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ADVANCED PLACEMENT ECONOMICS **MICROECONOMICS**

Teacher Resource Manual

4th Edition
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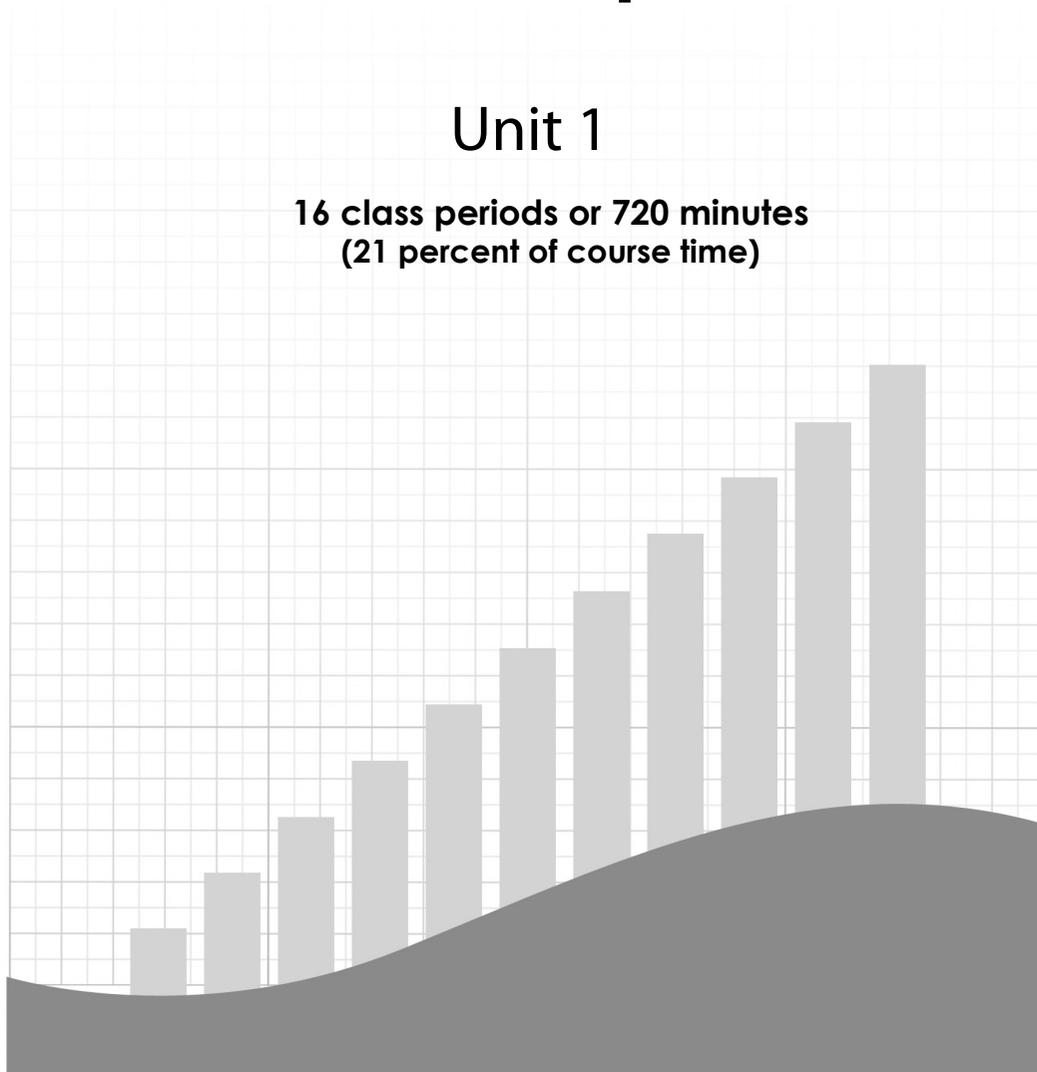


MICROECONOMICS

Basic Economic Concepts

Unit 1

16 class periods or 720 minutes
(21 percent of course time)



Unit 1 focuses on basic economic concepts, including the framework of demand and supply in a competitive market. These concepts account for 15–24 percent of the Advanced Placement (AP) Microeconomics Exam. More importantly, if students do not understand these concepts, they will have a difficult time throughout the course.

The most important introductory concept is scarcity. In any economy, scarce resources and unlimited wants result in the need to make choices. Students must understand scarcity, opportunity cost, and trade-offs. They should be able to illustrate these concepts on a production possibilities curve (PPC).

Because of scarcity, every economic system must determine which goods and services to produce, how to produce them, and for whom to produce them. Students will learn about how different types of economic systems answer these three questions.

A key part of a microeconomics course focuses on how specialization and exchange increase the total output of goods and services. Students must be able to differentiate between absolute advantage and comparative advantage. Comparative advantage is the key to specialization and trade. Be certain that students understand the difference between input and output examples of comparative advantage.

Unit 1 introduces students to the market forces of demand and supply. It is critical for their success on the AP Microeconomics Exam that students understand how demand and supply determine the market price and quantity, and how changes in demand and supply affect the market equilibrium. Much of the material in the microeconomics course requires students to understand the concepts of demand and supply.

Finally, the foundation of the economic way of thinking is established in Unit 1. This approach to an issue gives students the ability to think critically and make sound decisions. Understanding how marginal analysis leads to wise decisions by individuals, households, firms, and government gives students the flexibility to handle many questions on the AP Microeconomics Exam. Students should not memorize the concepts; instead, they should use the concepts as a framework for organizing the course.

The Lesson Planner

- Lesson 1** The Economic Way of Thinking; Activity 1-1 and Visual 1-1
- Lesson 2** Scarcity, Opportunity Cost, and Production Possibilities Curves; Activity 1-2 and Visual 1-2
- Lesson 3** Absolute Advantage and Comparative Advantage, Specialization, and Trade; Activity 1-3 and Visuals 1-3 and 1-4
- Lesson 4** Understanding Demand; Activities 1-4 and 1-5, and Visuals 1-5 and 1-6
- Lesson 5** Understanding Supply; Activities 1-6 and 1-7, and Visuals 1-7 and 1-8
- Lesson 6** Equilibrium Price and Quantity, Interrelation of Markets; Activities 1-8 and 1-9, and Visuals 1-9 and 1-10
- Lesson 7** Economic Systems; Activity 1-10
- Lesson 8** Marginal Analysis; Activity 1-11

Practice Free Response Questions (FRQs)

This is a partial list of FRQs that can be used with each unit of the *Advanced Placement Economics: Microeconomics* resource manual. These questions and grading rubrics are available at AP Central on the College Board Web site: <http://apcentral.collegeboard.com>

- | | |
|--------------------|--|
| 2012 | Question 2, part (b): change in demand versus change in supply |
| 2012 | Question 3: world market demand and supply graph; tariff |
| 2010 | Question 3, part (a): demand and supply graph; consumer and producer surplus |
| 2009 | Question 2, part (a): demand and supply graph; calculate producer surplus |
| 2006 Form B | Question 2, part (a): draw a demand and supply graph; show consumer and producer surplus |

Additional Resources

To download visuals for each lesson and to find related material, visit <http://www.councilforeconed.org/ap-economics>

The Economic Way of Thinking

Introduction and Description

AP Economics has many details that can confuse students. Students need a framework to organize these details. This lesson acquaints students with basic economic concepts and methodology. It begins with some key economic ideas that represent a new set of lenses through which students may view the world. The lesson ends with a test of economic myths that should get students' attention. This exercise also gives the teacher a way of reinforcing the economic concepts taught at the beginning of the lesson.

Objectives

1. Define *scarcity*.
2. Define *opportunity cost*.
3. Define the *economic way of thinking*.
4. Apply *scarcity* concepts to a variety of economic and noneconomic situations.

Time Required

Two class periods or 90 minutes

Materials

1. Activity 1-1
2. Visual 1-1



Bell Ringer

Have you ever been treated to a free lunch? What do economists mean when they say, "There is no such thing as a free lunch"? Explain the TINSTAAFL Principle, and have students give examples of this principle in their own lives.



Teacher Alert: Be sure students understand what "marginal" really means. Reinforce the difference between "marginal" and "total" frequently

throughout your course. Economists work on the *margin* to maximize *total* concepts such as total profit, total utility, and total surplus.

Procedure

1. Display Visual 1-1 and discuss the economic way of thinking. Here are some discussion ideas for each point on the visual.
 - **Everything has a cost.**

This is the basic idea of the TINSTAAFL Principle. It means that every action costs someone time, effort, or lost opportunities to do something else. Introduce the term *opportunity cost* here. Stress the concept that people incur costs when making decisions, even when people appear to pay nothing. Help students recognize that the true cost of a decision is measured in foregone alternatives rather than in dollars.
 - **People choose for good reasons.**

Because of scarcity, people always face choices, and they should choose the alternative that gives them the most advantageous combination of costs and benefits. You might stress here that if people have different values, they may make different choices. This might be a good place to discuss *normative* versus *positive economics*. Economists tend to be a tolerant lot because they realize people choose for good reasons. Also stress that *people* choose. Much of the AP Microeconomics course concerns business and government decision making. But business and government decisions are made by people.
 - **Incentives matter.**

This course is really about incentives. It has been said that economics is about incentives

and everything else is commentary. *Supply and demand analysis* is about incentives. The *theories of the firm* and *factor markets* are about incentives. Government decision making is about incentives. When incentives change, people's behavior changes in predictable ways.

■ **People create economic systems to influence choices and incentives.**

Cooperation among people is governed by written and unwritten rules that are the core of an economic system. As rules change, incentives and behavior change. The success of market systems and the failure of communism are rooted in incentives.

■ **People gain from voluntary trade.**

People trade when they believe the trade makes them better off. If they expect no benefits, they don't trade. Part of the AP Microeconomics course focuses on international trade. However, once again it is people, not countries, that trade. A market system is about voluntary trade. Economics is about voluntary trade between parties that respond to incentives.

■ **Economic thinking is marginal thinking.**

Students must understand the fact that marginal choices involve the effects of additions and subtractions from current conditions. (Should I study another hour for my economics exam? Should I work another hour this weekend?) Much of this course is about comparing marginal costs and marginal benefits to maximize a total concept such as total utility or total profit. Marginal thinking will be stressed in Units 3 and 4, where the theories of the firm and factor markets are discussed. It is important that marginal decision making is discussed in every unit.

■ **The value of a good or service is affected by people's choices.**

Goods and services do not have intrinsic value; their value is determined by the preferences of buyers and sellers. Because of this, trading moves goods and services to higher-valued uses. This is why trading is so important. The price of a good or service is set by supply and demand.

■ **Economic actions create secondary effects.**

Good economics involves analyzing secondary effects. For example, rent controls make apartments more affordable to some consumers, but they also make it less profitable to build and maintain apartments. The secondary effect is a shortage of apartments and houses for rent.

■ **The test of a theory is its ability to predict correctly.**

Students will discuss dozens of theories in an AP Economics course. All these theories have simplifying assumptions. However, the proof of the pudding is in the eating. If the theory correctly predicts the consequences of actions, it is a good theory. Nothing is "good in theory but bad in practice."

2. Tell students that they are going to take a brief quiz. Have students turn to Activity 1-1 in the Student Resource Manual. Give them a few minutes to answer the questions.
3. When everyone is finished, either poll students on their answers, or simply announce that all the answers are false. Some students will think this is a cheap trick.
4. Discuss the answers, and as you do, explain some of the basic laws of economics. Economics is the study of human behavior, and principles have been developed to explain this behavior.

You are laying the foundation for your students' understanding of the economic way of thinking!

The Economic Way of Thinking

- Everything has a cost.
- People choose for good reasons.
- Incentives matter.
- People create economic systems to influence choices and incentives.
- People gain from voluntary trade.
- Economic thinking is marginal thinking.
- The value of a good or service is affected by people's choices.
- Economic actions create secondary effects.
- The test of a theory is its ability to predict correctly.

- Scarcity exists because we have limited resources and unlimited wants. No society has ever had enough resources to produce all the goods and services its members wanted.
- Goods and services are produced from resources. These resources—land, labor, capital, and entrepreneurship—are limited.
- Scarcity requires people to make choices. If we use scarce resources for one purpose, we cannot use them for another.
- Opportunity cost is the forgone benefit of the next best alternative when resources are used for one purpose rather than another.
- Because of scarcity, every decision has an opportunity cost.
- Economic costs take account of the opportunity cost of doing one thing rather than another.
- Economic costs include explicit costs and implicit costs. Explicit costs are expenditures for something. Implicit costs are the opportunity costs of using your own resources rather than selling them to someone else. Both implicit and explicit costs are opportunity costs.
- Using free goods does not involve opportunity cost because free goods are available in unlimited quantities.
- Economics is concerned with marginal decision making. In economics, “making decisions at the margin” is very important. Marginal choices involve the effects of additions and subtractions from the current situation. We compare the marginal benefit of an extra unit of an activity with that unit’s marginal cost.
- A production possibilities curve can be used to illustrate scarcity, choice, and opportunity cost graphically.
- The slope of a production possibilities curve shows the opportunity cost of producing another unit of one good in terms of the amount of the other good that must be given up.
- Because resources are scarce, using them efficiently allows us to get the most from them. Efficiency is increased through specialization and trade. Economists use the concept of comparative advantage to explain why trade takes place between countries and between individuals. This concept is based on the differences in producers’ opportunity costs of producing goods and services.
- Because of scarcity, people and societies use economic systems to determine what to produce, how to produce, and for whom to produce.
- Throughout history, nations have used tradition, command, and market systems to allocate resources.
- The law of comparative advantage shows how everyone can gain through trade.
- Economic theory is useful in analyzing and understanding the world around us.
- The test of an economic theory is its ability to predict correctly the future consequences of economic actions.
- The broad social goals of a society influence decisions about how best to use resources.
- A diagram of the circular flow of resources, goods and services, and money-income payments is a simplified way of illustrating how a market economy operates. Prices in the product market and prices in the factor, or resource, market are determined by the interaction of supply and demand. This diagram is also called the circular flow of income.

- Markets bring together buyers and sellers of a good or service.
- The law of demand states that buyers will want more of an item at a low price than at a high price, other things being equal.
- The law of supply states that sellers will provide more of an item at a high price than at a low price, other things being equal.
- The equilibrium price is the price at which the quantity demanded of an item equals the quantity supplied. That quantity is called the equilibrium quantity.
- Shifts in the market demand and supply curves result in new values of the equilibrium price and quantity. Understanding what causes shifts in the demand and supply curves is an important part of knowing how a market operates.

Do You Think Like an Economist?

Circle T for *true* or F for *false* in the statements that follow.

- T F 1. Because it is desirable, sunshine is scarce.
- T F 2. Because it is limited, polio is scarce.
- T F 3. Because water covers three-fourths of the earth's surface and is renewable, it cannot be considered scarce.
- T F 4. The main cost of going to college is tuition, room, and board.
- T F 5. If mass transportation fares are raised, almost everyone will take the trains anyway.
- T F 6. You get what you pay for.
- T F 7. If someone makes an economic gain, someone else loses.
- T F 8. If one nation produces everything better than another nation, there is no economic reason for these two nations to trade.
- T F 9. A nonregulated monopoly tends to charge the highest possible price.
- T F 10. A business owner's decision to show more care for consumers is a decision to accept lower levels of profits.