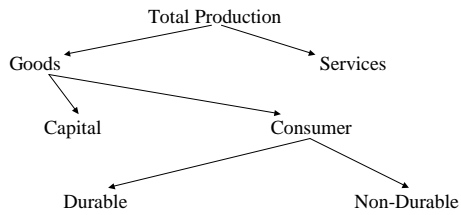


Production

- 2 types of production - goods and services



How can we better illustrate this trade off?

Production Possibilities: An example

- Assumptions made:

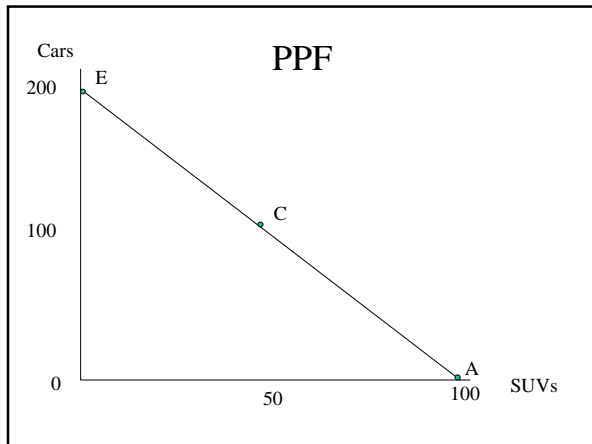
1) only 2 goods produced (all the rest held constant by ceteris paribus condition)

2) A fixed level of technology and fixed amount of the factors of production are present.

- Suppose this firm can produce either cars or SUVs at the following ratio:

	CARS	SUVs
A.	0	100
B.	50	75
C.	100	50
D.	150	25
E.	200	0

- These figures represent the maximum quantities of each combination.



PPF and Opportunity Cost

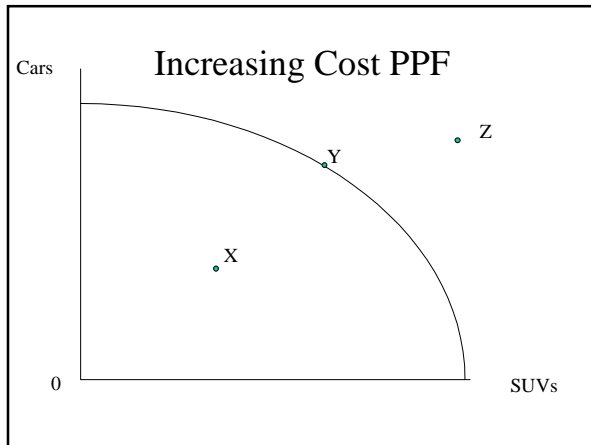
- Here, we see that we have a linear PPF - this implies a constant slope of the PPF.
- Slope = (D cars) / (D buses)
 $= (-50) / 25 = -2 \text{ cars/bus}$
- Question: How do we show opportunity cost from this?

Opportunity Cost

- Opportunity cost = $\frac{\text{“Give up”}}{\text{“Get”}}$
- So, if company moves production from E \Rightarrow D, what is the opportunity cost of:
 - 1) buses in terms of cars?
 - 2) cars in terms of buses?

Specialization and the PPF

- We know from the example of the misallocation - factors of production are indeed specialized
- By specialization, we mean that these factors are relatively more productive in some activity than others
- PPF are not always linear - can be “bowed outward”



Efficiency and the PPF

- **Definition** A certain allocation is “technically efficient” if there is no way for one good to be increased in quantity without lowering the other good.
- How does this relate to the PPF?
- Is point X efficient? Is point Y efficient?

Efficient Production

- Thus, we could say that points ON the PPF are characterized by
 - 1) full utilization of the factors of production
 - 2) factors are being used efficiently
- A violation of either of these 2 properties will result in a combination that lies INSIDE of the PPF.
