

Microeconomics Problem Set 1 Answers

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1

At first we might be tempted to say the cost of going to skiing is the money that would have been earned by doing the part time job. But in reality (assuming skiing with our friend is more enjoyable than part-time job) we use up the time that would have gone in the part time job instead in something we enjoy. So the net cost would be:

$$< \text{money that could have been earned} > - < \text{value of pleasure of going skiing with friend} > \quad (1)$$

2

By spending the \$100 now we give up the profit of \$5 after a year (assuming no inflation). We must also take into account the value of time it takes to yield \$5.

$$< \$5 > - < \text{value of one year time} > \quad (2)$$

3

Yes, now that 5 million is already spent spending 1 million more to achieve a profit of 3 million would be worth it as:

case 1: Cancel the product \rightarrow Loss of 5 million

case 2: Spend 1 million \rightarrow Net loss of 6 million Profit of 3 million \rightarrow Net loss of 3 million 3 million is lesser loss than 5 million

this is an example of thinking at the margin

4

University A will have a higher average consumption as the \$500 they have paid is fixed and they will try obtain highest profit by eating till the brim of their stomachs. But University B students will get

exactly what they paid for and hence they will eat a comfortable amount and not more or less, since eating lesser or more does not affect the cost of their food.

5

The shape of the frontier is determined how much the resources used up in maintaining clean environment could have rather been used to increase the quantity of goods. The opportunity cost of reducing pollution is the reduction of production. It is seen in the graph, when environmental cleanliness is low, the production is high and vice versa. (The Below Graph is not to scale.)

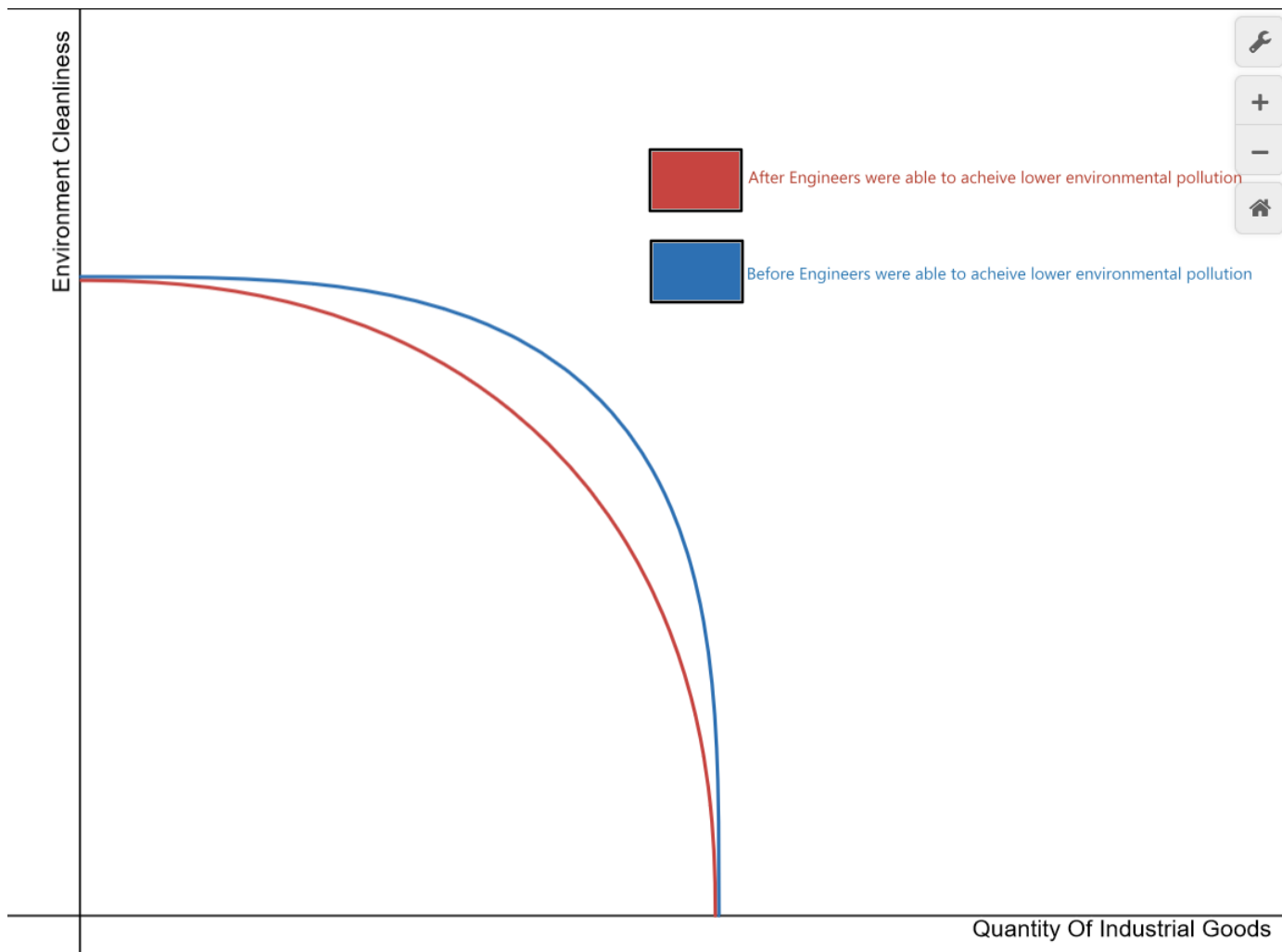


Figure 1: PPF graph for Q5

6

Germany's PPF would have suffered an immense blow after WW2 and it would have become several times smaller in area. This is because most of its Resources were gone, either taken away or destroyed.

