Skelton

Eco 1312

Homework 1

1. Production Possibilities Frontier

A. Draw two PPFs and label them PPF1 and PPF2 (The PPFs should be on the same graph). Let your imagination decide which goods the two economies will produce.

B. Which country would you rather live in (the one represented by PPF1 or PPF2)? Why?

C. In general, what does the slope of the PPF tell us?

D. On the graph, plot a point where one of the countries is not using its resources efficiently. Label it point A. Give one specific reason the economy would be at point A.

E. Would it be possible for the richer economy's production possibilities curve to shift inward? If so, give a specific example of how this could happen. If not, justify why this would not happen.

F. How could a technological innovation specific to the production of one good allow us to increase production of the other good?

2. Thomas Sowell, an economist at the Hoover Institution at Stanford University, wrote: “All economic systems not only provide people with goods and services, but also restrict or prevent them from getting as much of these goods and services as they wish.”

A. Why is it necessary for all economic systems to do this?

B. How does a market system prevent people from getting as many goods and services as they wish?

3. Why would a tomato farmer be interested in orange juice prices?

4. Use Supply and Demand to show the effects on price and quantity for each of the following scenarios that occur in the market for McDonald’s Big Mac.

* 1. Consumer income falls.
  2. French fries become more expensive due to a potato famine.
  3. Mad cow disease afflicts the U.S. cattle population.
  4. A hillbilly revolt in Arkansas cuts off the supply of hot dogs.
  5. Kentucky Fried Chicken increases the price of a bucket of fried chicken.

F. The government relaxes standards for handling raw meat.

G. Concerned about the obesity epidemic, Americans begin to diet more.

1. In the Wealth of Nations, Adam Smith wrote the following statement:

“It is not from the benevolence of the butcher, the brewer or the baker that we expect our dinner, but from their regard to their own interest.”

What did he mean by this?

1. Recently, Shell disclosed that they overstated their proven oil reserves by 20%. How might this affect the oil market? The gasoline market? The SUV market? Alternative fuels? You should draw a supply and demand diagram for each of these markets.
2. Demand for watermelons is typically highest during the summer and lowest during the winter. Yet, watermelon prices are normally lower in summer than in winter. Use a supply and demand diagram to illustrate why this happens. Be sure to clearly indicate summer and winter equilibrium prices.
3. Briefly explain whether each of the following statements is true or false:
   1. If both supply and demand for a product increase, the equilibrium quantity of the product must also increase.
   2. If both supply and demand for a product increase, the equilibrium price of the product must also increase.
4. Assess the following argument:

“A price floor reduces the amount of a product consumers buy, because it keeps the price above the competitive market equilibrium price. On the other hand, a price ceiling increases the amount people buy because it keeps the price below the competitive market equilibrium.”

Do you agree with the argument above? Use a supply and demand diagram to illustrate your answer. Be sure to analyze the impact of these price controls in the short- and long-run.