## Key Terms

behavioral economics

a branch of economics that seeks to enrich the understanding of decision-making by integrating the insights of psychology and by investigating how given dollar amounts can mean different things to individuals depending on the situation

budget constraint (or budget line)

shows the possible combinations of two goods that are affordable given a consumer’s limited income

consumer equilibrium

point on the budget line where the consumer gets the most satisfaction; this occurs when the ratio of the prices of goods is equal to the ratio of the marginal utilities.

diminishing marginal utility

the common pattern that each marginal unit of a good consumed provides less of an addition to utility than the previous unit

fungible

the idea that units of a good, such as dollars, ounces of gold, or barrels of oil are capable of mutual substitution with each other and carry equal value to the individual

income effect

a higher price means that, in effect, the buying power of income has been reduced, even though actual income has not changed; always happens simultaneously with a substitution effect

marginal utility

the additional utility provided by one additional unit of consumption

marginal utility per dollar

the additional satisfaction gained from purchasing a good given the price of the product; MU/Price

substitution effect

when a price changes, consumers have an incentive to consume less of the good with a relatively higher price and more of the good with a relatively lower price; always happens simultaneously with an income effect

total utility

satisfaction derived from consumer choices