Problem Set # 2     Bruce Brown, Economics 1 (Microeconomic Principles), SMC

These questions cover material through the end of Chapter 4.

1) Consider #10 from problem set one; where the economy had two types of workers: 100 type A workers who could make 1 bell or 2 whistles (per period) each; and 100 type B workers who could make 3 bells or 1 whistle (per period) each. Interpret the corresponding diagram drawn below:

a) What is the slope between A and B?

b) What type of worker is moving from production of Whistles into Bells as the economy moves from A to B?

c) What is the slope between B and C?

d) What type of worker is moving from production of Whistles into Bells as the economy moves from B to C?

e) What is the opportunity cost of an additional Bell on the segment AB? On the segment BC?

f) What is the opportunity cost of an additional Whistle on the segment AB? On the segment BC?

2) True or False:
   i) Costs of firms equals income to households in the simple circular flow model presented in Chapter 2.
   ii) When two persons engage in a trade, both persons gain equally from the transaction.
   iii) A good economic model may have unrealistic assumptions.
   iv) A technological advance will tend to shift out the PPF of an economy.
   v) When a society produces more of one good by moving along a PPF, technology is held constant. Thus we assume that producers do not learn how to better produce the good, as they make more (no “learning by doing”).
   vi) Suppose you fix your brother’s car in exchange for his painting your house. In order for both of you to gain from this trade, your brother must be a better, faster, painter than you.
   vii) The model of trade based on different, given (pre-existing), opportunity costs of production presented in Chapter 3, can better explain why trade occurs between France and Germany, than between the U.S. and China.
   viii) David Ricardo invented the notion of the “invisible hand” presented in this class.
   ix) David Ricardo wanted to reduce imports of corn into the U.K., because such imports hurt British farmers.
   x) Economists generally believe that if the U.S. can produce good A with less labor time than would be required to produce it in other countries, then the U.S. should produce and export good A.
   xi) In the text’s example regarding whether Tiger Woods should mow his lawn, the possibility that Tiger Woods will enjoy mowing his lawn is explicitly included.
   xii) Cigarettes produced in the U.S. and sold in Japan are exported by the U.S. and imported by Japanese.
   xiii) Economists such as the author of our text, N.G. Mankiw, generally believe a country will have a healthier economy (with wealthier citizens) if it exports more goods than it imports.
   xiv) The price where supply equals demand for a good will indicate the value of the “last unit “ bought to the person who purchased it (but who would not have purchased it if the price were slightly higher).
   xv) In the PPF model (assuming efficiency) if an economy consumes less this period and invests more, it will grow faster in the future.
vi) When two persons engage in a trade, usually one person is made better off, and the other worse off (realize we compare the pre-trade to post-trade situations)

vii) When a competitive firm makes big profits, it indicates that some consumer is being made worse off.

viii) If price of potatoes decreases, demand for potatoes will shift right.

ix) If income increases and demand for beans shifts left as a result, then beans must be an inferior good.

x) If an exogenous (unexplained) fall in the price of chips causes the demand curve for dip to shift rightward, then chips and dip are by definition complementary goods.

3. Which of the following are positive statements, and which are normative?
i) “A reduction in welfare payments to unmarried mothers will increase the percentage of such mothers who work”

ii) “A reduction in welfare payments to unmarried mothers will increase the percentage children in single parent families who die before the age of five”

iii) “It is inappropriate for government to pay money to unmarried mothers who do not work”

iv) “Government should reduce the amount of foreign-produced steel that the U.S. imports”

v) “If government reduces the amount of foreign-produced steel which can be imported into U.S., profits of firms that produce steel in the U.S. will increase”

vi) “It is morally unacceptable that people go hungry in this country”

4. Draw supply and demand curves and show shifts to depict the impact of following situations on equilibrium price and quantity (assume all other factors are constant = ceteris paribus):

i) Farmers in the Midwest have a summer of very good weather for growing wheat (look at the wheat market).

ii) Wage of auto workers increases (look at the market for automobiles)

iii) Price of carrots decreases (look at market for potatoes, a substitute for carrots)

iv) Incomes of buyers increases (look at the market for bus rides, an inferior good)

v) The future price of coffee expected by consumers increases (look at the market for coffee this period)

vi) The future price of coffee expected by producers increases (look at the market for coffee this period)

vii) The number of coffee producers increases (look at the market for coffee).

viii) The price of RAM memory chips, an essential input into the production of personal computers, falls dramatically. (look at the computer market)

ix) In central park, the weather gets hot and humid and there are both many more people who want to buy ice cream, and many more vendors.

x) A recession dramatically reduces the number of home-buying families moving into Southern California (consider the home market).

xi) In May there is a large campaign to boycott beef in an effort to reduce its price. Then in June, victory is declared by the consumers and the boycott is ended.

xii) In 2002, there are few grown hogs ready for sale and so the price is high. As a result, in 2002 many farmers start to raise baby pigs which become grown hogs ready for sale in 2003. Suppose the demand for hogs is stable year to year, and that in any year the (short run) supply curve is perfectly inelastic (= vertical). What happens to the price of hogs in 2003? If farmers have bad memories, what happens to the number of baby pigs farmers start to raise in 2003 and so the price of hogs in 2004?