

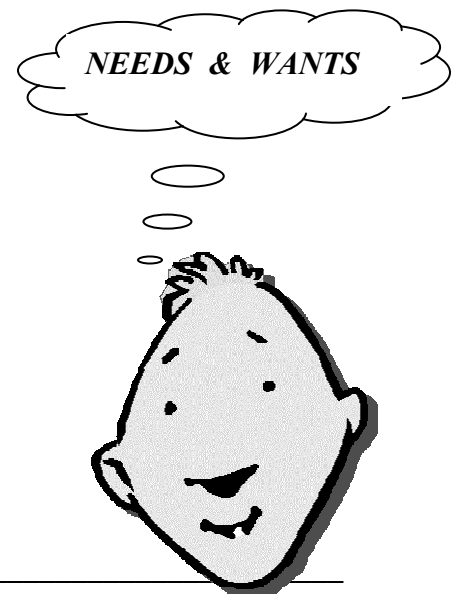
KOFA HIGH SCHOOL SOCIAL SCIENCES DEPARTMENT
AP ECONOMICS

STUDY GUIDE # 2 - THE ESSENCE OF ECONOMICS -
THE ART OF DECISION MAKING



CHAPTER LEARNING OBJECTIVES

1. **STUDENTS WILL BE ABLE TO EXPLAIN THE FIRST LAW OF ECONOMICS AND LIFE**
2. **STUDENTS WILL BE ABLE TO EXPLAIN THE CONCEPT OF OPPORTUNITY COSTS AND ILLUSTRATE AN EXAMPLE**
3. **IN ECONOMIC TERMS, STUDENTS WILL BE ABLE TO EXPLAIN THE CONCEPT OF “THINKING AT THE MARGIN ” AND ILLUSTRATE AN EXAMPLE OF USING MARGINAL ANALYSIS**
4. **STUDENTS WILL BE ABLE TO IDENTIFY THE 3 BASIC FOCAL POINTS OF A COST BENEFIT ANALYSIS**
5. **STUDENTS WILL BE ABLE TO EXPLAIN AND ILLUSTRATE THE FOLLOWING LAWS AND PRINCIPLES :**
 1. **MARGINAL PRODUCT OF LABOR**
 2. **INCREASING MARGINAL RETURNS**
 3. **DIMINISHING MARGINAL RETURNS**
 4. **NEGATIVE MARGINAL RETURNS**
 5. **DIVISION OF LABOR**
 6. **SPECIALIZATION**
 7. **HOW PROFIT IS DETERMINED**



DECISION MAKING STEP # 1 > WE NEED TO UNDERSTAND THE HIGHLY VALUED , AND SECRET FIRST LAW OF ECONOMICS AND LIFE :

WHAT DOES THE WORD “FREE ” MEAN ?

ARE THERE ANY “FREE” GOODS ?

WHAT IS THE FIRST LAW OF ECONOMICS AND LIFE ?

WHAT ARE THE FOUR REASONS WHY YOU WANT TO HAVE A BETTER UNDERSTANDING ABOUT HOW TO MAKE DECISIONS ?

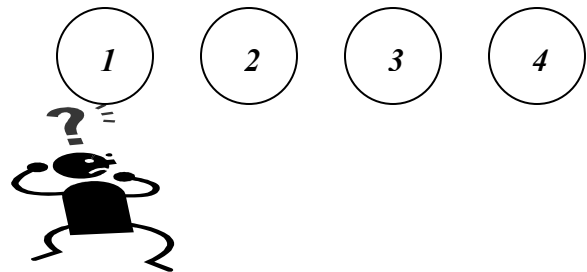
- 1.
- 2.
- 3.
- 4.



DECISION MAKING STEP # 2 > WE NEED TO UNDERSTAND HOW TO EFFECTIVELY HANDLE “ TRADE OFFS ” :



VALUE / COST



WHAT IS “OPPORTUNITY COST” ?

EXAMPLE #1 > ILLUSTRATES OPPORTUNITY COSTS > PENNY PICKUP

PICKED UP



NOT PICKED UP

EXAMPLES # 2 AND 3 > ILLUSTRATES OPPORTUNITY COSTS > BODY SCENT

DEODORANT SOAP



AXE BODY SPRAY



EXAMPLES # 4 AND 5 > NO NOTES NEEDED JUST PAY ATTENTION AND SEEK TO UNDERSTAND THE SERIOUSNESS OF THE CONCEPT !!

HOW DO WE FIGURE OUT WHAT TO DO WHEN CONFRONTED WITH MORE THAN ONE OPTION AND ALL THE OPTIONS HAVE VALUE MAKING IT DIFFICULT TO DECIDE ?

WE USE “ MARGINAL ANALYSIS ” -

WHAT DOES “ MARGINAL ” MEAN ?

WHAT ARE “ MARGINAL BENEFITS ” ?

WHAT DOES “ MARGINAL UTILITY ” MEAN ?



**THE CASE OF THE
GLAZED DOUGHNUTS**

HOW TO CONDUCT MARGINAL ANALYSIS :

WHAT ARE “ IMPLICIT COSTS ” ?

WHAT ARE “EXPLICIT COSTS” ?

WHAT ARE “SUNK COSTS” ?

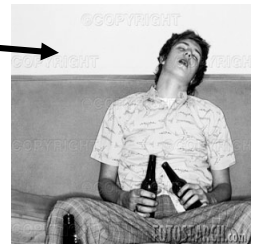
DESCRIBE THE CONCEPT OF “THINKING AT THE MARGIN” :



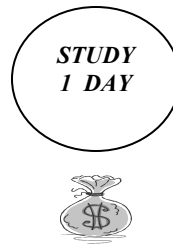
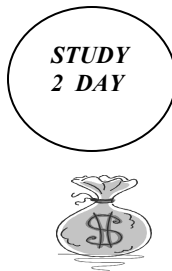
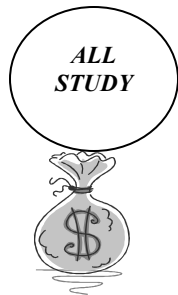
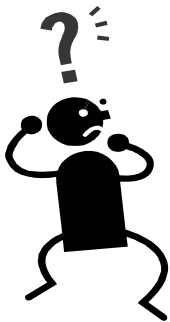
EXAMPLE # 6 > ILLUSTRATES OPPORTUNITY COSTS AND MARGINAL ANALYSIS > PARTY PETE

PARTY -

NO PARTY -



IS THERE ANYTHING IN BETWEEN ?? USING MARGINAL ANALYSIS TO “WEIGH” THE BENEFITS AND COSTS OF THE ALTERNATIVES



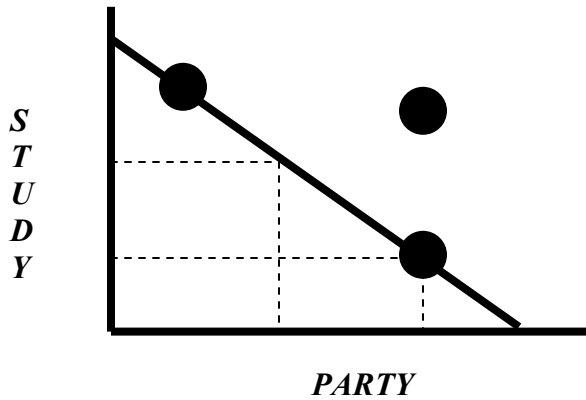
FIRST QUESTION :

SECOND QUESTION :

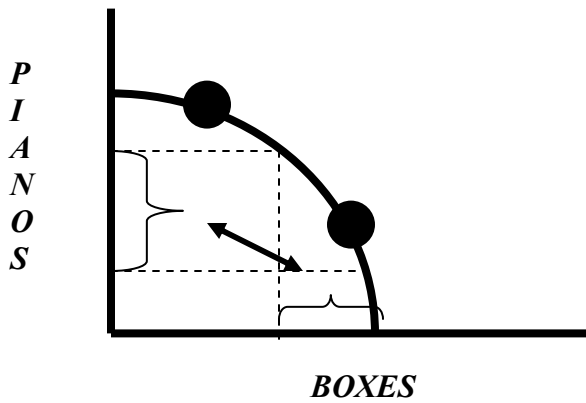
THIRD QUESTION :

THE BETTER THIRD QUESTION : WHAT IS THE “MARGINAL COST” -

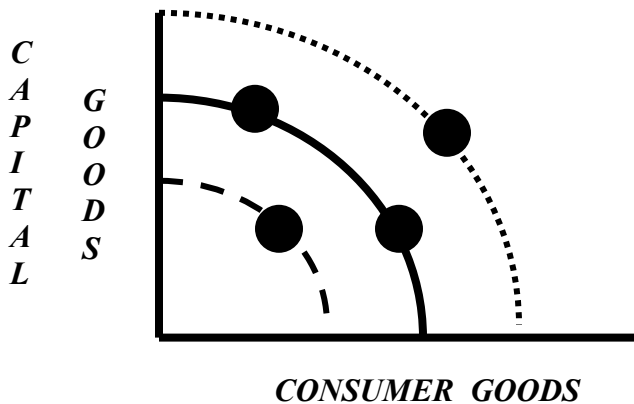
USING THE “ PRODUCTION POSSIBILITIES CURVE ” TO ILLUSTRATE PARTY PETE’S TRADE OFF OPTIONS RELATED TO RESOURCES (TIME) AVAILABLE :



WITH BUSINESSES AND SOCIETIES IT IS DIFFERENT BECAUSE THERE ARE MORE RESOURCES THAT CAN HAVE AN IMPACT ON PRODUCING SOMETHING > THIS CREATES A DIFFERENT CURVE > CONSIDER A MOVING COMPANY :



NOW CONSIDER A SOCIETY :

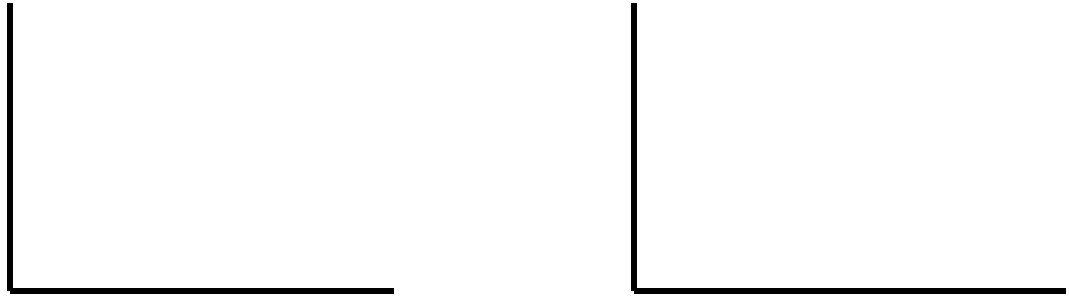


“ UNDERUTILIZATION ” -

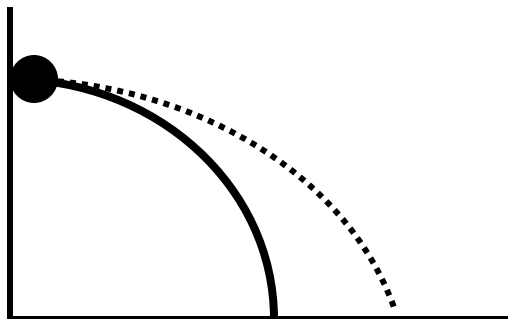
“ CAPITAL GOODS ” -

“ CONSUMER GOODS ” -

THE IMPORTANCE OF THE FACTORS OF PRODUCTION AND THE IMPACT THEY HAVE ON A SOCIETY'S PPC :



BY PRODUCING MORE CAPITAL GOODS , AN ECONOMY'S CAPITAL STOCK IS INCREASED AND THE PRODUCTION POSSIBILITIES CURVE SHIFTS OUT FASTER :



THE TWO VARIABLES THAT WILL SHIFT THE PRODUCTION POSSIBILITIES CURVE OUTWARD :

1.

2.

1.

2.

3.

A DEEPER LOOK AT ECONOMIC AND BUSINESS MEASUREMENTS USING MARGINAL CONCEPTS :

FIRST, HOW IS A BUSINESS FUNDAMENTALLY MEASURED ??

WHAT ARE “COSTS” ? -

1. “COSTS OF PRODUCTION” -

2. “ADMINISTRATIVE COSTS” -

WHAT IS “REVENUE” ?

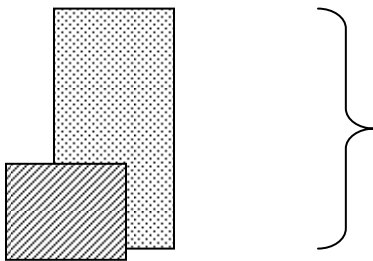
WHAT IS “PROFIT” ?

EACH FIRM WANTS TO MAXIMIZE PROFITS > THERE ARE 2 TYPES OF PROFIT :

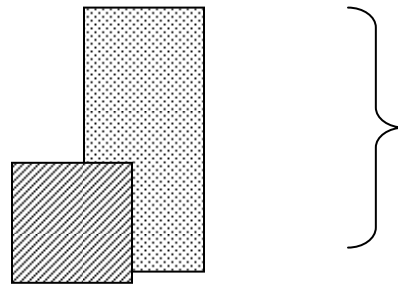
1. “ACCOUNTING PROFIT” -

2. “ECONOMIC PROFIT” -

“RETURN ON CAPITAL” -



GLOBAL WIDGET COMPANY



GLOBAL DOHIGGIE COMPANY

IN THE LONG RUN , ECONOMIC PROFITS WILL ALWAYS BE DRIVEN TO ZERO

BY _____

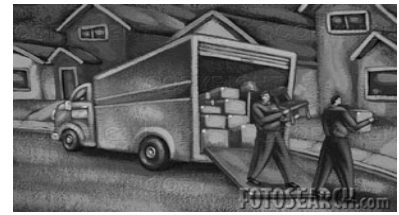
A BUSINESS IS SUCCESSFUL IN MANAGING COSTS WHEN IT MAXIMIZES :

1. “PRODUCTIVITY” -

2. “EFFICIENCY” -

MARGINAL ANALYSIS APPLIED TO PRODUCTIVITY AND EFFICIENCY - COST OF PRODUCTION MEASUREMENTS :

1. "MARGINAL PRODUCT" -
2. "MARGINAL PRODUCT OF LABOR" -
3. "INCREASING MARGINAL RETURNS" -



**STARVING STUDENTS
MOVING COMPANY**

**HOW DO WE TRY TO ENSURE THAT WE GET
"INCREASING MARGINAL RETURNS" ?**

1. "DIVISION OF LABOR" -
2. "SPECIALIZATION" -
4. "DIMINISHING MARGINAL RETURNS" -



WHAT 3 THINGS MIGHT CAUSE THIS ?

- 1.
- 2.
- 3.
5. "NEGATIVE MARGINAL RETURNS" -



HOW MUCH SHOULD WE LOOK TO TRADE OFF ?

1. "COMPARATIVE ADVANTAGE" -
2. "ABSOLUTE ADVANTAGE" -



RICARDO

DR. HOLDEN'S COMPARATIVE ADVANTAGE EXAMPLE :

LABOR HOURS NEEDED TO MAKE

	ONE CAR	ONE TON OF CHEESE
UNITED KINGDOM		
CHINA		

WHICH COUNTRY HAS AN ABSOLUTE ADVANTAGE IN CARS ?

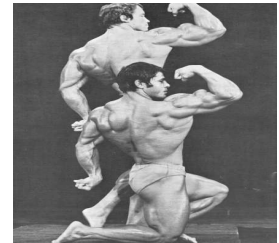
WHICH COUNTRY HAS AN ABSOLUTE ADVANTAGE IN CHEESE ?

WHICH COUNTRY HAS A COMPARATIVE ADVANTAGE IN CARS ?

WHICH COUNTRY HAS A COMPARATIVE ADVANTAGE IN CHEESE ?

WHAT SHOULD EACH COUNTRY SPECIALIZE IN AND DO WITH IT ?

WHAT IS THE “ LAW OF INCREASING COSTS ” ?



DO SOCIETIES HANDLE THE DECISION MAKING PROCESS ANY DIFFERENTLY THAN INDIVIDUALS OR BUSINESSES ? AND WHO MAKES THE DECISIONS FOR A SOCIETY ?

WHAT ARE THE 4 WAYS A GOVERNMENT PUTS ITS ECONOMIC DECISIONS INTO ACTION ?

- 1.
- 2.
- 3.
- 4.

DECISION MAKING GOALS AND 3 FOCAL POINTS OF A COST BENEFIT ANALYSIS ?

1.

2. “GROWTH” -

3.