NAME ______________________ DATE ____________ CLASS ____________

Lesson Summary

Opportunity Cost and Trade-Offs

When making decisions people face **trade-offs**, or alternatives we give up when we choose one course of action over another. Individuals, businesses, and governments all face trade-offs. A person who chooses to spend more time at work has less time to spend at home. A business that uses all of its factories to build chairs cannot build tables at the same time. A country that decides to produce more military goods has fewer resources to use for consumer goods. Economists use the term **guns or butter** to describe this trade-off.

A person who chooses one alternative gives up other alternatives. The most desirable alternative given up is called the **opportunity cost**. For example, suppose you have to choose between sleeping late or getting up early to study for a test. The opportunity cost of extra study time is less sleep. The opportunity cost of more sleep is less study time.

Decisions also involve **thinking at the margin**. This means deciding about adding or subtracting one unit of a resource, such as one hour of sleep. In the example above, the decision was between sleeping late or studying. But you could also choose to sleep an hour late, then wake up to study. To make a decision at the margin, you would compare the opportunity cost and benefit of each extra hour of studying. The benefit of adding one more unit of anything, such as one more hour of studying, is called the **marginal benefit**. The cost of adding one more unit of anything is called the **marginal cost.** The process of making decisions based on costs and benefits is called a **cost/benefit analysis**.