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

Krugman/Wells Economics

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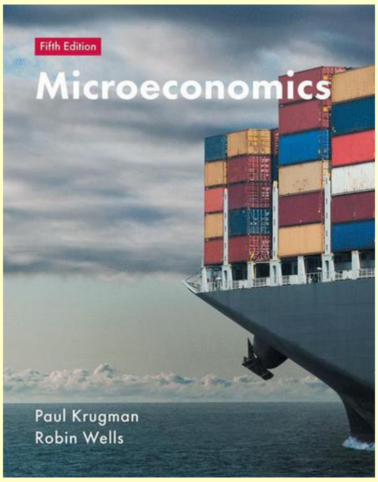
Bibliography

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



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Documentos complementares

UNIVERSIDADE DE LISBOA

INSTITUTO SUPERIOR DE ECONOMIA E GESTÃO

ECONOMIA I

ANO LECTIVO 2020/2021

ANÁLISE QUANTITATIVA DISCRETA E
ANÁLISE QUANTITATIVA CONTÍNUA NOS
MANUAIS DE MICROECONOMIA

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INSTITUTO SUPERIOR DE ECONOMIA E GESTÃO

ECONOMIA I / ECONOMIA I-G

ANO LECTIVO 2020/2021

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).

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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*].

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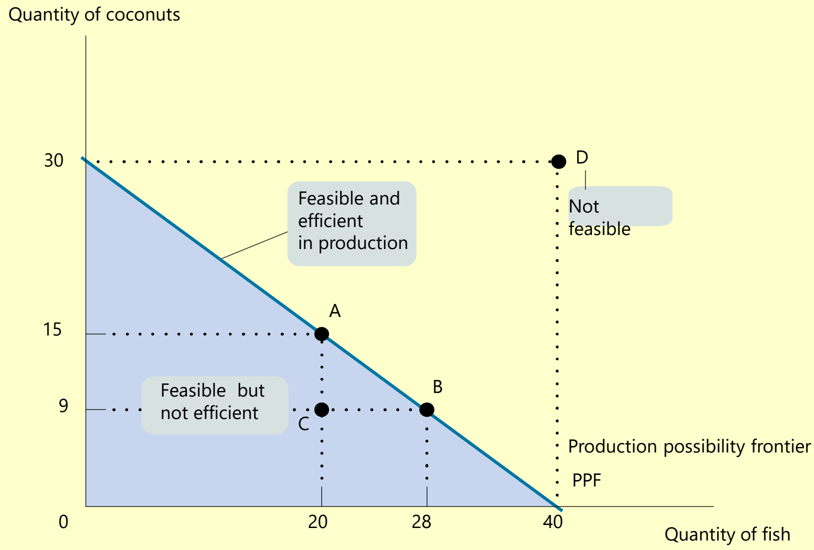
Models in Economics

- 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



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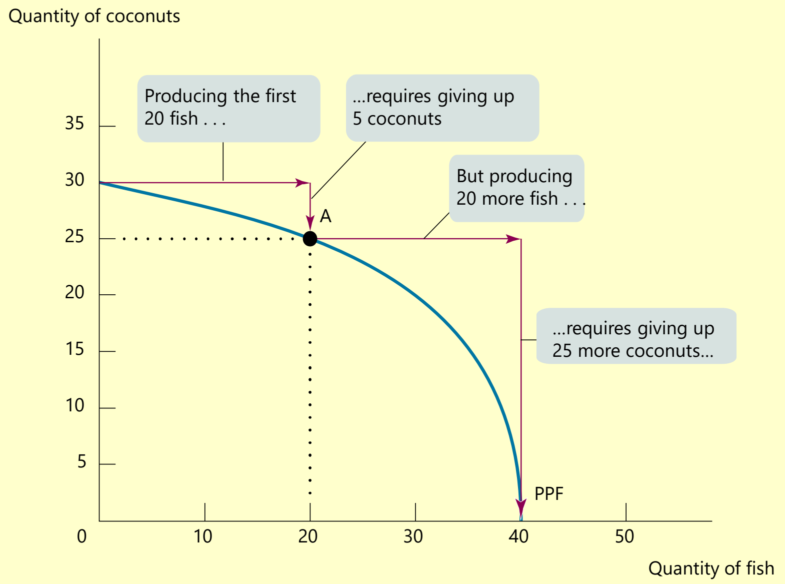
Increasing Opportunity Cost



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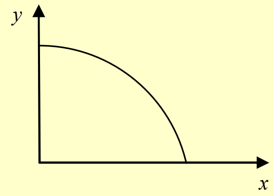
No domínio contínuo



$$y = f(x)$$ → Expressão analítica da FPP

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

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

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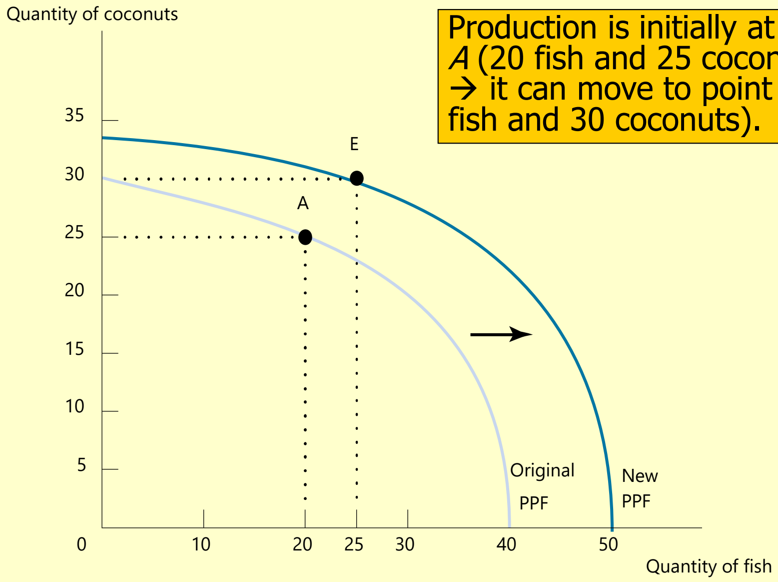
Economic Growth



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

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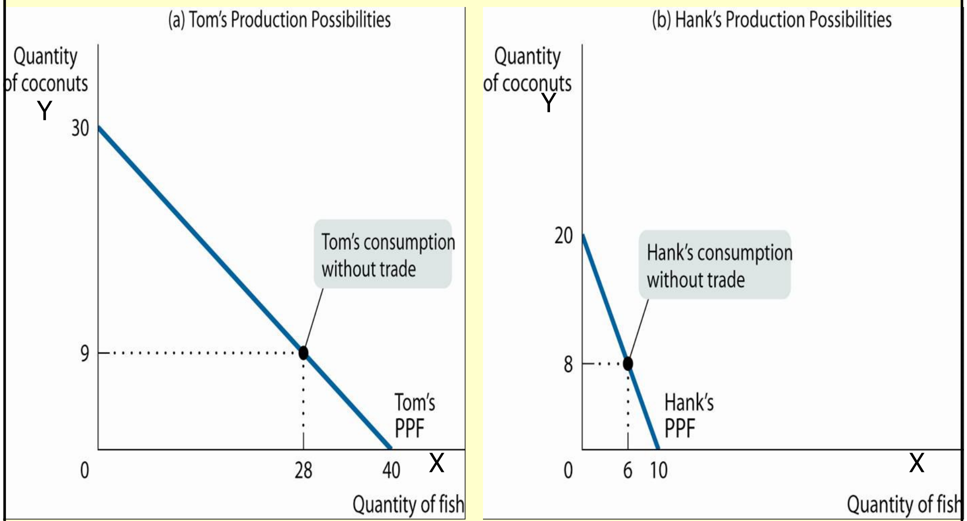
Comparative Advantage and Gains from Trade
Ex.: Tom and Hank



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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. 14

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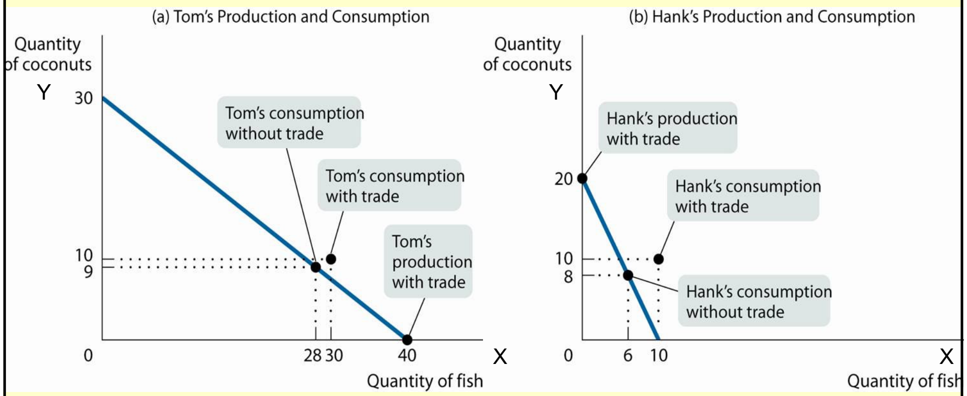
Specialize and Trade



		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