

OUTLINE — August 27, 2018

- Normative Questions: What are the Goals?
- Production Possibilities Frontier
 - Law of Increasing Opportunity Costs
- Economic Growth

*No laptops (unless pre-approved); Tablets ok
Cell phones silenced & put away*

Announcements sent by email by Prof. Olney
Extra handouts: in racks outside 532 Evans

Criteria for Judging

- Efficiency
- Growth
- Equity
- Stability
- What if goals conflict?
 - Your value system dictates which goals are more important than others

Normative vs. Positive Allocating Scarce Resources Production Possibilities Frontier Economic Growth

A Simple but Powerful Economic Model

- How does the economy allocate its scarce resources?
- Resources include
- Subject to constraints

Normative vs. Positive **Allocating Scarce Resources** Production Possibilities Frontier Economic Growth

Production Possibilities Frontier

- Every model:
 - Question – Simplifications - Assumptions
- Question:

What are the general characteristics of the possible combinations of output that can be produced in an economy within a given time period?

Normative vs. Positive Allocating Scarce Resources **Production Possibilities Frontier** Economic Growth

Production Possibilities Frontier

- Simplify: Only 2 types of output
- Assume: No deliberate waste
 - We use all resources as efficiently as possible

Normative vs. Positive Allocating Scarce Resources **Production Possibilities Frontier** Economic Growth

Demonstration: "No Deliberate Waste"

- On a scale of 0 (horrible) to 100 (fabulous),
 - Rank your ability to produce food
 - Rank your ability to produce machines
- Now, compute the ratio: $\frac{\text{Food}}{\text{Machines}}$
- Line up high-to-low according to ratio: $\frac{\text{Food}}{\text{Machines}}$
- Who produces food? Machines?

Normative vs. Positive Allocating Scarce Resources **Production Possibilities Frontier** Economic Growth

Example: Food & Machines

- Possible combinations of food (F) & machines (M)?

January	February
100 machines 2,000 units food	110 machines _____ units food

- Opportunity cost of those 10 additional machines?

February	March
110 machines _____ units food	120 machines _____ units food

- Opportunity cost of those 10 additional machines?

Normative vs. Positive Allocating Scarce Resources **Production Possibilities Frontier** Economic Growth

Opportunity Cost

- Opportunity Cost definition
 -
- Law of Increasing Opportunity Cost
 - The "law":
- Explanation:

Normative vs. Positive Allocating Scarce Resources **Production Possibilities Frontier** Economic Growth

Production Possibilities Frontier for this example

January: 100 M & 2,000 F
 February: 110 M & 1,900 F
 March: 120 M & 1,500 F



Normative vs. Positive Allocating Scarce Resources **Production Possibilities Frontier** Economic Growth

Production Possibilities Frontier, in general



Normative vs. Positive Allocating Scarce Resources **Production Possibilities Frontier** Economic Growth

Economic Growth

- Economic Growth shifts the PPF out
- Growth: an increase in total *possible* output
 - (or sometimes, increase in total possible output *per person*)
- Sources of growth
 1. increased quantity of resources
 2. increased productivity of resources

Normative vs. Positive Allocating Scarce Resources Production Possibilities Frontier **Economic Growth**

Example: Increase labor force



Normative vs. Positive Allocating Scarce Resources Production Possibilities Frontier **Economic Growth**

Ex.: Increase productivity in **food** production



Normative vs. Positive Allocating Scarce Resources Production Possibilities Frontier Economic Growth

What can increase productivity?

- Institutions!

Normative vs. Positive Allocating Scarce Resources Production Possibilities Frontier Economic Growth

Example: Hurricane Maria



Normative vs. Positive Allocating Scarce Resources Production Possibilities Frontier Economic Growth

Consuming beyond PPF: aid

- When one economy or foreign organization provides resources to another economy
- Examples
 - *Bridges to Prosperity*
 - *Cal's Alternative-Break trips to New Orleans*
 - *Marshall Plan after WWII*
- Marshall Plan
 - US aid to Europe after WWII
 - World War II, massive bombing throughout Europe
 - Destroyed much of the transportation infrastructure
 - 1948-1952, rebuild infrastructure, modernize industry

Normative vs. Positive Allocating Scarce Resources Production Possibilities Frontier Economic Growth