AP Macroeconomics

Key Assumptions in Economics, Scarcity, Opportunity Cost and the Production Possibilities Curve

Key Assumptions in Economics

- People are rationally self-interested
  - They seek to maximize their utility (happy points)
- People generally make decisions at the margin
  - They weigh the marginal benefit against the marginal cost of a decision
- Ceteris Paribus
  - Economists hold factors constant, except for what's being considered

Basic Economic Vocabulary

- Economics
  - The study of choices people make to satisfy their needs and wants
- Microeconomics
  - The study of how individuals and firms deal with scarcity
- Macroeconomics
  - The study of how society as a whole deals with scarcity

Basic Economic Vocabulary

- Needs
  - Necessities for survival
- Wants
  - Goods and services consumed beyond what is necessary for survival

Basic Economic Vocabulary

- Goods
  - Physical objects that can be purchased
- Services
  - Actions or activities performed for a fee
- Consumers
  - People who purchase goods and services
- Producers
  - People who supply goods and services

Resources a.k.a. The Factors of Production

- Economists classify resources into 4 categories
  1. Land
     - Natural resources
     - The payment for Land is RENT

  2. Labor
     - Human resources
     - The payment for Labor is WAGES

  3. Capital (a product of Investment)
     - Tools, machines, factories
     - The payment for Capital is INTEREST

  4. Entrepreneurship
     - The special ability of risk-takers to combine land, labor and capital in new ways in order to make profit
     - The payment for Entrepreneurship is PROFIT

The Fundamental Problem of Economics: Scarcity

- People have unlimited wants but the resources to satisfy those wants are scarce.
- Therefore, we must make choices about how to use our scarce resources. We face trade-offs when it comes to using available resources.
  - Ex. Assume flour is a scarce resource: 3 cups of flour can be used to make a loaf of bread or a cake, but the 3 cups cannot be used to make both.

The Fundamental Problem of Economics: Scarcity

OR

Opportunity Cost

- Once a resource or factor of production has been put to productive use an opportunity cost is incurred.
- Opportunity cost is the next best alternative use for a resource.
  - Ex. If the 3 cups of flour are used to bake bread, then the opportunity cost is the cake that could also have been baked with the 3 cups of flour.
- No matter what we do with our time or resources, we always incur opportunity cost. TINSTAAFL.

TINSTAAFL

There is no such thing as a free lunch.

TINSTAAFL

Everything has a cost.

TINSTAAFL Illustrated: The PPC

- The PPC = The Production Possibilities Curve
- The PPC = a graph showing all of the possible combinations of output for an economy fully employing all of its resources in producing 2 goods.

TINSTAAFL Illustrated: The PPC