Microeconomics: Scarcity, Opportunity Cost & PPF

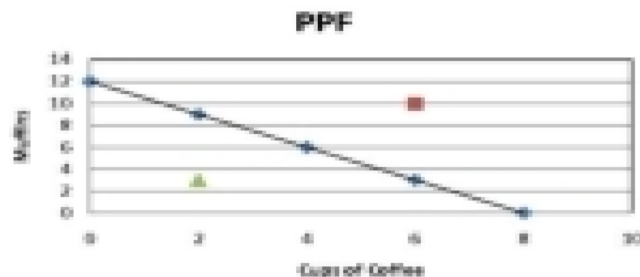
Economics is the study of how we allocate scarce resources. The problem with the world is that there will always be UNLIMITED WANTS, but we have LIMITED or SCARCE resources to meet those wants. Therefore, we must make choices about what to produce and what to consume.

Resources include **land** (trees, animals, minerals, oil, actual land for a business, home, etc.), **labour** (the physical and mental skills and effort by humans to produce goods), **capital** (equipment and structures used to produce goods and services), and **entrepreneurship** (the process of combining land, labour, and capital to produce services). These are also called **factors of production**.

We call the thing we have to give up when we choose something else the **opportunity cost** (i.e. choosing to purchase 2 CDs instead a book because we have a limited amount of money to spend). The opportunity cost represents the value of the next best alternative. It applies to both the **supply** side of the market (production) and the **demand** side of the market (consumption).

A graph of the **production possibility frontier** (PPF) demonstrates the existence of opportunity costs (see below). The PPF is the *boundary line showing what combinations of two goods are possible to produce* (or buy) given the full employment of resources (the line with the diamonds).

Producing on the PPF means all resources are fully utilized; this is called **productive efficiency.** Any combination of goods below the PPF curve (ex. green triangle) can also be produced, but resources will be underemployed. Any point outside of the PPF (ex. square) represents a combination of goods that is not attainable TODAY.



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