

Economics 105: Principles of Macroeconomics

Assignment set #1 answer key

1. You are planning to spend Saturday working at your part-time job, but a friend asks you to go swimming. What is the true cost of going swimming? Now suppose that you had been planning to spend the day studying at the library. What is the cost of going swimming in this case? Explain.
2. In the *Wealth of Nations* Adam Smith said: "It is not by the benevolence of the baker that you receive your bread." What do you think he meant?
3. Why are property rights important to a market economy?
4. People respond to incentives. Government can alter people's incentives with public policy. However, sometimes public policy generates unintended consequences by producing results that were not anticipated. Try to find an unintended consequence of each of the following public policies. (Note: answers to these questions are not unique)
 - a. To help people with low skills, the government raises the minimum wage to \$25/hr.
 - b. To help the homeless, the government places rent controls on apartments restricting rent to \$150 per month.
 - c. To limit the consumption of gasoline, the government raises the tax on gasoline by \$2.00 per litre.
 - d. To reduce the consumption of drugs, the government makes drugs illegal.
 - e. To raise the population of wolves, the government prohibits the killing of wolves.
5. Is a more realistic model always better?
6. Give two reasons why economists disagree.

Answer

1. *If you are thinking of going swimming instead of working at your part-time job, the cost of swimming includes its monetary cost and time cost, which includes the wage income you are giving up by not working. If the choice is between swimming and going to the library to study, then the cost of swimming is its monetary cost and time cost, which includes the cost of getting a lower grade in your course.*
2. *The baker produces the best bread possible, not out of kindness, but because it is in his best interest to do so. Self-interest results in maximization of social wellbeing.*

3. *Market works only if property rights are enforced. A farmer won't grow food if he expects his crops to be stolen. We rely on government to enforce our rights over the things we produce.*
4.
 - a. *Many people would want to work at \$25/hr but few firms would want to hire low-skilled workers at this wage. Therefore it would create unemployment.*
 - b. *Many renters would like to rent an apartment, but few landlords could produce an apartment at this price. Therefore rent control would create more homelessness.*
 - c. *High gas prices would reduce the kilometers driven. This would lower auto accidents, put less wear and tear on the roads and cars, and reduce the demand for cars and road repairs.*
 - d. *This raises the price of drugs and makes selling them more profitable. This creates more drug sellers and more violent crimes.*
 - e. *Restrictions on killing wolves reduce the population of animals upon which wolves may feed (rabbits, deer, etc).*
5. *Not necessarily. Realistic models are more complex. They may be confusing and they may fail to focus on what is important.*
6. *Economists may have different scientific judgments. Economists may have different values.*