How Privatized Banking Really Works,” Nelson Nash wrote this comment:

“At long last, two prominent thinkers of the Austrian School of Thought see that dividend-paying Whole Life Insurance is Austrian economics in action. Lara and Murphy have done a fantastic job of isolating this truth. They have fulfilled my dream of over 25 years.”²

In essence, the more you read and study Austrian economics the clearer Nash’s concepts become.

In previous articles, we have isolated several of Nash’s concepts in an attempt to help clarify their use in the practice of privatized banking. In this article, we will attempt to explain one more. This is the concept of opportunity cost. To understand the Infinite Banking Concept (IBC) is to understand opportunity cost and vice versa.

Opportunity cost is probably the single most important concept in economics. Nash first mentions the term on page 23 of his book. This comes under the section “Creating Your Own Banking System.” Notice that he highlights it by saying:

IN THIS MONTH’S ISSUE:

- Opportunity Cost



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“The very first principle that must be understood (in privatized banking) is that you finance everything that you buy—you either pay interest to someone else or you give up interest you could have earned otherwise. The alternate use of money must always be reckoned with.”³

The word “alternate” in this statement is the key word to focus on. Opportunity cost is found in the alternate choice, not in the choice you actually make. Here is where your wheels must start turning in order to grasp this valuable concept. Opportunity cost is about what is given up to get something else. It’s about the choices that we have to make and the sacrifices we have to make when we make them. We all have choices to make and every choice means having to give up something else. The opportunity cost is the one choice you do not choose—the option. It’s the one choice you don’t make, and its worth—its cost.

If we switch our focus from choices of spending money to another scarce resource, our time—perhaps we can better illustrate our point. We all have twenty-four hours in a day. To use time in one place instead of another means that not doing something that you could have done involves sacrificing the other thing. You are giving it up. That is your cost—your opportunity cost. As you can see, the basic idea of trade-off is very much involved in this process of choosing.

Analyzing opportunity cost is indispensable in assessing the true cost of any choice or course of action. To ignore opportunity cost may create the false impression that the benefits of the next-best alternative choice cost nothing when in fact there are unseen hidden costs to any course of action. This is Nash’s basic message to us and why he continually points to the concept of Economic Value Added (EVA), first on page 23, then again on page 39, and again on page 41. Here is his bottom line:

“In summary, before being introduced to EVA, corporations were borrowing capital from banks and paying interest—but they were treating their own capital (equity) as if it had no cost! When they were brought face-to-face with the error of their ways and conducted their business with this fact in the equation, then profitability increased dramatically. ...All the concept amounts to (Nash says) is the recognition of the fact that your own capital has a cost of money as well as that which has been borrowed from banks.”⁴

In other words, “There ain’t no such thing as a free lunch.”⁵ Even if something appears to be free, there is always a cost even though the cost may be hidden. I can think of no better definition of opportunity cost than this.

THE AUSTRIAN PERSPECTIVE

Opportunity cost, however, can have a much more profound interpretation than what we have examined thus far. There is a deeper perspective within this concept, other than the idea that it’s impossible to get something for nothing. If we see it correctly, we become aware that when an individual or group gets something at “no cost,” somebody else actually pays for it.

Nothing explains this overarching Austrian perspective more clearly than the “parable of the broken window,” by Frederic Bastiat in his 1850 essay, “That Which Is Seen and That Which Is Unseen.” Here is what the parable says:

Have you ever witnessed the anger of the good shopkeeper, James Goodfellow, when his careless son happened to break a pane of glass? If you have been present at such a scene, you will most assuredly bear witness to the fact that every one of the spectators were there even thirty of them, by common consent apparently, offered the unfortunate owner this invariable consolation— “It is an ill wind that blows nobody good. Everybody must live, and what would become of the glaziers if panes of glass were never broken?”

Now, this form of condolence contains an entire theory, which it will be well to show up in this simple case, seeing that it is precisely the same as that which, unhappily, regulates the greater part of our economical institutions.

Suppose it cost six francs to repair the damage, and you say that the accident brings six francs to the glazier’s trade—that it encourages that trade to the amount of six francs—I grant it; I have not a word to say against it; you reason justly. The glazier comes, performs his task, receives his six francs, rubs his hands, and, in his heart, blesses the careless child. All this is that which is seen.

But if, on the other hand, you come to the conclusion, as is too often the case, that it is a good thing to break windows, that it causes money to circulate, and that the encouragement of industry in general will be the result of it, you will oblige me to call out, “Stop

there! Your theory is confined to that which is seen; it takes no account of that which is not seen."

It is not seen that as our shopkeeper has spent six francs upon one thing, he cannot spend them upon another. It is not seen that if he had not had a window to replace, he would, perhaps, have replaced his old shoes, or added another book to his library. In short, he would have employed his six francs in some way, which this accident has prevented. ⁶

Here we see how this classic story easily fires our imagination and engages our thinking. In the midst of this exercise Bastiat's lesson cannot be missed. On the one hand we see clearly the concept of opportunity cost, but we also cannot fail to grasp Bastiat's intended conclusion— *destruction is not profit*. If breaking windows was all that good, why not break everybody's windows? But why stop there? Why not break down the doors too, in fact, destroy the whole town? Taken to these extremes, we see the absurdity of it all. Nevertheless, we will find that people today, as in the day of Bastiat, will argue vehemently to support the benefits of war, how it is good for the economy, the advancement of technology and the reduction of unemployment. No consideration is given to the hidden costs which war inevitably brings about. And there are many. These costs always fall squarely upon the backs of taxpayers, not to mention the fact that war destroys property and lives. Whatever economic stimulus war may produce it is immediately offset by opportunity costs. Even rebuilding war-torn cities cannot replace the immense resources required to restore a country to its pre-war conditions. Without a war, those resources could be used for more productive purposes.

According to Henry Hazlitt, who used this parable in his 1946 best selling book, "Economics In One Lesson," said:

"It is never an advantage to have one's plants destroyed by shells or bombs unless those plants have already become valueless or acquired a negative value by depreciation and obsolescence. ... Plants and equipment cannot be replaced by an individual (or a socialist government) unless he or it has acquired or can acquire the savings, the capital accumulation, to make the replacement. But war destroys accumulated capital. ...Complications should not divert us from recognizing the basic truth that the wanton destruction of anything of real value

is always a net loss, a misfortune, or a disaster, and whatever the offsetting considerations in a particular instance, can never be, on net balance, a boon or a blessing." ⁷

Nothing I can think of has more unseen costs than inflation. We need no more proof than the fact that inflation has caused the value of our money to be reduced by 97% since 1913. The consequences surround us. Inflation is the epitome of wealth destruction, yet in the same way that war is defended, inflation has its many supporters. The reason, of course, is quite obvious. It benefits special interest groups. This may be difficult to see on the surface of Bastiat's parable, but suppose it was discovered that the glazier had paid the boy one franc for every window he would break. Suddenly, the act is now clearly seen as theft, yet the facts observed by the onlookers remain true. Bastiat argued that there were people who actually endorse activities that parallel the glazier's hiring the boy to break windows. These activities, however, are usually not seen. In the same way, too, inflation is a hidden destructive force.

As we can see, Bastiat's parable is an excellent example for understanding opportunity cost, but it also helps us to understand so much more and at a much deeper level. Bastiat is teaching us that the destruction of wealth is never a good thing, but he is also opening up our eyes to the immense unseen destruction going on all around us. This, I believe, is what gives Bastiat's parable its immense power. We begin with the destruction of windows, but soon we are analyzing the destruction of war, then the destruction of the institution of money itself. And it doesn't stop there because this parable will not let us. We start to assess the opportunity costs of all things, especially those that are most important to us. We can no longer lull ourselves to sleep and not think about what is really going on. This is the entire point of having access to the Austrian perspective and we should not want it any other way.

Bastiat saw the need to present this parable in 1850 because he realized that special interest groups request money from the government and the government forces the taxpayer to provide the funds. Many of these grants and subsidies are camouflaged in benevolence so taxpayers believe the whole population benefits. But the people are failing to take into account the hidden costs (opportunity cost) of those funds given up and that it makes them that much poorer by exactly that much money.

Hazlitt saw the need to reintroduce the story in his lifetime because he recognized that the government continues to break windows. Men like Nash and other great Austrians like him replicate the parable in their own way because it bears repeating in every age. It's a message that must not stop. The message is this, and we should never forget it: "Everything we get, outside the free gifts of nature, must in some way be paid for." ⁸

Bibliography

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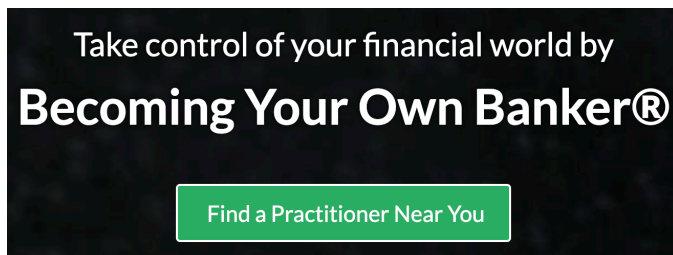


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IBC Practitioners have completed the *IBC Practitioner's Program* and have passed the program exam to ensure that they possess a solid foundation in the theory and implementation of IBC, as well as an understanding of Austrian economics and its unique insights into our monetary and banking institutions. The *IBC Practitioner* has a broad base of knowledge to ensure a minimal level of competency in all of the areas

a financial professional needs, in order to adequately discuss IBC with his or her clients.

Before you look for a practitioner, we suggest listening to the following two episodes of [The Lara Murphy Report](#):

- [How-To Guide for Starting IBC, Part 1](#) How to begin your study of Infinite Banking, including finding an Authorized Practitioner.
- [How-To Guide for Starting IBC, Part 2](#) How to prepare for your first meeting with an Infinite Banking Authorized Practitioner.

The financial professionals listed below joined or renewed their membership as part of the *Authorized Infinite Banking Concepts Practitioners* team in December.

MEMBERSHIP RENEWALS

- Robert Burnett, Estero, Florida
- Michael Burrill, Youngsville, North Carolina
- Jonah Dew, Greenville, South Carolina
- Wayne Durksen, Warman, Saskatchewan
- Leo Fernandez, Fort Myers, Florida
- Kyle Fuller, Mesa, Arizona
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- Chey O'Brien, Greeneville, Tennessee
- Dane Volek, San Francisco, California

THE FOUNDATIONS OF IBC

The Foundations of IBC is an online **video series** for the general public that provides a comprehensive introduction to the *Infinite Banking Concept*.

The first four modules are free, you can view them here: infinitebanking.org/foundations

The remaining eight modules are subscription-based, costing \$49.95 for all eight.

Or contact an Authorized IBC Practitioner and ask for a coupon code that will enable you to watch all twelve modules FREE.

Module 1: Introduction to the Nelson Nash Institute

Module 2: What the Infinite Banking Concept Is

Module 3, Part 1: How IBC Works

Module 3, Part 2: Policy Loans & The Nature of Collateral

Module 3, Part 3: How to Read a Policy Illustration

Module 4: Why Nelson Calls It The Infinite Banking Concept

Module 5: The Life Insurance Industry

Module 6: Why Not Buy Term and Invest the Difference?

Module 7: Using IBC to Pass Wealth to Future Generations

Module 8: The MEC Rule and Policy Design

Module 9: Does IBC Work for Older People?

Module 10, Part 1: IBC for the Business Owner

Module 10, Part 2: IBC for the Business Owner

Module 11, Part 1: Using Your IBC Policy: Premiums, Dividends, and Policy Loans

Module 11, Part 2: Using Your IBC Policy: Premiums, Dividends, and Policy Loans

Module 12: IBC as a Way of Life