Cost-Benefit

Rational Decisions

- Due to scarcity, Every decision involves an opportunity cost.
- Economists assume that people make rational decisions.
- We get something we want, but we give up something else.

Rational Decisions

- We weigh the benefits and cost of each option.

- **"Cost-benefit analysis"** is when we choose the option whose benefits (in your opinion) outweigh its cost.
- **A Rational Economic Decision** is when we make a decision and our benefits exceed our costs.

Rational Decisions
Marginal Benefit/Marginal Cost

- **Marginal Benefit** – Extra amount gained when a choice is made.
- **Marginal cost** refers to the **value** of what is given up in order to produce that additional unit. Extra amount given up when a choice is made (could be the same as opportunity cost).
- Additional units of a good should be produced as long as **marginal benefit** *exceeds* **marginal cost**.
- It would be inefficient to produce goods when the marginal benefit is less than the marginal cost. Therefore an efficient level of product is achieved when marginal benefit is equal to marginal cost.

Marginal Benefit/Marginal Cost

- When the marginal benefits you receive from a decision are equal to or greater than the marginal costs of making that choice, you are making a rational decision.

The Production Possibilities Curve

The graph Economists use to show what combination of two products is possible with a given amount of resources.

The Production Possibilities Curve

- Companies that make and sell products also need to make rational decisions, in order to make a profit and stay in business.

- Producers use their own version of cost-benefit analysis to decide what combination of things they should make to earn the highest possible profit, using their limited resources.

The Production Possibilities Curve

- Like buyers, sellers must weigh marginal benefits and marginal costs.
- A farmer grows corn and soybeans. If he can afford to hire ten workers, but he uses them all in his corn field, he is wasting his labor resources.
- For the same labor cost, he could move some of the ten workers to his soybean field

The Production Possibilities Curve

- If a farmer moves a few of workers, he would achieve a big marginal benefit in soybean production, while causing only a small decline in his corn production.

- He would be operating more “efficiently” to use his resources to achieve greater overall production without increasing his costs.