

>> **Basic Concepts and Economic Models: Trade-offs and Trade**

**Krugman/Wells
Economics**

Bibliography

Paul **Krugman** e Robin **Wells** (2018),
Microeconomics, 5th Edition New York: Worth
Publishers.

OR

Paul **Krugman** e Robin **Wells** (2015),
Microeconomics, 4th Edition New York: Worth
Publishers.

Documentos complementares

UNIVERSIDADE DE LISBOA

INSTITUTO SUPERIOR DE ECONOMIA E GESTÃO

ECONOMIA I

ANO LECTIVO 2016/2017

**ANÁLISE QUANTITATIVA DISCRETA E
ANÁLISE QUANTITATIVA CONTÍNUA NOS
MANUAIS DE MICROECONOMIA**

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ECONOMIA I / ECONOMIA I-G

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Caderno de Exercícios

Aulas Práticas

WHAT YOU WILL LEARN IN THIS CHAPTER

- The difference between positive economics and normative economics
- When economists agree and why they sometimes disagree
- Why **models**? Simplified representations of reality—play a crucial role in economics
- Two simple but important models: (scarcity / choice)
 - production possibility frontier
 - Comparative advantage model

Discourses in Economics

- **Positive economics** is the branch of economic analysis that describes the way the economy actually works.
- **Normative economics** makes prescriptions (values/ judgements) about the way the economy *should* work.
- A **forecast** is a simple prediction of the future (*positive economics*).

Why economists disagree sometimes?

There are two main reasons economists **disagree**:

- Which ***simplifications*** to make in a model
- ***Values*** (*normative* economics): Economists can determine correct answers for positive questions, but typically not for normative questions, which involve value judgments.
- [The exceptions are when policies designed to achieve a certain prescription can be clearly ranked in terms of *efficiency*].

Models in Economics

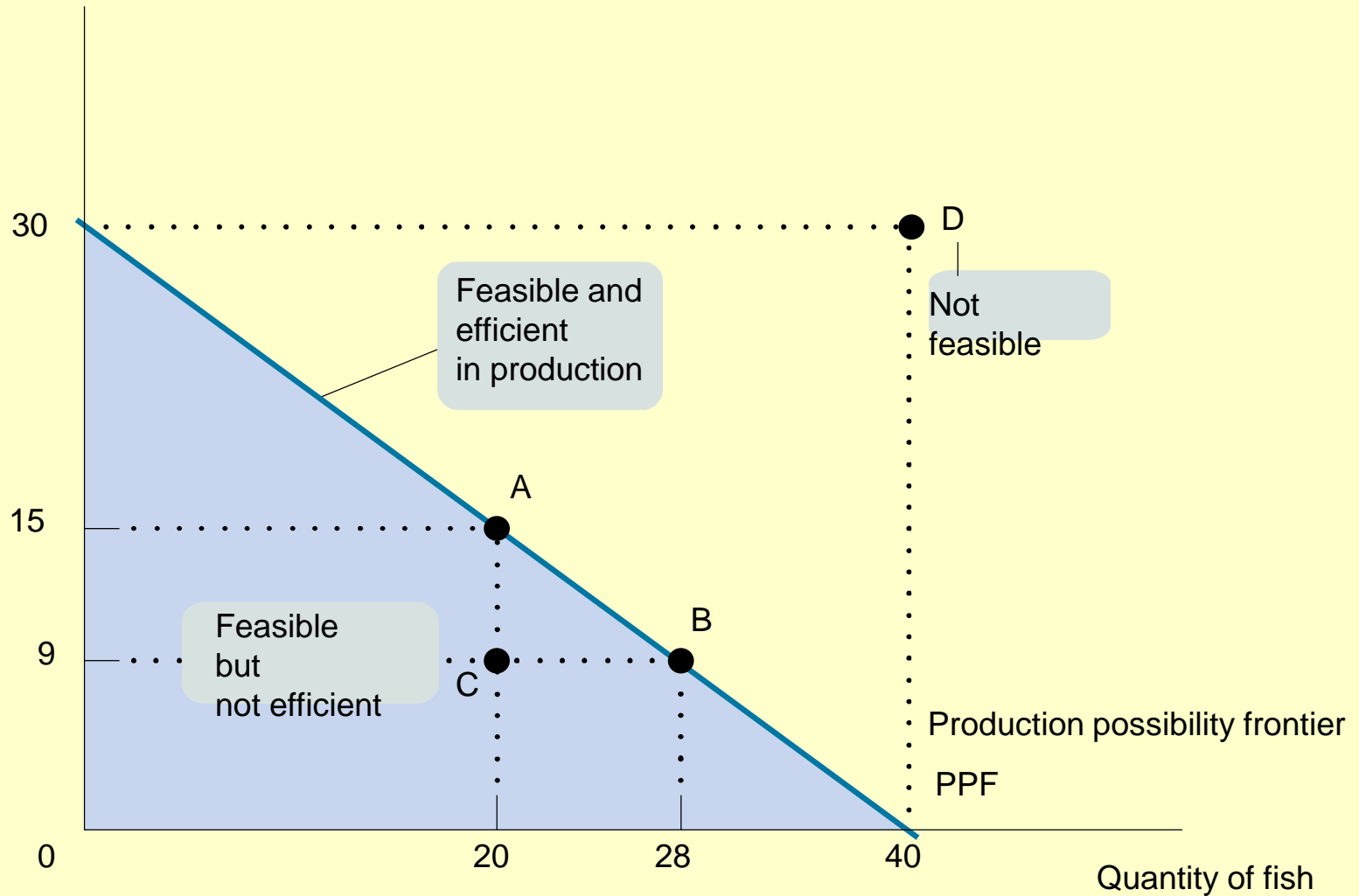
- A **model** is a simplified representation of a real situation that is used to better understand real-life situations.
 - Create a real but simplified economy
 - Simulate an economy on a computer
- The “**other things equal**” **assumption** means that all other relevant factors remain unchanged.
[*ceteris paribus* assumption]

Trade-offs: The Production Possibility Frontier

- The **production possibility frontier (PPF)** illustrates the trade-offs facing an economy that produces only two goods. It shows the maximum quantity of one good that can be produced for any given production of the other.
- The PPF improves our understanding of trade-offs by considering a simplified economy that produces only two goods by showing this trade-off graphically.

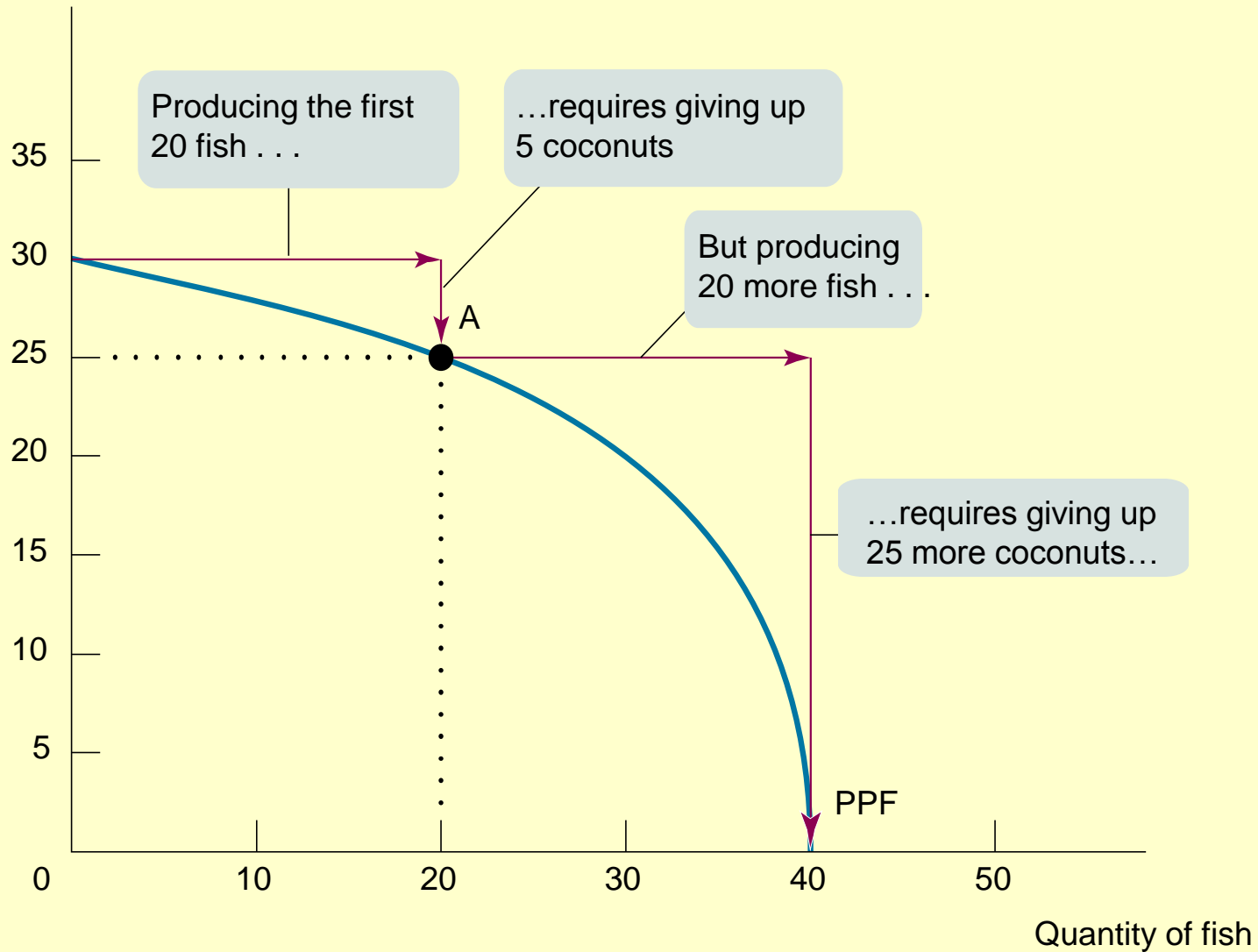
The Production Possibility Frontier

Quantity of coconuts

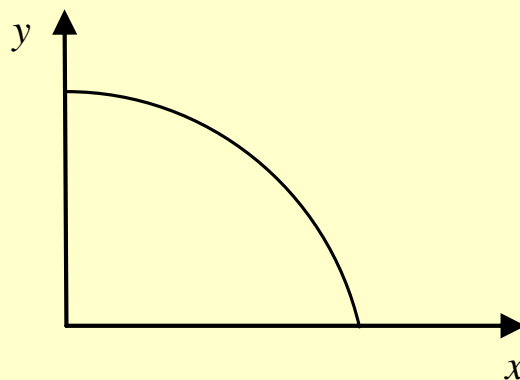


Increasing Opportunity Cost

Quantity of coconuts



No domínio contínuo



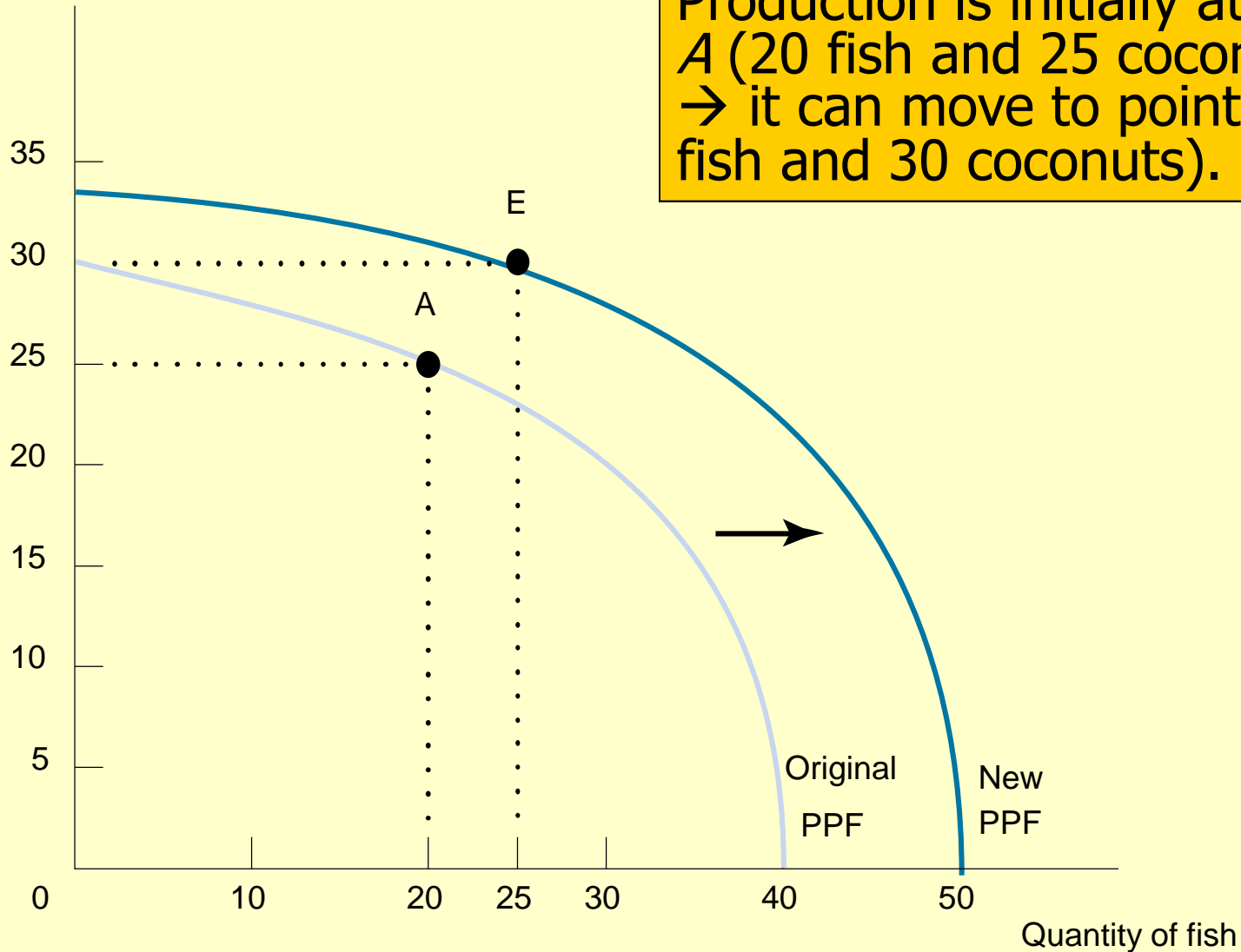
$y = f(x)$ \rightarrow Expressão analítica da FPP

$$CO_{X,Y} = - \frac{dy}{dx}$$

$\frac{d^2 y}{dx^2} < 0$ \rightarrow FPP côncava (custo de oportunidade crescente)

Economic Growth

Quantity of coconuts

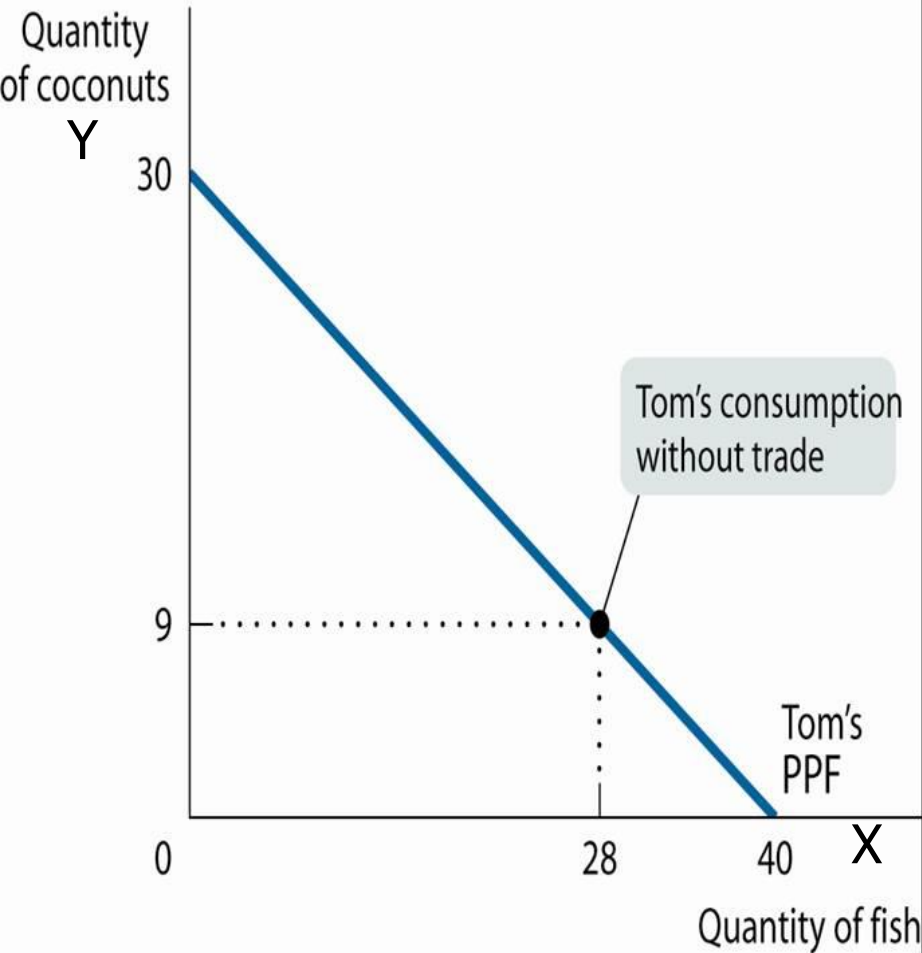


Production is initially at point A (20 fish and 25 coconuts),
→ it can move to point E (25 fish and 30 coconuts).

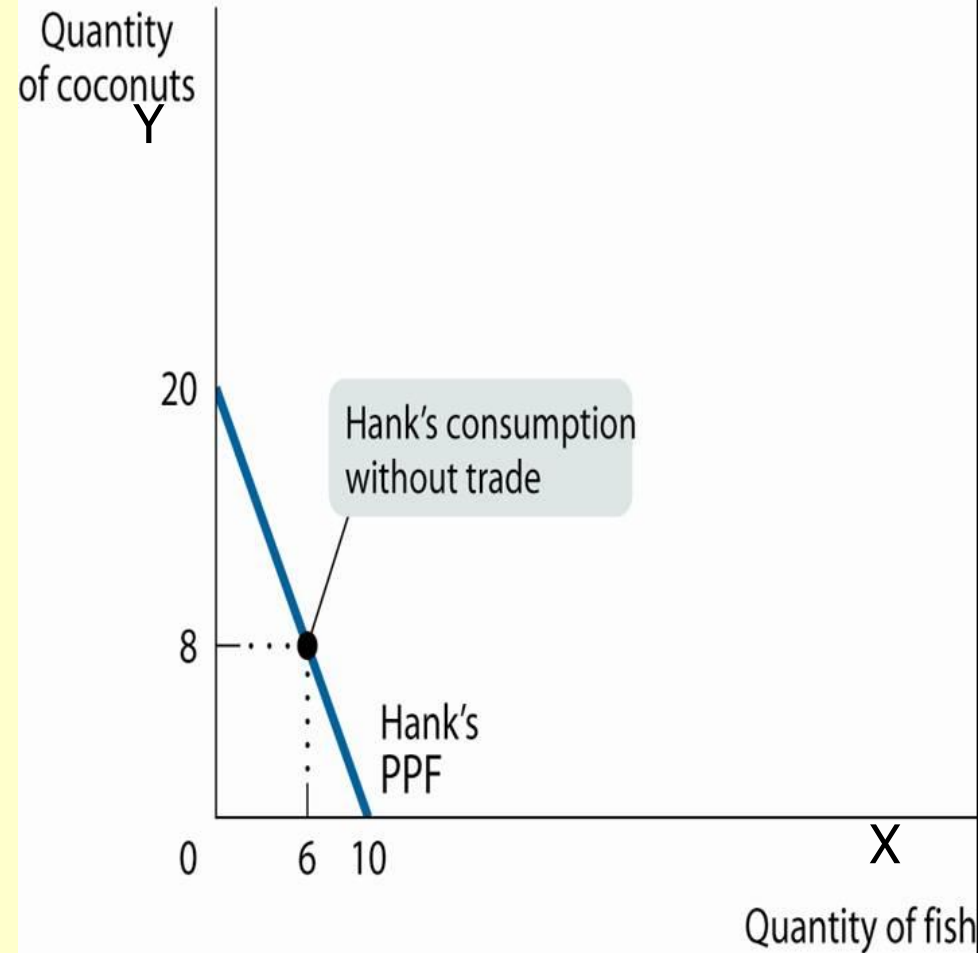
Comparative Advantage and Gains from Trade

Ex.: Tom and Hank

(a) Tom's Production Possibilities



(b) Hank's Production Possibilities



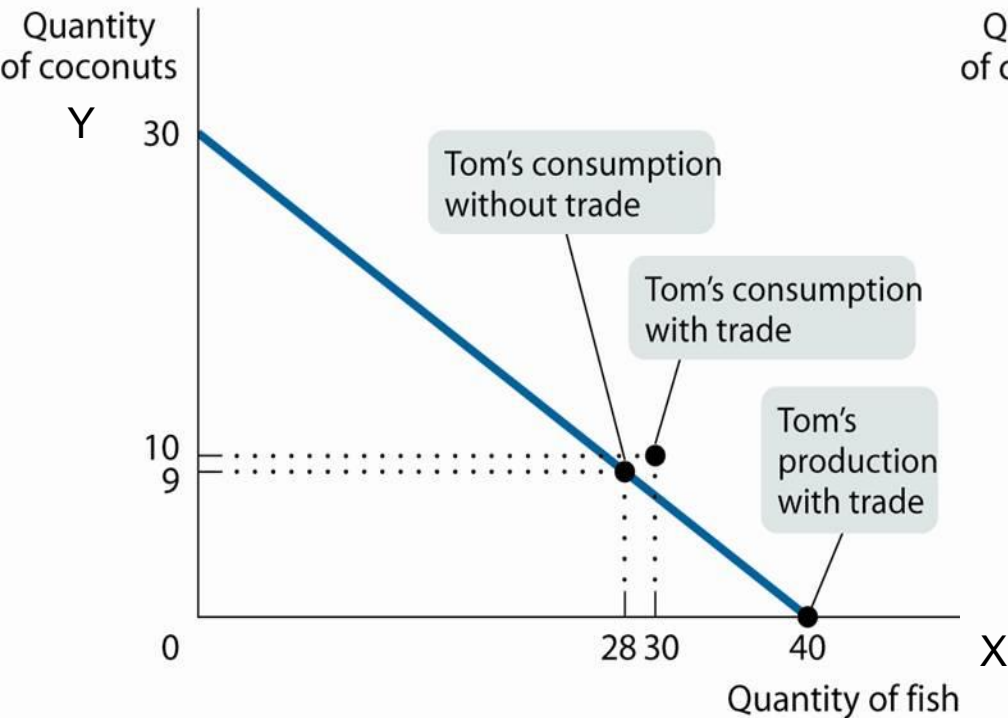
Tom and Hank's Opportunity Costs

	Tom's Opportunity Cost	Hank's Opportunity Cost
One fish (X)	3/4 coconut [Cox,y]_Tom	2 coconuts [COx,y]_Hank
One coconut (Y)	4/3 fish [COy,x]_Tom	1/2 fish [COy,x]_Hank

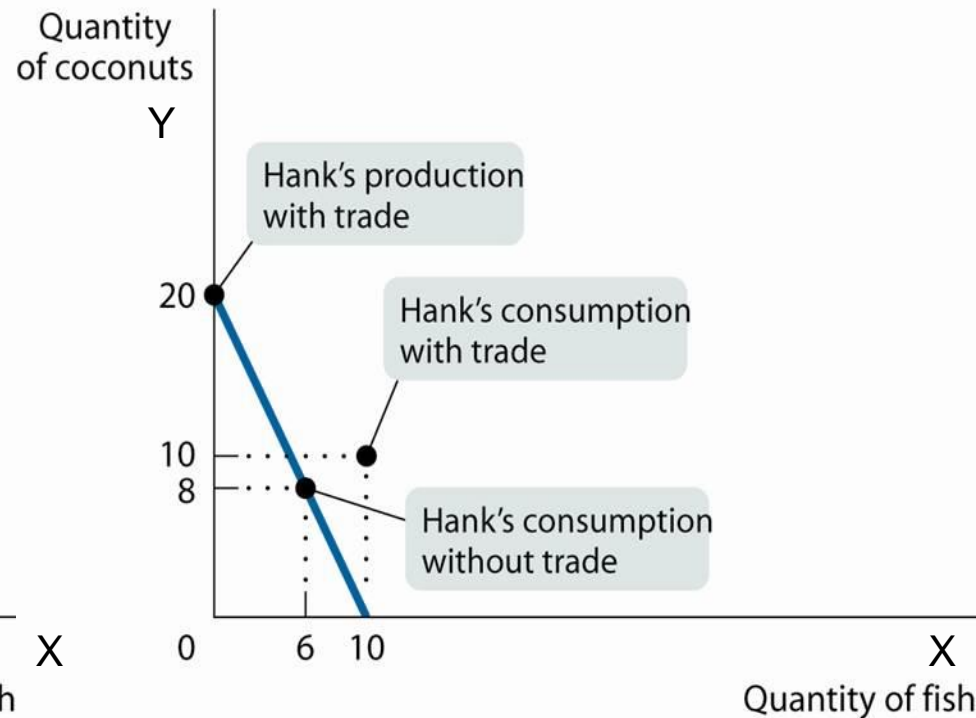
Both castaways are better off when they each specialize in what they are good at and trade.

Specialize and Trade

(a) Tom's Production and Consumption



(b) Hank's Production and Consumption



		Without Trade		With Trade		Gains from Trade
		Production	Consumption	Production	Consumption	
Tom	Fish (X)	28	28	40	30	+2
	Coconuts (Y)	9	9	0	10	+1
Hank	Fish	6	6	0	10	+4
	Coconuts	8	8	20	10	+2

Comparative vs. Absolute Advantage

- An individual has a **comparative advantage** in producing a good or service if the opportunity cost of producing the good is lower for that individual than for other people.
- An individual has an **absolute advantage** in an activity if he or she can do it better than other people. Having an absolute advantage is not the same thing as having a comparative advantage.

The End of Chapter 2

Coming attraction
Chapter 3:
Supply and Demand