## Key Terms

allocative efficiency

when the mix of goods produced represents the mix that society most desires

budget constraint

all possible consumption combinations of goods that someone can afford, given the prices of goods, when all income is spent; the boundary of the opportunity set

comparative advantage

when a country can produce a good at a lower cost in terms of other goods; or, when a country has a lower opportunity cost of production

invisible hand

Adam Smith's concept that individuals' self-interested behavior can lead to positive social outcomes

law of diminishing marginal utility

as we consume more of a good or service, the utility we get from additional units of the good or service tends to become smaller than what we received from earlier units

law of diminishing returns

as we add additional increments of resources to producing a good or service, the marginal benefit from those additional increments will decline

marginal analysis

examination of decisions on the margin, meaning a little more or a little less from the status quo

normative statement

statement which describes how the world should be

opportunity cost

measures cost by what we give up/forfeit in exchange; opportunity cost measures the value of the forgone alternative

opportunity set

all possible combinations of consumption that someone can afford given the prices of goods and the individual’s income

positive statement

statement which describes the world as it is

production possibilities frontier (PPF)

a diagram that shows the productively efficient combinations of two products that an economy can produce given the resources it has available.

productive efficiency

when it is impossible to produce more of one good (or service) without decreasing the quantity produced of another good (or service)

sunk costs

costs that we make in the past that we cannot recover

utility

satisfaction, usefulness, or value one obtains from consuming goods and services