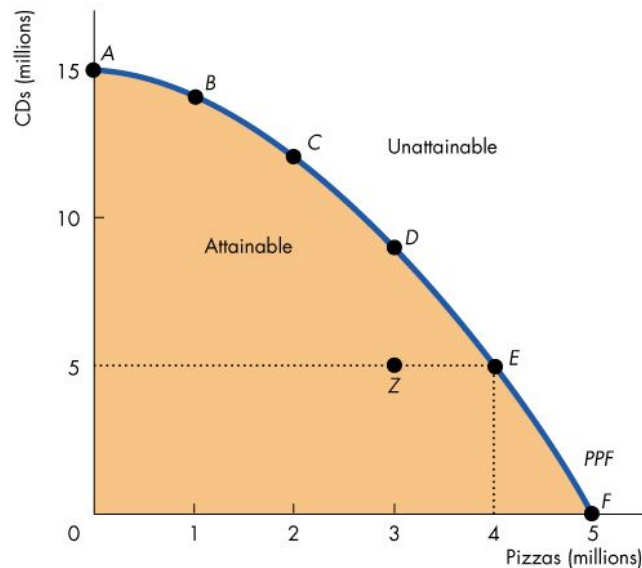


ECO101: Introduction to Microeconomics

Lecture 2

Production Possibility Frontier (PPF)

- The **production possibilities frontier** (*PPF*) is the boundary between those combinations of goods and services that can be produced and those that cannot.




Production Possibility Frontier (PPF)

- Production Efficiency: We achieve **production efficiency** if we cannot produce more of one good without producing less of some other good
- PPF involves ➡ *trade-off* ➡ *Opportunity Cost*

Production Possibility Frontier (PPF)

- Increasing Opportunity Cost
- Why does the PPF bows outward ?

PPF and Marginal Cost

- The *PPF* determines opportunity cost.
- The **marginal cost** of a good or service is the opportunity cost of producing *one more unit* of it.
- Increasing opportunity cost of a pizza  means increasing marginal cost of a pizza

Calculating Marginal Cost

- Let us draw a PPF out of this:

Possibility	Pizzas (millions)		CDs (millions)
<i>A</i>	0	and	15
<i>B</i>	1	and	14
<i>C</i>	2	and	12
<i>D</i>	3	and	9
<i>E</i>	4	and	5
<i>F</i>	5	and	0

Preferences and Marginal Benefit —

- Marginal benefit- benefit received from consuming one more unit of goods and service —this depends on people's likes and dislikes and it is totally unrelated to PPF

Allocative Efficiency —

- Allocative efficiency- When we cannot produce more of any one good without giving up some other good *that we value more highly*, we have achieved allocative efficiency. Such that it's an optimal distribution of goods and it is determined by the point where $MC=MB$

Economic Growth

- The expansion of production possibilities – and increase in the standard of living – is called **economic growth**.
- Two major factors of economic growth:
 - 1. Technological change - is the development of new goods and of better ways of producing goods and services.
 - 2. Capital accumulation - is the growth of capital resources, which includes *human capital*.

The Cost of Economic Growth

- Economic growth is not free
- • To use resource in research and development, we must decrease our production of **consumption goods and** services
- Hence opportunity cost of Economic growth is less consumption today

Gains From Trade

- *Comparative advantage-* A person has a **comparative advantage in an activity** if **that** person can perform the activity at a lower opportunity cost than anyone else.
- *Absolute advantage-* A person has an **absolute advantage** if **that person** more **productive than** others.

Essential Reading for Today!

- *Parkin, Powell, Matthews. Economics. 8th Edition*
- *Chapter 2: Pages 32 to 42*