



FLAT WORLD
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SURVEY OF ECONOMICS V. 1.1

By Libby Rittenber

The background of the slide is a light gray grid of various icons. These icons include symbols for documents, books, charts, social media (like Facebook and Twitter), and various utility icons like a lightbulb, a hand, a magnifying glass, and a trash can. The icons are arranged in a repeating pattern across the entire slide.

CHAPTER 2

CONFRONTING SCARCITY: CHOICES IN PRODUCTION



LEARNING OBJECTIVES

- Define the three factors of production– labor, capital, and natural resources.
- Explain the role of technology and entrepreneurs in the utilization of the economy's factors of production.
- Explain the concept of the production possibilities curve and understand the implications of its downward slope and bowed-out shape.
- Use the production possibilities model to distinguish between full employment and situations of idle factors of production and between efficient and inefficient production.
- Understand specialization and its relationship to the production possibilities model and comparative advantage.



LEARNING OBJECTIVES

- Understand the argument for unrestricted international trade in terms of economic specialization and comparative advantage.
- Define economic growth in terms of the production possibilities model and discuss factors that make such growth possible.
- Explain the classification of economic systems, the role of government in different economic systems, and the strengths and weaknesses of different systems.



CHOICE IN PRODUCTION

- The **production possibilities model** shows the goods and services that an economy is capable of producing – its opportunities – given the factors of production and the technology it has available.
- An **economic system** is the set of rules that define how an economy's resources are to be owned and how decisions about their use are to be made.
- **Factors of production** are the resources available to the economy for the production of goods and services.
- **Utility** is the value, or satisfaction, that people derive from the goods and services they consume and the activities they pursue.



FACTORS OF PRODUCTION

- **Labor** is the human effort that can be applied to the production of goods and services.
 - **Human capital** are the skills a worker has as a result of education, training, or experience that can be used in production.
- **Capital** is a factor of production that has been produced for use in the production of other goods and services.
 - Financial capital includes money and other “paper ” assets (such as stocks and bonds) that represent claims on future payments.
 - Examples of capital include tools and transportation equipment.
- **Natural resources** are the resources of nature that can be used for the production of goods and services.



TECHNOLOGY AND THE ENTREPRENEUR

- **Technology** is the knowledge that can be applied to the production of goods and services.
- An **entrepreneur** is a person who, operating within the context of a market economy, assumes various risks in the hopes of earning profits by finding new ways to organize factors of production.



PRODUCTION POSSIBILITIES CURB

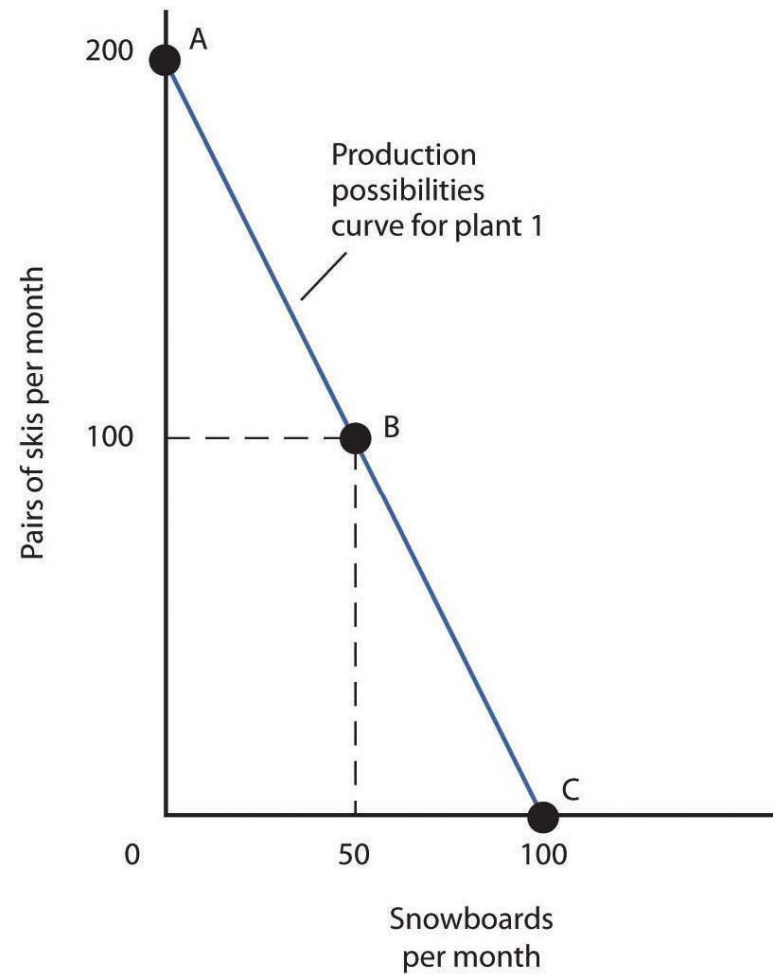
A GRAPHICAL REPRESENTATION OF THE
ALTERNATIVE COMBINATIONS OF GOODS AND
SERVICES AN ECONOMY CAN PRODUCE

- Describes opportunity costs and tradeoffs.



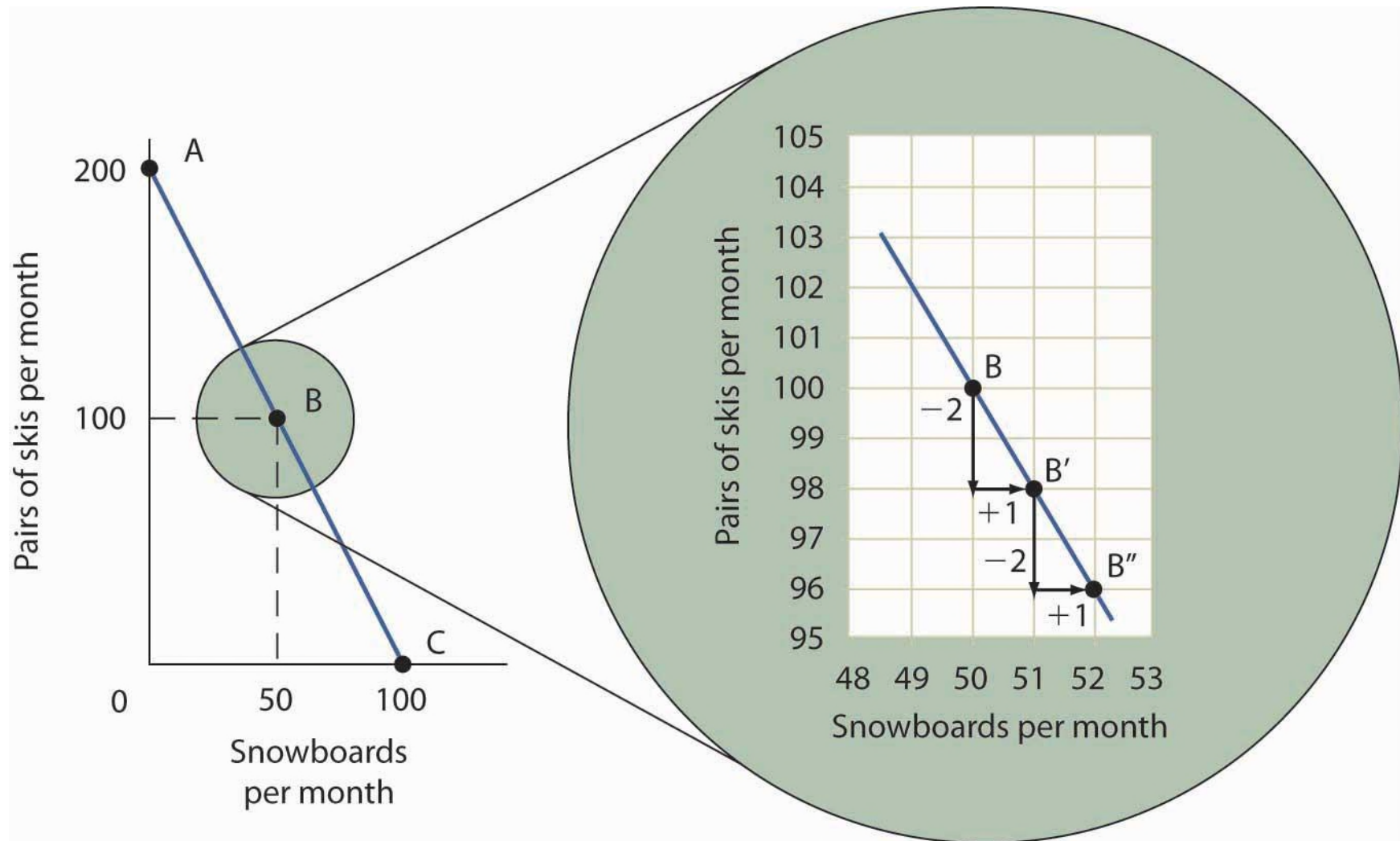
A PRODUCTION POSSIBILITIES CURVE

	Pairs of skis per month	Snowboards per month
A	200	0
B	100	50
C	0	100



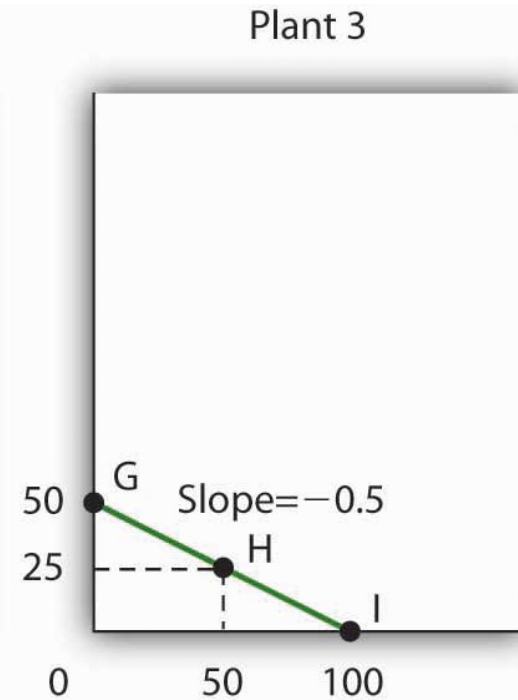
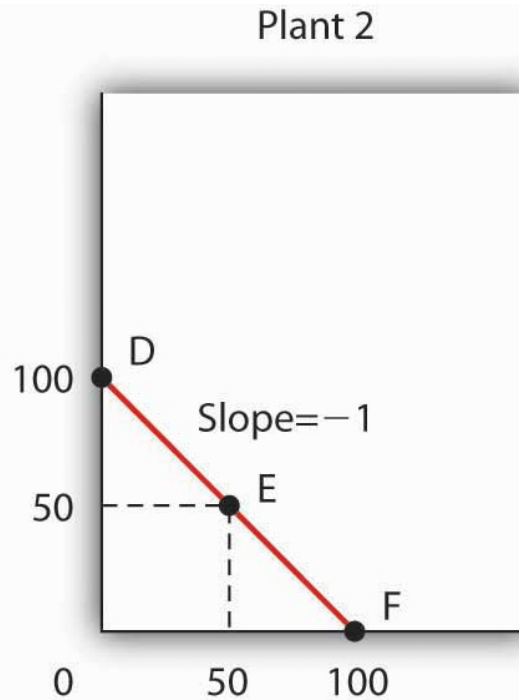
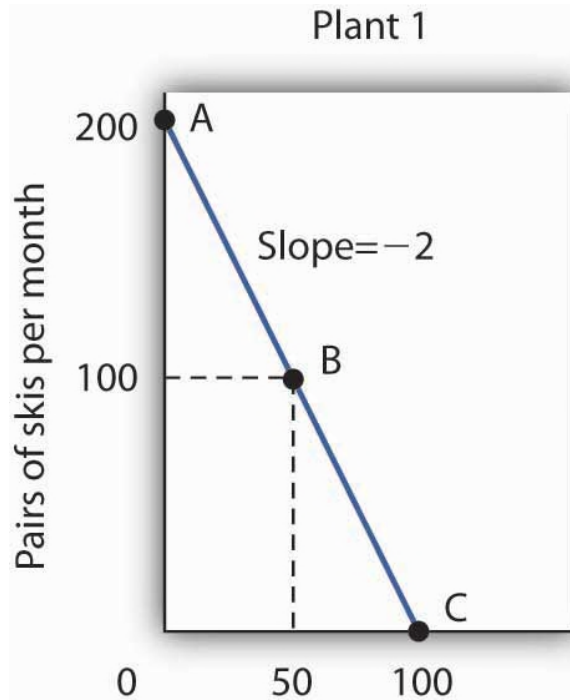


THE SLOPE OF A PRODUCTION POSSIBILITIES CURVE





PRODUCTION POSSIBILITIES AT THREE PLANTS



Snowboards per month

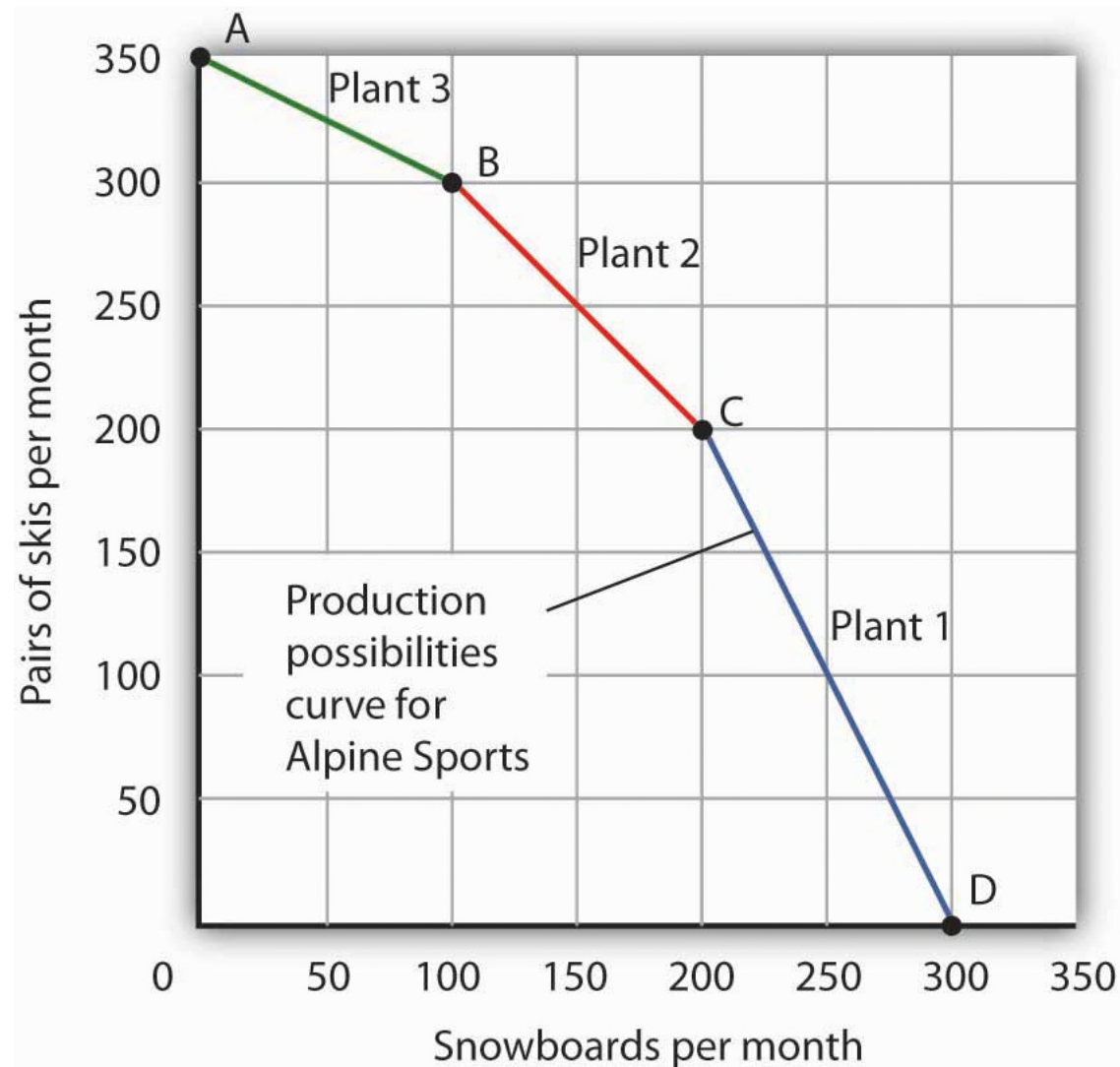


COMPARATIVE ADVANTAGE

THE OPPORTUNITY COST OF PRODUCING
THAT GOOD OR SERVICE IS LOWER FOR THAT
ECONOMY THAN FOR ANY OTHER



COMBINED PRODUCTION POSSIBILITIES CURVE



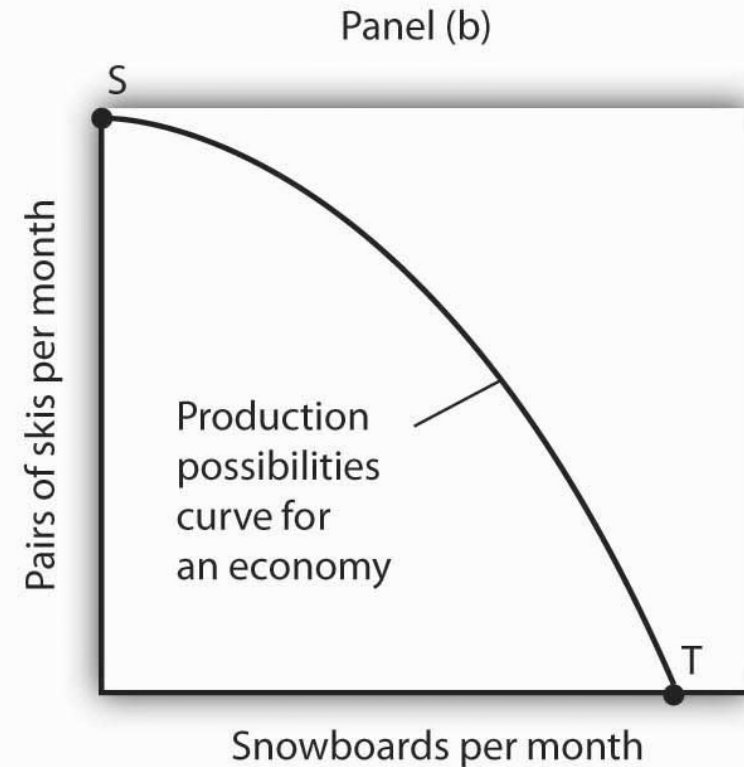
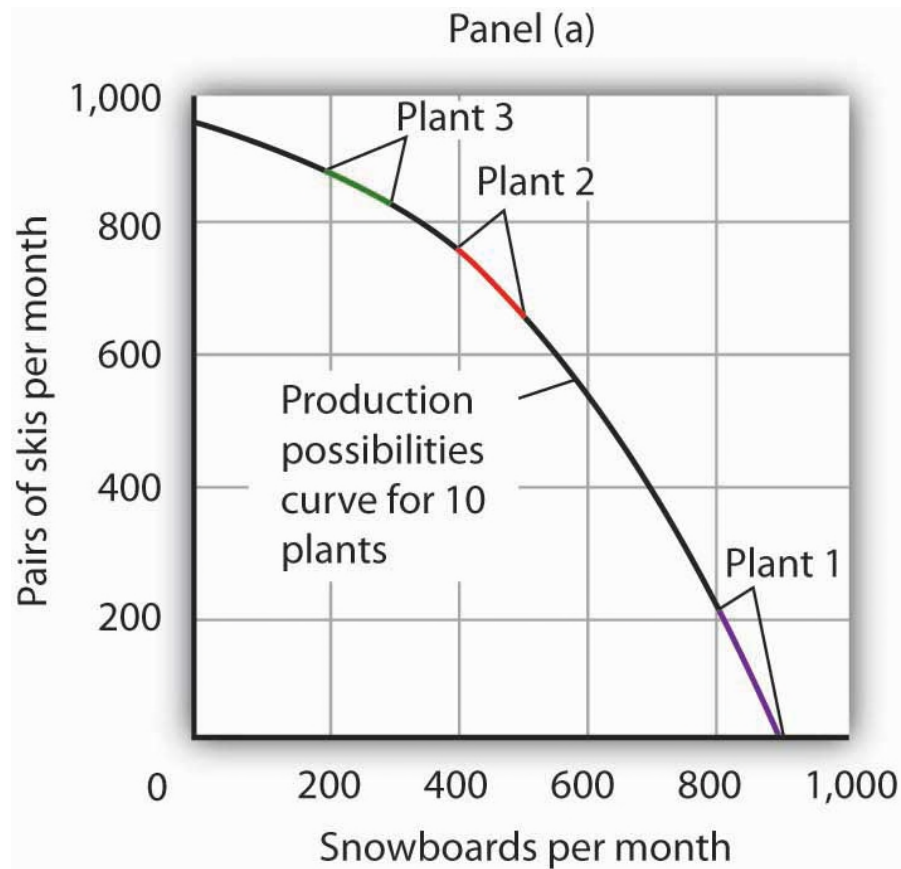


THE LAW OF INCREASING OPPORTUNITY COST

AS AN ECONOMY CONTINUES TO PUT RESOURCES INTO PRODUCING MORE OF A PARTICULAR GOOD, THE OPPORTUNITY COST OF ADDITIONAL UNITS OF THAT GOOD WILL INCREASE



PRODUCTION POSSIBILITIES FOR THE ECONOMY





MOVEMENTS ALONG THE CURVE

- We can use the production possibilities model to examine choices in the production of goods and services.
- In applying the model, we assume that:
 - The economy can produce two goods.
 - Technology and the factors of production available to the economy remain unchanged.

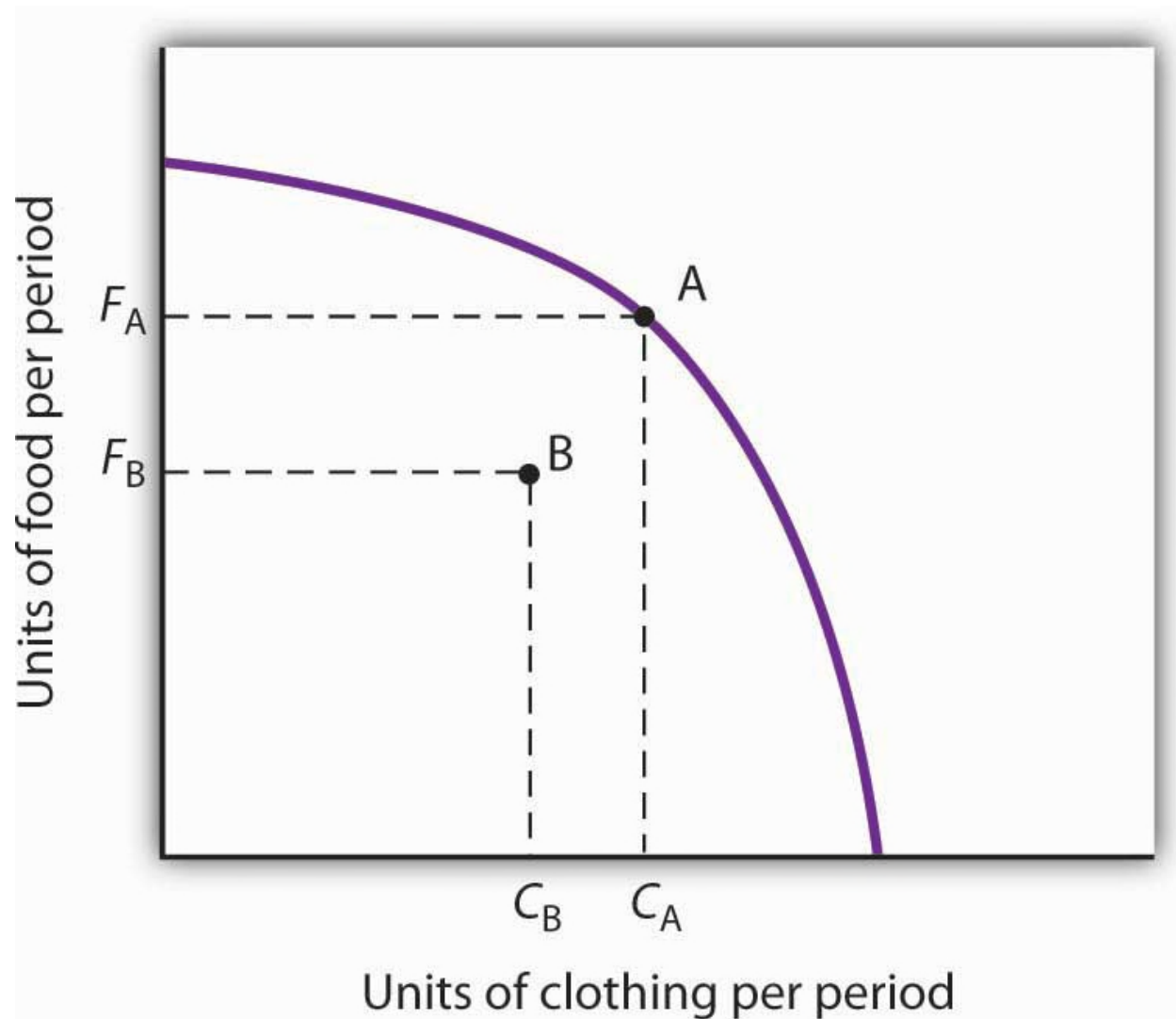


PRODUCING INSIDE THE CURVE

- Two things could leave an economy operating at a point inside its production possibilities curve:
 - The economy might fail to use fully the resources available to it.
 - It might not allocate resources on the basis of comparative advantage.
- In either case, production within the production possibilities curve implies the economy could improve its performance.

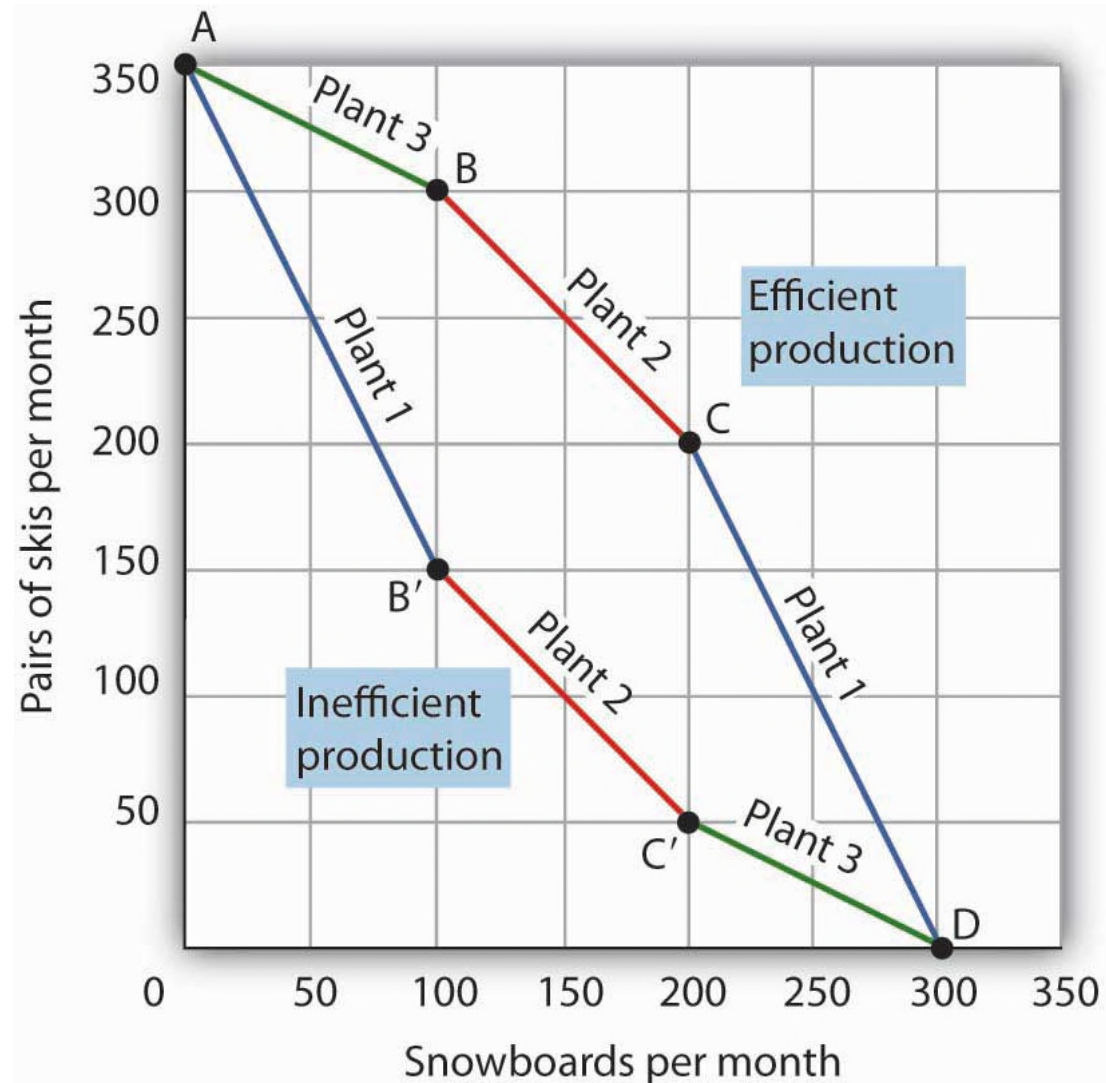


IDLE FACTORS AND PRODUCTION





EFFICIENT VERSUS INEFFICIENT PRODUCTION





SPECIALIZATION

A SITUATION IN WHICH AN ECONOMY IS PRODUCING THE GOODS AND SERVICES IN WHICH IT HAS A COMPARATIVE ADVANTAGE

- The most important implications of the concepts of comparative advantage, specialization and the production possibilities curve relates to international trade.

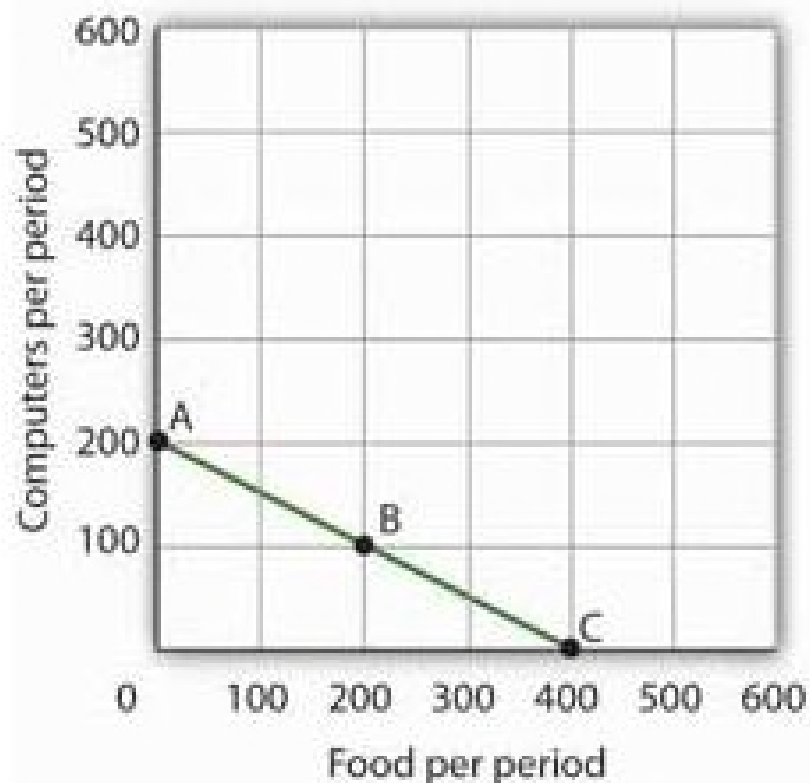


PRODUCTION POSSIBILITIES CURVES AND TRADE

Panel (a)

South America's Production Possibilities

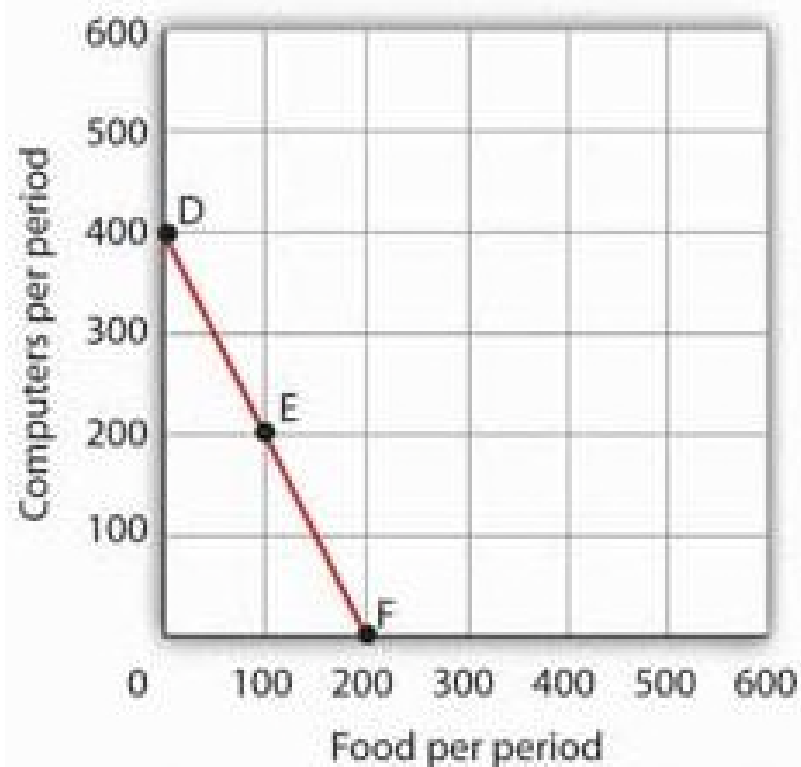
	Computers per period	Food per period
A	200	0
B	100	200
C	0	400



Panel (b)

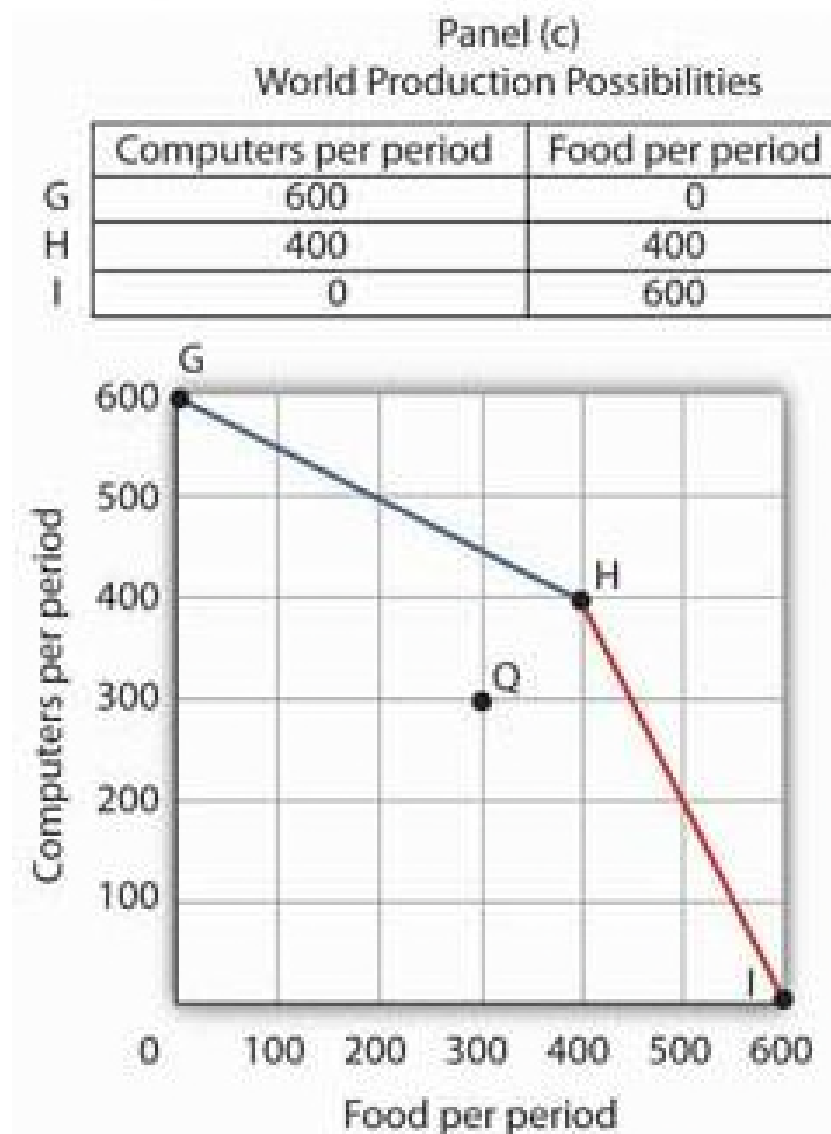
Europe's Production Possibilities

	Computers per period	Food per period
D	400	0
E	200	100
F	0	200





PRODUCTION POSSIBILITIES CURVES AND TRADE



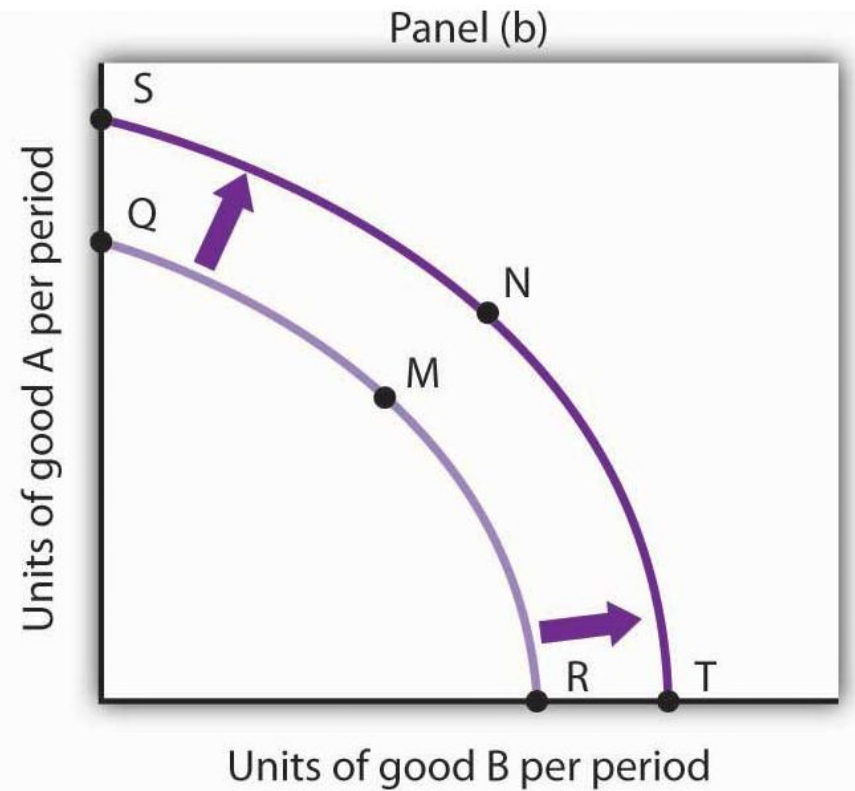
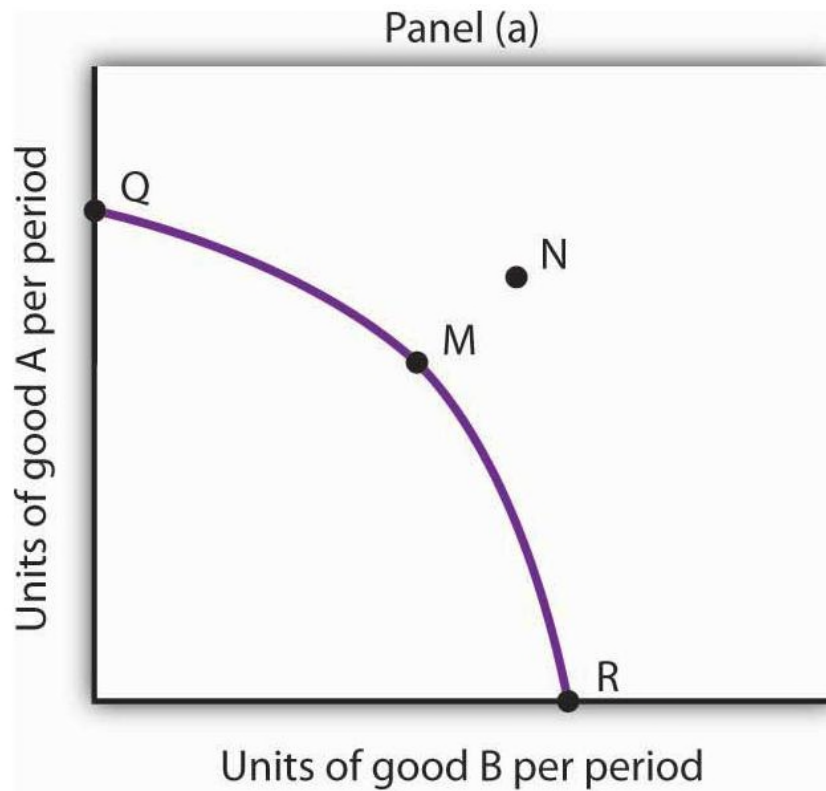


ECONOMIC GROWTH

- An increase in the physical quantity or in the quality of factors of production available to an economy or a technological gain will allow the economy to produce more goods and services.
 - It will shift the economy's production possibilities curve outward.
- The process through which an economy achieves an outward shift in its production possibilities curve is called economic growth.



ECONOMIC GROWTH AND THE CURVE





SOURCES OF U.S. ECONOMIC GROWTH, 1960-2007

PERIOD	PERCENTAGE CONTRIBUTION TO GROWTH	PERIOD GROWTH RATE
Years 1960-2007		3.45%
Increase in quantity of labor	0.74%	
Increase in quantity of capital	1.48%	
Increase in quality of labor	0.23%	
Increase in quality of capital	0.58%	
Improved technology	0.41%	
Years 1960-1995		3.42%
Increase in quantity of labor	0.80%	
Increase in quantity of capital	1.55%	
Increase in quality of labor	0.24%	
Increase in quality of capital	0.56%	
Improved technology	0.28%	



SOURCES OF U.S. ECONOMIC GROWTH, 1960-2007

PERIOD	PERCENTAGE CONTRIBUTION TO GROWTH	PERIOD GROWTH RATE
Years 1995-2000		4.52%
Increase in quantity of labor	1.09%	
Increase in quantity of	1.43%	
Increase in quality of labor	0.20%	
Increase in quality of capital	0.89%	
Improved technology	0.90%	
Years 1960-1995		2.78%
Increase in quantity of labor	0.17%	
Increase in quantity of capital	1.21%	
Increase in quality of labor	0.22%	
Increase in quality of capital	0.46%	
Improved technology	0.72%	



CLASSIFYING ECONOMIC SYSTEMS

MARKET CAPITALIST ECONOMY

- Resources are generally owned by private individuals.
- Owners have the power to make decisions about their use.

COMMAND SOCIALIST ECONOMY

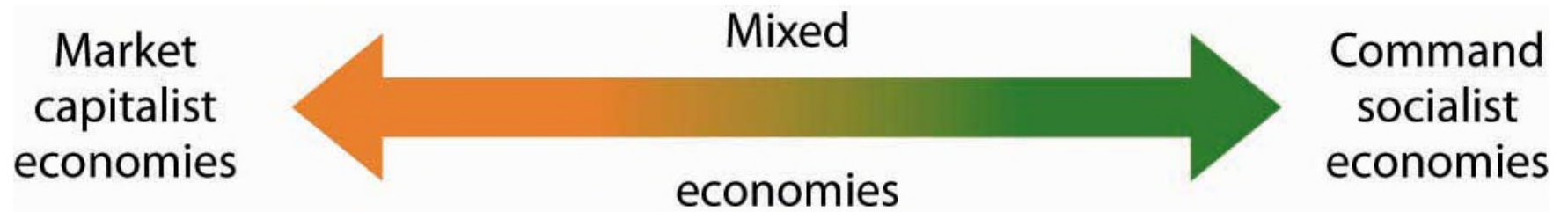
- Government is the primary owner of capital and natural resources
- Government has broad power to allocate the use of factors of production.

MIXED ECONOMY

- Combines elements of market capitalist and command socialist economic systems.

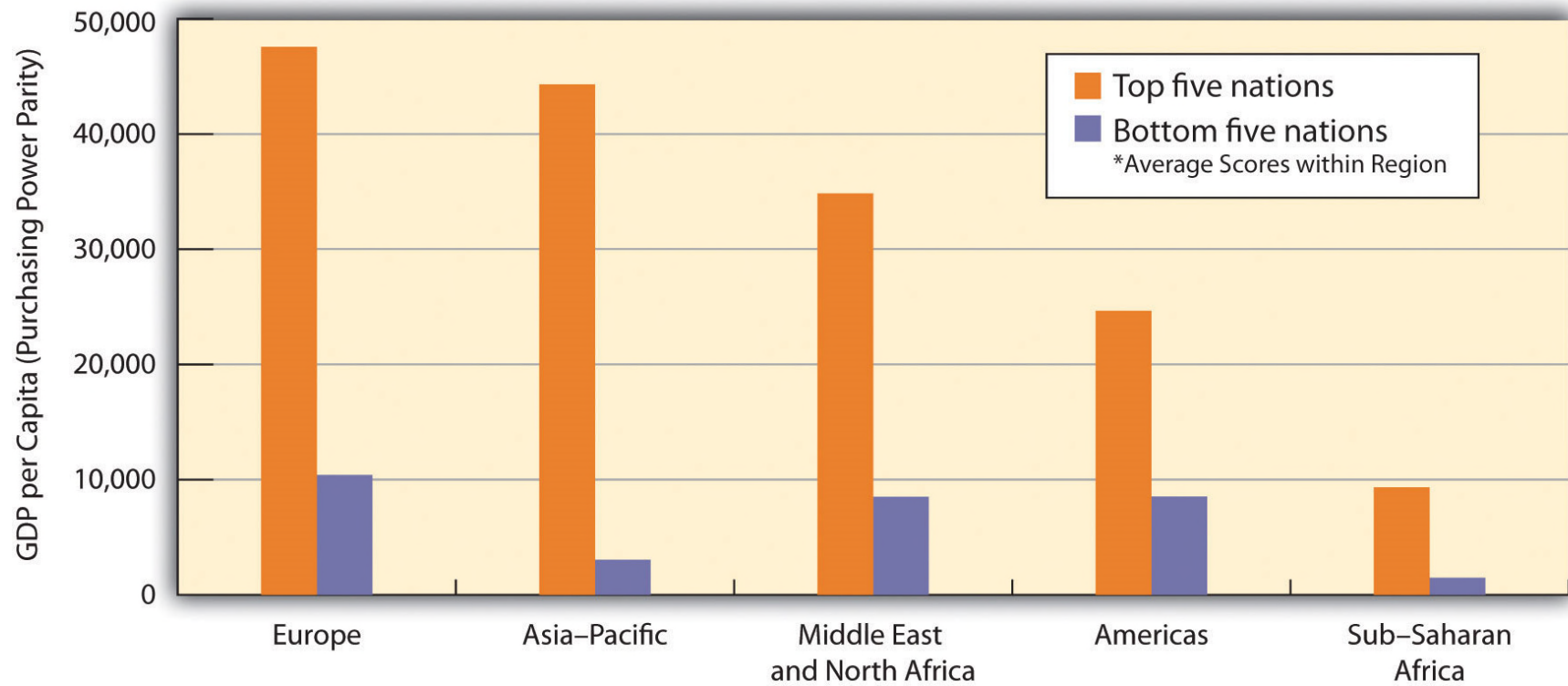


ECONOMIC SYSTEMS





ECONOMIC FREEDOM AND INCOME





GOVERNMENT IN A MARKET ECONOMY

- In a market economy interactions of individual buyers and sellers determine where on a production possibilities curve an economy will produce.
- Government plays a role as well:
 - For example, it may seek to encourage greater consumption of some goods and discourage consumption of others.