

Chapter 2

Economic Tools and Economic Systems

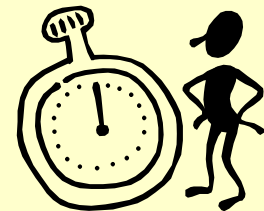
**These slides supplement the
textbook, but should not
replace reading the textbook**

What is opportunity cost?

The value of the best alternative forgone when an item or activity is chosen

How is opportunity cost estimated?

Opportunity cost is *subjectively* estimated by the individual decision maker



What is the opportunity cost of a city to use local taxes to pay for a park?

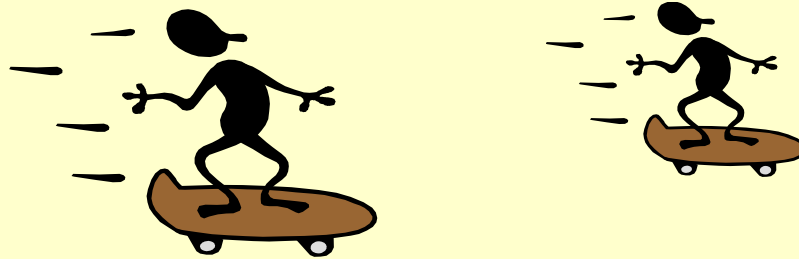
The best alternative foregone by not building the park

What is your opportunity cost of attending college?

If make \$300 a week, but you *expect* you could make \$500 without school - your opportunity cost is \$200

What is the opportunity cost of cleaning your room?

It's greater on sunny days than on rainy days



Why is opportunity cost subjective?

- calculation requires time and information
- time is the ultimate restraint
- may vary with circumstances

What is a sunk cost?

A cost that is irrelevant when an economic choice is being made

What is an example of a sunk cost?

The \$6.75 you pay to watch a boring movie is irrelevant to whether or not you watch it to the end

What is absolute advantage?

The ability to produce something with fewer resources than other producers use

**You can paint a room in
2 hrs, a high school
student in 3 hrs, who has
absolute advantage?**

**You do because you
can do it faster**

What is comparative advantage?

The ability to produce something at a lower opportunity cost than other producers face

**You can make \$50 an hr,
the high school student
makes minimum wage,
who should paint?**

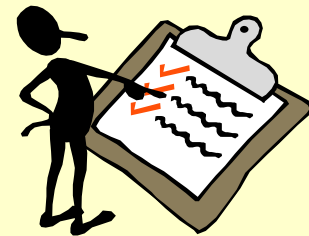
**The high school student
because of a lower
opportunity cost**

What is barter?

The direct exchange of one good for another without using money

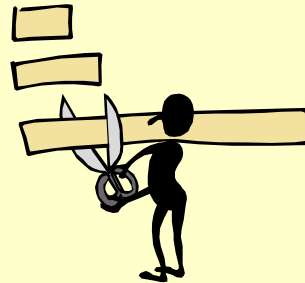
What is a division of labor?

The production of a single good into separate tasks in which people specialize

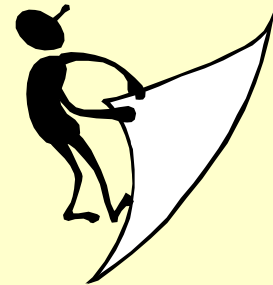


What is a specialization of labor?

Focusing an individual's efforts on a particular product or a single task



**How does the
specialization of
labor increase
productivity?**



- Takes advantage of individual natural abilities
- Allows workers to develop more experience at a particular task
- Permits the introduction of labor-saving machinery
- Reduces time required to shift between tasks

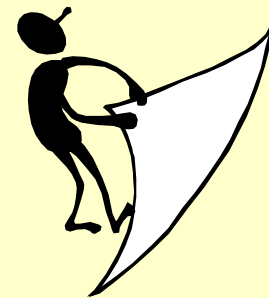
What is the production possibilities frontier?

A curve showing all combinations of goods that can be produced when resources are used most efficiently

What is efficiency?

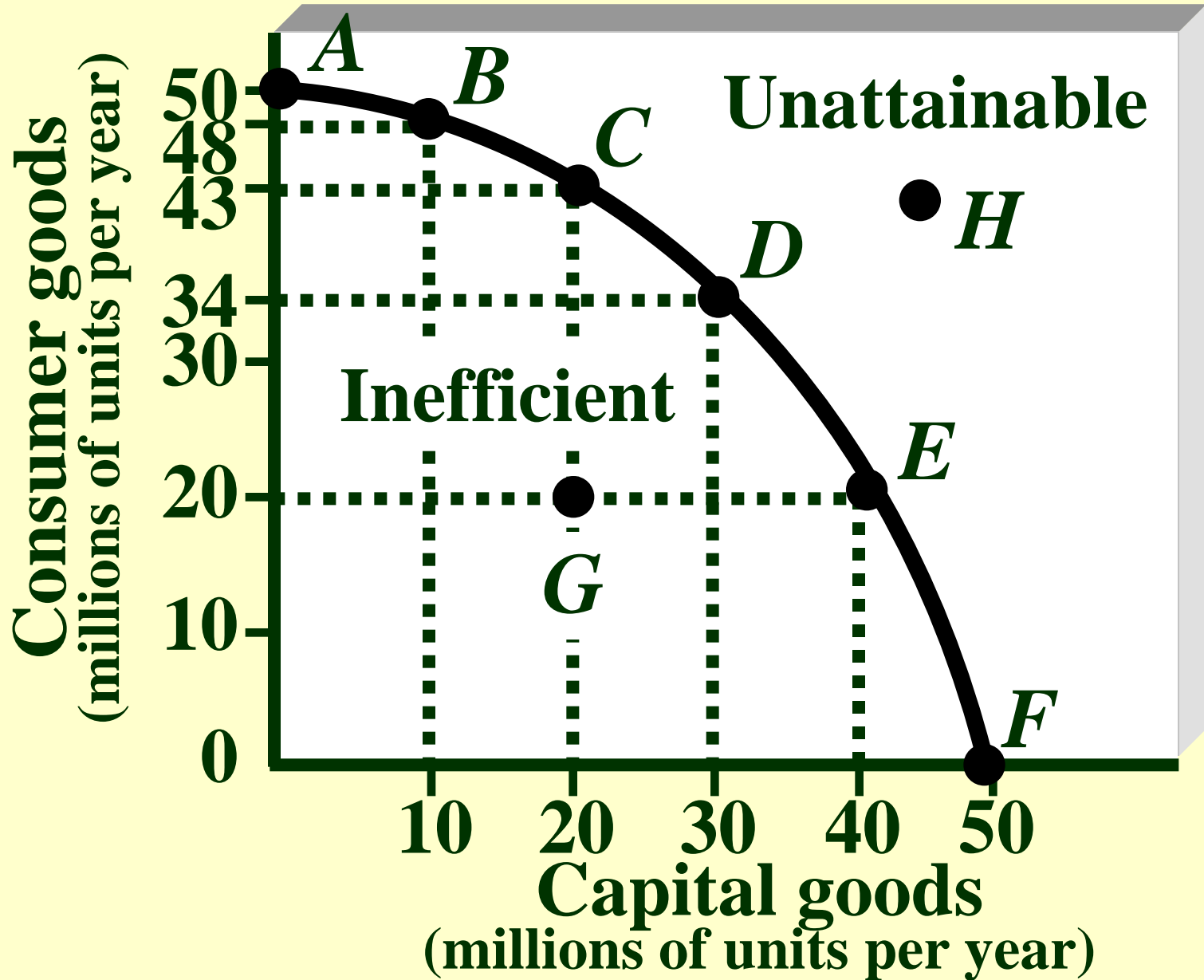
The condition that exists when there is no way resources can be reallocated to increase the production of one good without decreasing the production of another

**What assumptions
do we make with the
production
possibilities model?**



- Output is limited to two classes of products
- Focus is on production during a given time period
- Available supplies of resources are fixed
- Technology is constant

The Production Possibilities Frontier



What is the law of increasing opportunity?

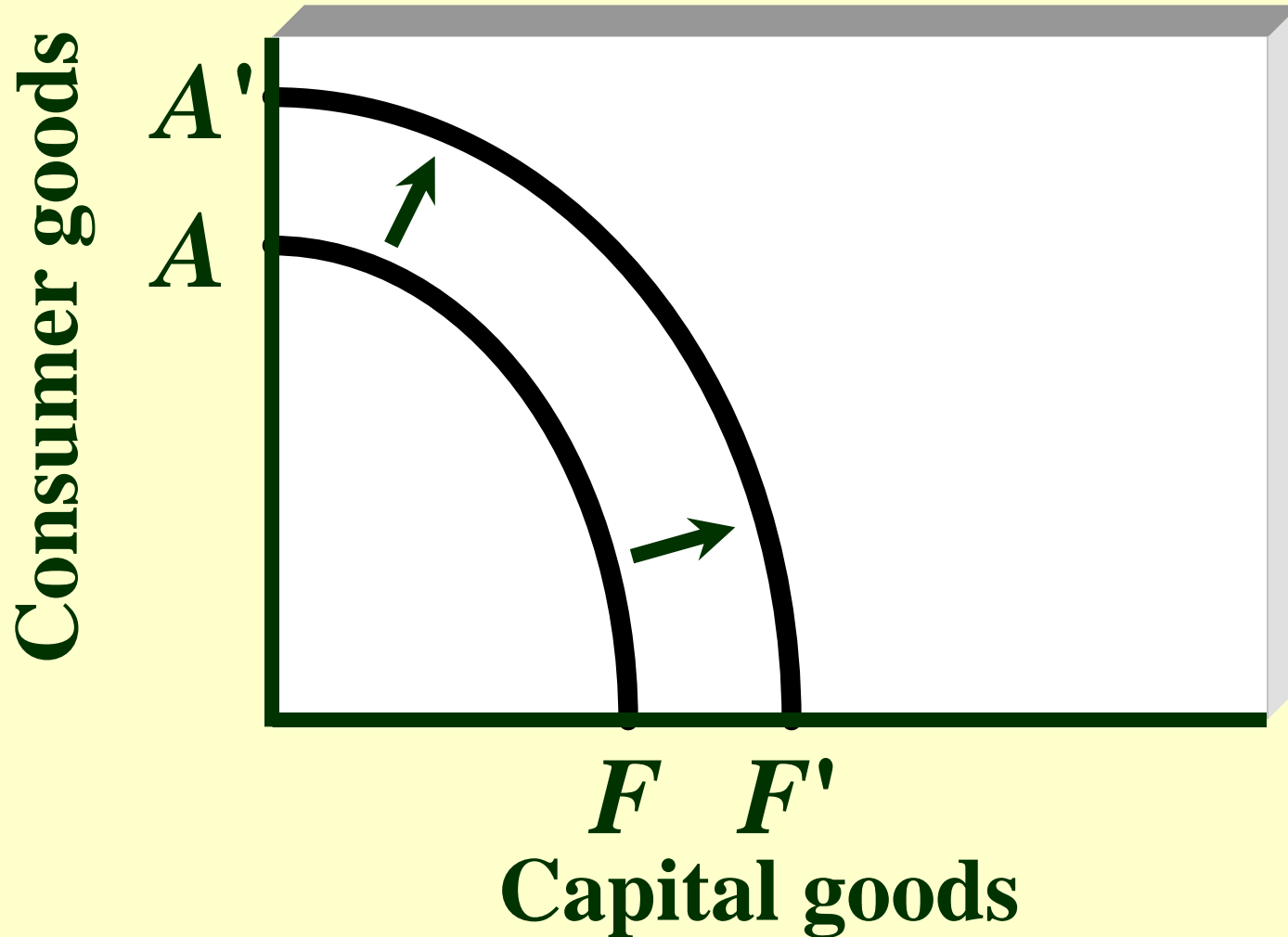
As more of a good is produced, larger quantities of another good must be sacrificed if resources are already used efficiently

What shifts the production possibilities frontier?

- Changes in resources
- Increase in the capital stock
- Technological change

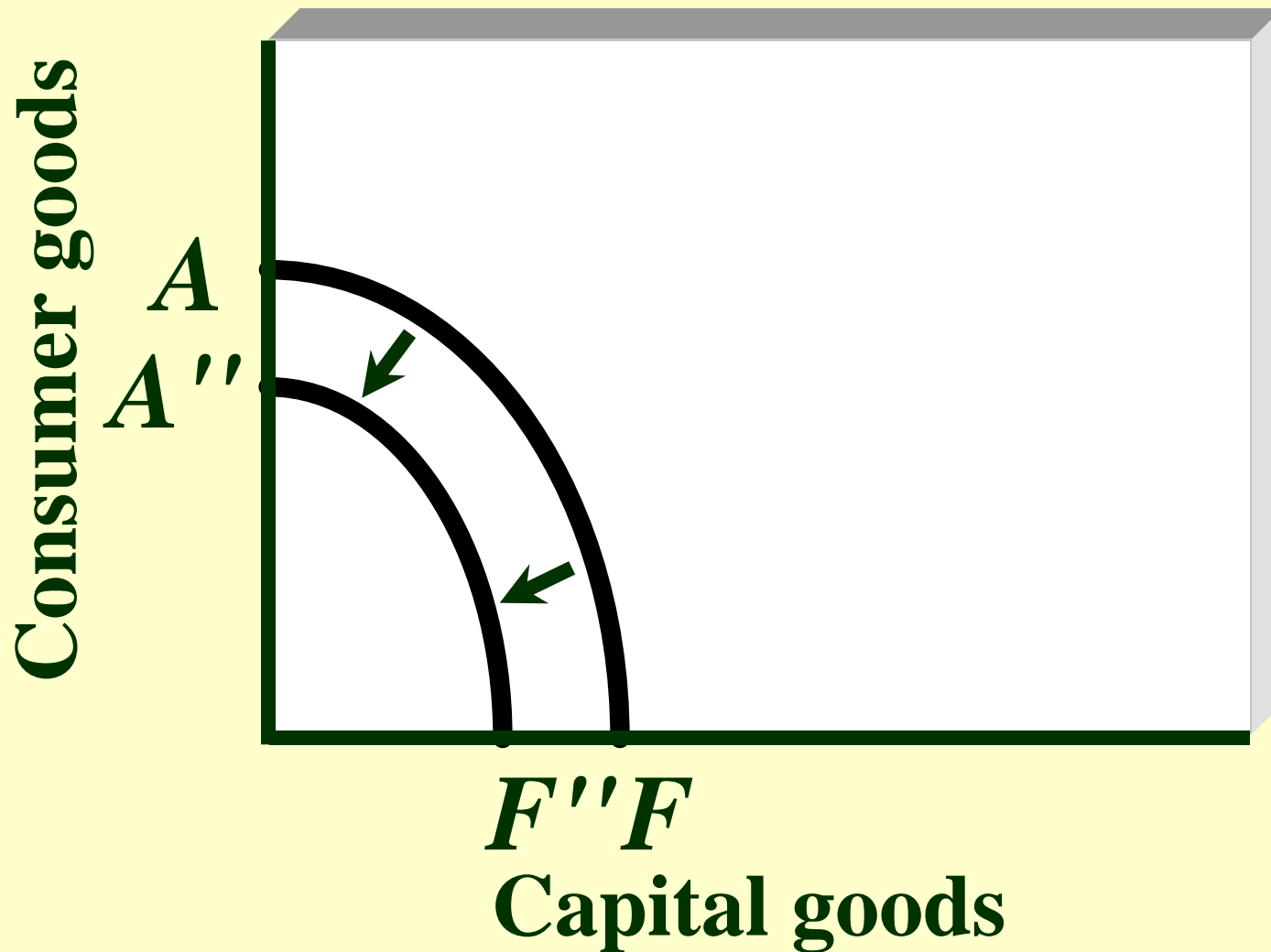
Shifts in the Economy's PPF

Panel A: Increase in available resources



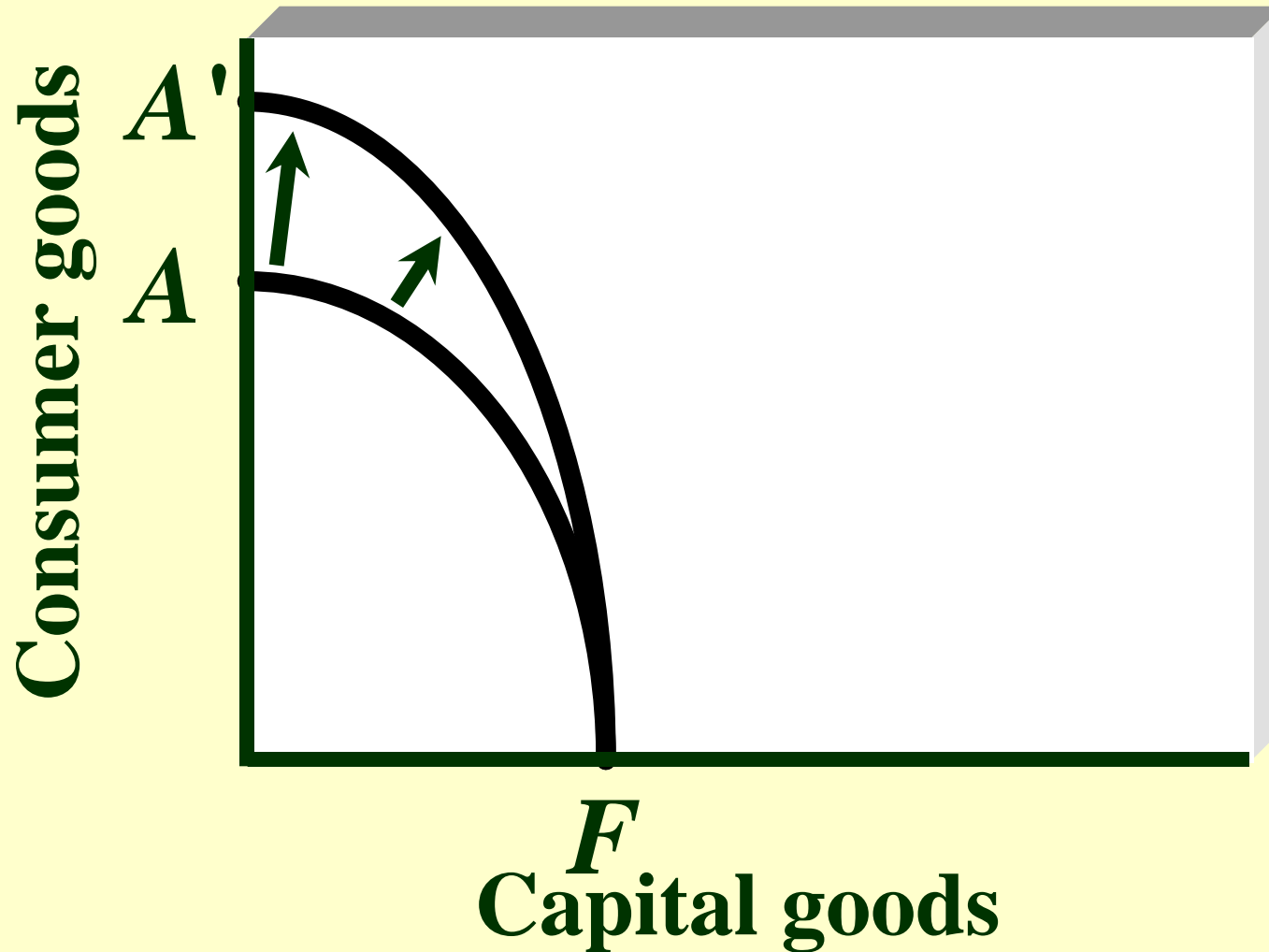
Shifts in the Economy's PPF

Panel B: Decrease in available resources



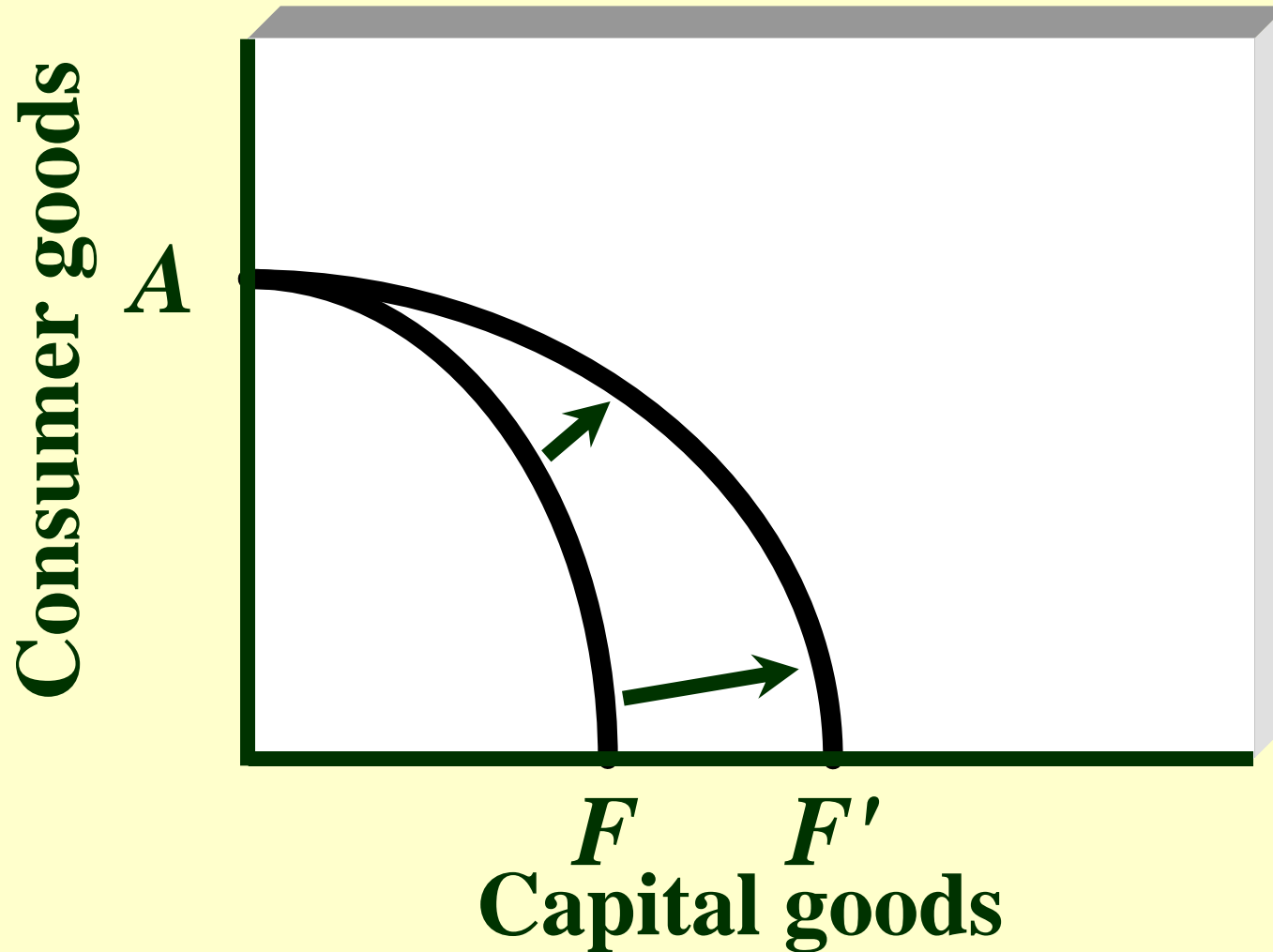
Shifts in the Economy's PPF

Panel C: Increase in resources or technology that benefits consumer goods



Shifts in the Economy's PPF

Panel D: Increase in resources or technology that benefits capital goods



What is true along the production possibilities curve?

- resources are used fully
- maximized division of labor
- most efficient combination of resources

**What choices are made
along the production
possibilities curve?**

To have more of one
product units of the other
have to be given up

Production Possibilities Curve analysis includes?

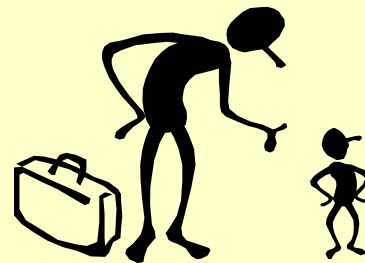
- opportunity cost
- scarcity
- maximum choices
- efficiency
- increasing opportunity costs
- economic growth

What is an economic system?

A set of social institutions and mechanisms organized to answer the three economic questions

What are the three questions?

*Who gets what
and how much?*



What is pure capitalism?

An economic system characterized by private ownership of resources and the use of prices to coordinate economic activity in unregulated markets

What is a command economy?

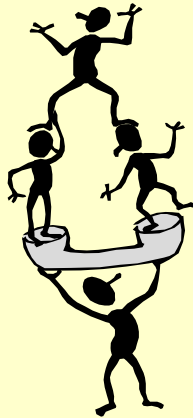
An economic system characterized by public ownership of resources and centralized economic planning

What is a mixed capitalist economy?

An economic system characterized by private ownership of some resources and public ownership of others; some markets are regulated, others are not

What kind of economic system do we have?

A mixed capitalist economy



END