ECN 360, Homework #2
Due 9/23/2021

Directions: Answer the questions on a separate piece of paper. Please be neat! Submit your homework assignment to me via email at: ccdougla@umich.edu A .pdf is preferred, though any file works in practice.

1. Suppose that in world markets, the relative price of S is lower than Country A's autarky price. Would A be a net exporter or importer of S? What would be the case for good T in Country A in this situation?

2. Suppose that Country A produces two goods under conditions of constant opportunity costs. Given its resources, the maximum S that it can make is 500 units and the opportunity cost of making one unit of T is 2 units of S. What is the maximum amount of T that Country A can produce? Draw a graph and explain, and be clear about what the slope of the graph you draw represents.

3. Recall the discussion in class about general equilibrium for an economy characterized by a **bowed out** production possibilities frontier.

    a. Draw this production possibilities frontier with S on the x-axis and T on the y-axis. Using the production possibilities frontier, price line, and community indifference curve, draw the economy in general equilibrium.

    b. In general equilibrium, what is the intuition for community indifference curve being tangent to the production possibilities frontier?

    c. In general equilibrium, what is the intuition for the price line being tangent to the production possibilities frontier?

    d. Now, suppose consumer preferences for T increase relative to S (this is the exact opposite of the case we discussed in class).

        (i) How do the indifference curves change as a result? What is the intuition for this?

        (ii) Draw this new indifference curve on the graph. Your new general equilibrium point should consist of more T and less S than the general equilibrium point in part (a). Clearly state the intuition on how the economy moves from the general equilibrium point in part (a) to this new general equilibrium point.

4. Suppose an economy is characterized by constant opportunity costs so that P_S/P_T equals 1.5. Use this to derive the economy's national supply curve for S. How does it differ from the national supply curve in Figure 2.8 in Chapter 2? Explain.