

Econ 101 Discussion Section-Handout 2

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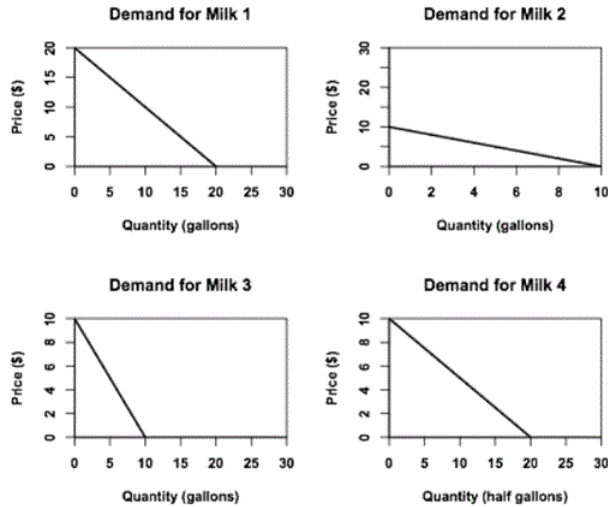
1 Review

Important Key Concepts of the week:

- Economics, be sure that you understand the definition we reviewed in lecture. Also remember that there are two mayor fields in Economics: Microeconomics and Macroeconomics.
 - One definition of Economics: The science that studies how individuals make decisions that help them fulfill their unlimited wishes with limited resources.
 - Micro: Studies the individual, the firm, some special markets and special interaction between individuals
 - Macro: Studies an aggregate economy (countries, states, cities, even the world), economic growth, inflation, employment etc.
- Positive and Normative analysis, try to assign these labels to your everyday arguments so you can master them quickly!
 - Positive: Objective, relies on facts and leaves out any possible doubt of the results
 - Normative: Subjective, however tries to give answers to hard questions like what is the best plan for..?
- Production Possibilities Frontier (PPF), This important tool help us to visualize how many possibilities exist in a plan. Solve as many exercisers you can, It has appeared several times in midterms
 - Visit Professor Kelly website: <http://www.ssc.wisc.edu/~ekelly/econ101/>
- Opportunity Cost, This is a key concept in Economics, remember that whenever you make a decision you are leaving something outside and it is Costly!
 - What is the opportunity cost of attending discussion section?

2 Problems: More Graphs and PPF

1. (Question 22 from the first morning midterm, 2013)
 - (a) Carefully Examine the demand curves shown below, Which of them are the same?



- a) Demand Curves 1 and 4 b) Demand Curves 2 and 3
 c) Demand curves 2,3, and 4 d) Demand curves 1,2 and 3

2. Classify the following statements as either normative or positive:

- (a) “The current unemployment rate is 6.2%.”
 (b) “The government should keep interest rates low in order to help lower the unemployment rate.”
 (c) “Economic theory predicts that an increase in the minimum wage should, all else held equal, result in an increase in unemployment.

3. Crusoe finds himself stranded on an island. He devotes 10 hours each day to either gathering coconuts or catching fish. Crusoe can gather 4 coconuts in an hour, but he needs 5 hours to catch a single fish. On the other side of the island is Friday. Friday also devotes 10 hours each day to gathering coconuts and fishing. He can gather 3 coconuts per hour and needs only 2.5 hours to catch a fish.

- (a) Construct a table showing how much each person can produce of each good they can produce if they do not produce any of the other good
 (b) What is the opportunity cost of gathering a coconut for Crusoe? For Friday?
 (c) What is the opportunity cost of catching a fish for Crusoe? For Friday?
 (d) Draw Crusoe’s production possibilities frontier with coconuts on the x-axis. Give its equation (with the number of fish on the left hand side). On a separate graph, do the same for Friday.
 (e) One day, Crusoe and Friday befriend each other and they decide to explore the possibility of trade. For maximum output, who should specialize in coconuts? In fish? Justify your answer using the language of comparative advantage. Who has the absolute advantage in each good?
 (f) Draw a PPF that shows how much can be produced in total by Crusoe and Friday, i.e. their joint PPF.
 (g) With trade, would it be possible for each person to consume two fish and 20 coconuts? Without trade?

4. Abbey and Road make Records(x) and Videos (y). The table below lists their output per hour for each task. Assume they work for 6 hours a day.

	Videos	Records
Abbey	20	6
Road	12	2

- (a) List the opportunity costs each of them face. Does this depend on the number of hours they work?
 (b) Describe the comparative and absolute advantages each person possesses.
 (c) Abby and Road would like to trade. What would be mutually beneficial range of trading prices? Give your answer as a price for Records in terms of Video (i.e. a Record costs __ Video).
 (d) Draw the PPF’s of Abby and Road separately (for one day’s output). Then construct their joint PPF.