

Econ 104 Study Questions Exam #1

Chapter 2

1. What is economics?

- economics is the study of the choices people make to attain their goals, given scarce resources

2. How is microeconomics different from macroeconomics?

- microeconomics is the decisions of household's firms, industry, local government
- macroeconomics is the decisions of the economy as a whole

3. What is the economic problem confronting all societies?

- scarcity of resources
- resources: factors of production are: land, labor, capital (capital = machinery, equipment, etc.)
- because resources are scarce we have to make choices/tradeoffs

4. How is a centrally planned economy different from a market economy?

What is a "mixed" economy?

- centrally planned economy: government decides what, how, who; managers follow government orders
- market economy: consumers decide what is produced; firms decide how goods are produced; market decides who receives the goods (what is produced)
- "mixed" economy: ex: US, Canada, etc.; US is not a pure market economy; our government plays a significant role in the economy (environmental protection, minimum wage, social security, etc.)

5. How is positive economics different from normative economics?

- positive economics: factual; concerned with things that are verifiable "data show Bush tax cuts stimulated economic growth in the U.S."
- normative economics: opinion; opinion based; statements usually made about what ought to be; "if the minimum wage is increased to \$7.50 some workers will have difficulty finding jobs"

6. In economics, "capital" refers to _____.

- machinery, equipment, etc.

7. What do we mean by factors of production? Opportunity cost? Ceteris paribus?

- factors of production: land, labor, capital
- opportunity cost: what you give up to achieve something else
- ceteris paribus: all equals/holding everything constant (resources fixed, technology fixed, full employment of resources)

8. What points in the PPF diagram are unattainable? Efficient? Attainable? Which points reflect full employment of resources?

- unattainable = outside
- efficient = on the curve (and attainable)
- attainable = inside (but inefficient)
- full employment of resources = on the line (efficient/attainable)

9. Why does the production possibilities curve display a bowed-out shape (i.e., concave to the origin)?

- illustrates increase in opportunity cost (concave to origin)
- the opportunity cost increases as the production of one output expands: the law of increasing opportunity cost

10. What are the ceteris paribus assumptions behind the production possibilities curve? How would technological advance, an increase in the capital stock (i.e., investment) or an increase in the labor force affect the production possibilities curve?

- ceteris paribus assumptions: fixed resources, technology fixed, full employment of resources
- 1. Increase resources, e.g. size of (increased) labor force, increase of physical capital (machinery, etc.) → PPF shifts rightward
- 2. Technological change/advance: technology advance in the direction of household appliance industry → PPF shifts rightward

11. What does an outward shift in the PPF represent economic growth? What must occur for an economy to experience economic growth? Why?

- economic growth: when there is an increase in resources base or increase in technology (technological advance) and the standard of living increases in terms of goods and services available
- there must be an increase in resources (i.e. baby boom, discover oil, reduce trade barriers) or a technological advance (i.e. wheel, inventions – light bulb, internet, computer, fax machines, innovations of entrepreneurship)

12. What is society's tradeoff between producing more investment goods (that is, capital goods) versus consumer goods in the present?

- as the production of consumer goods increases, opportunity cost increases
- cost is increased because workers are better suited for military goods
- A → B low skilled workers are moved from production of military goods to consumer goods
- B → C and C → D more and more highly skilled workers (in the production of military goods) are being utilized in production of consumer goods → opportunity cost increases because they need more training

13. What is the law of increasing opportunity cost? How is it related to the production possibilities curve?

- law of increasing opportunity cost: the opportunity cost increases as the

production of one output expands

- bowed shape (concave to origin) of PPF = illustrates the increasing opportunity cost

14. Because of scarcity, all societies are limited to which points on the production possibility curve?

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Chapter 8

15. What is gross domestic product? Which goods are counted? Which goods are not counted?

- Gross Domestic Product (GDP): market value (today's \$) of all final goods and services produced in a nation during a period of time (e.g. 1 year)

- only counts:

- new goods

- final goods (we don't count intermediate goods – i.e. computer chips used to produce final good)

16. What are the assumptions behind the basic circular flow?

a.) household's (HH) supply or own all the factors of production

b.) HH spend (consume) everything they earn on goods and services produced (no savings, no taxes)

c.) firms spend all their revenues on resources (land, labor, capital) from factor market

17. What is the intuition (meaning) behind the basic circular flow? Answer: Total Production ~ Total Expenditures ~ Total Incomes in this closed economy (“~” means “approximately equals”) If we add in financial markets, government and foreign markets, what are the leakages and injections to the spending flow?

- leakages: savings, taxes, imports

- injections: exports, government, investment (firms buy new buildings, equipment, delivery trucks, etc.)

18. How do we calculate GDP using the expenditure approach? What is gross private domestic investment (I)? Net Exports (NX)? Consumption (C)?

Government (G)?

- $GDP = C + I + G + NX$

C= household (HH) consumption

I= firms investment expenditures

G= government

$NX = x - m = (\text{exports} - \text{imports}) = \text{net exports}$

19. Consumption spending is approximately _____ of total expenditures on GDP.