Production possibility frontier

Literature, Russian Literature

Production Possibility Frontier – " a model that 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 quantity produced of the other" (Krugman & Wells, 2009, G-7). When an economy produces only two goods, the increase in production of one good will necessarily draw a decrease in production of the other, because the resources are limited.

Production possibility frontier, in the form of a graph, defines how to use the resources efficiently to produce two goods. For example, if an economy produces fruit juices and furniture, an increase of juice production will lead to a decrease of furniture production, because part of the resources will necessarily be diverted from furniture production. The choice can be made according to the demand – if fruit juices are more in demand, it is better to sacrifice in furniture production, and the opportunity cost is justified then.

Comparative Advantage – " the advantage conferred on an individual or nation in producing a good or service if the opportunity cost of producing the good or service is lower for that individual or nation than for other producers" (Krugman & Wells, 2009, G-2). An individual or a company has a comparative advantage if they can produce a good at a lower opportunity cost than others. It does not mean that they should do it better than others, but only that it costs them less.

This is the term that can be contrasted with absolute advantage, when an individual or a company can produce a good at a lower absolute cost than the others. Concerning comparative advantages, it is opportunity costs that matter and not absolute advantages. For example, a company may produce computers of the same or even better quality than another company, and the absolute costs may be more or less equal. But the first company may be even better at producing phones, so it would cost them abandoning phone production to produce computers, which is a high opportunity cost.

In this case, the second company will have a comparative advantage even if they produce computers of lower quality. Absolute Advantage – “ the advantage conferred on an individual in an activity if he or she can do it better than other people” (Krugman & Wells, 2009, G-1). An individual, a company, or a nation have an absolute advantage over others if it can produce the same amount of goods or services with fewer resources, or a greater amount of goods and services with the same resources. In this case, the absolute costs and not the opportunity costs matter.

Increasing Marginal Costs. Marginal cost is the cost of production of one more unit. For example, if a factory produces 100 computers, the change of total cost to produce the 101st computer will be the marginal cost. Until the same equipment can be used to produce more goods, the increase of marginal costs will be insignificant or the marginal costs will even decrease because the resources will be used efficiently. Yet, the greater increase in production requires building a new factory, and the marginal costs increase significantly.

Therefore, marginal costs curve is usually U-shaped, as marginal costs tend to decline for small quantities of units and rise for larger quantities of units. Increasing marginal costs usually mean diminishing marginal returns. Positive economic statements. Positive economics is “ the branch of economic analysis that describes the way the economy actually works” (Krugman & Wells, 2009, G-7); therefore, positive economic statement is the statement that describes the way the economy actually works, in other words, that depicts real facts and data.

It presents no judgments and no advices about how it should be, but simply describes the situation as it is. Normative economic statement. Normative economics is “ the branch of economic analysis that makes prescriptions about the way the economy should work” (Krugman & Wells, 2009, G-7); therefore, normative economic statement is a statement that operates with judgments.

It states how the things should be rather than how they work in reality. For example, the statement “ in the Philippines, the unemployment rate in 2009 only increased slightly to 7. 5 percent” is a positive one as it simply reports the facts, and the statement “ it is crucial to have job protection policies in place” is a normative one because it contains judgment about what should be done (“ World unemployment”, 2010).

In fact, positive and normative economic statements are often mixed in one and the same article or a report, so it is important to distinguish between them.

References

Krugman, P. , & Wells, R. (2009). Macroeconomics. 2nd ed. New York, NY: Worth Publishers. World unemployment reached highest level on record in 2009. (2010, January 29). Retrieved from http://worldunemployment. blogspot. com/2010/01/world-unemployment-reached-highest. html