Chapter 1: Opportunity Cost and Comparative Advantage

Model: A simplified version of reality

Production Possibility Curve (PPC): A graphical representation of all possible output combinations if resources are used efficiently

Efficient Production Point: A combination of goods for which currently available resources do not allow an increase in the production of one good without a reduction in the production of the other. All the points on the PPC are efficient.

Inefficient Production Point: An Inefficient Production Point represents a combination of goods for which currently available resources allow an increase in the production of one good without a reduction in the production of the other. All the points below and to the left of the PPC are inefficient.

Attainable Production Point: An Attainable Production Point represents any combination of goods that can be produced with the currently available resources. All the points on the PPC or below and to the left of the PPC are attainable.

Unattainable Production Point: An Unattainable Production Point represents any combination of goods that cannot be produced with the currently available resources. All the points that lie outside of the PPC are unattainable.

Absolute Advantage: An agent (or an economy) has an Absolute Advantage in a productive when he/she can carry on this activity with less resources than another agent.

Opportunity Cost: The Opportunity Cost of a given action is the value of the next best alternative to that particular action.

Comparative Advantage: An agent (or an economy) has a Comparative Advantage in a productive activity (like collecting bananas or catching rabbits) when he/she has a lower opportunity cost of carrying on that activity than another agent.

Gains from Specialization: The additional output that an economy can produce through each agent specializing.

Principle of Comparative Advantage: Everyone is better off if each agent (or each country) specializes in the activities for which they have a comparative advantage.

The Low-Hanging Fruit Principle (or Increasing Opportunity Cost): In the process of increasing the production of any good, one first employs those resources with the lowest opportunity cost and only once these are exhausted turn to resources with higher cost.

Consumption Possibility Curve (CPC): The CPC represents all possible combinations of bananas and rabbits that the economy can feasibly consume when it is open to international trade.

Chapter 2: Perfectly competitive markets (Supply)

Market: The Market for a given good or service is the set of all the consumers and suppliers who are willing to buy and sell that good or service.

Market Equilibrium: Market Equilibrium occurs when the price and the quantity sold of a given good is stable. Alternatively, Market Equilibrium occurs when the equilibrium price is such that the quantity consumers want today is the same as the quantity suppliers want to sell.

Perfectly Competitive Market: A Perfectly competitive market is a market with the following characteristics**:**

1. **Consumers and Suppliers are Price-Takers:** Consumers and Suppliers are not able to affect the price of the goods they are consuming/producing
2. **Homogeneous Goods:** All suppliers sell exactly the same product.
3. **No Externality:** All consumption/production costs/benefits are accrued solely by the producer and consumer
4. **Goods are Excludable and Rival:** Suppliers can prevent consumers from consuming a certain good (excludability) and, once consumed, that good becomes unavailable to other consumers (rivalry).
5. **Full Information:** The suppliers and the consumers are perfectly informed regarding the characteristics of the good
6. **Free Entry and Exit:** Suppliers are free to enter and exit the market.

Marginal Benefit: The Marginal Benefit of producing a certain unit of a given good is the extra benefit accrued by producing that unit.

Marginal Cost: The Marginal Cost of producing a certain unit of a given good is the extra cost of producing that unit. (Keep in mind here that the relevant cost is the "opportunity cost" and not just the "absolute cost" of producing the good.)

Cost-Benefit Principle: The Cost-Benefit Principle states that an action should be taken if the marginal benefit is greater than the marginal cost.

Economic Surplus: The Economic Surplus of a certain action is the difference between the marginal benefit and the marginal cost of taking that action.

Quantity Supplied: The Quantity Supplied by a supplier represents the quantity of a given good or service that maximizes the profit of the supplier.

Supply Curve: The Supply Curve represents the relationship between the price of a good or service and the quantity supplied of that good or service.

Law of Supply: The Law of Supply describes the tendency for a producer to offer more of a certain good or service when the price of that good or service increases.