

Homework – Week 2

Name: _____

Production Possibilities and Trade

There are two towns, SF and LA. They have an economy with two goods only, software and movies. Habitants of each town work 10 months per year, and the following table shows the combination of software and movies that can be produced in 1 month:

	Software	Movies
SF	3	2
LA	6	3

1) Calculate the following opportunity costs:

- A) Opportunity cost of movies for SF
- B) Opportunity cost of movies for LA
- C) Opportunity cost of software for SF
- D) Opportunity cost of software for LA

2) Which town has an absolute advantage in movies? And which town has an absolute advantage in software?

3) Which town has a comparative advantage in movies? And which town has a comparative advantage in software?

4) Suppose each town spends 5 months producing movies and 5 months developing software. Without trade how much will they consume of each good?

5) Suppose SF spends 10 months producing movies and zero months developing software, while LA spends 2 months producing movies and 8 months developing software.

A) How much will each town produce of each good?

B) Can both towns get to a trade deal where both will consume more of each good than in the allocation calculated in 4)? Give a possible trade deal.

Demand and Supply

For the following exercise you will start by drawing the initial demand and/or supply in the market. In the answer to your question you will graph the corresponding shifts in the supply and/or demand curves for each good.

1) Smart phones become very popular in Argentina. At the same time the government makes a regulation forcing all smart phones to be produced in a small town at the Southern tip of the country which forces companies to pay higher salaries to attract workers.

- a. What happens to the demand for smart phones? Will the change in tastes cause a change along the demand curve or a shift in the demand curve? Illustrate.
- b. What happens to the supply of smart phones? Will the change in input prices cause a change along the supply curve or a shift in the supply curve? Illustrate.

Complete the following table by selecting (with an X) the term that matches each definition.

	Quantity Demanded	Demand Curve	Demand Schedule	Law of Demand
The claim that, with other things being equal, the quantity demanded of a good falls when the price of that good rises.				
A graphical object showing the relationship between the price of a good and the amount of the good that buyers are willing and able to purchase at various prices.				
The amount of a good that buyers are willing and able to purchase at a given price.				
A table showing the relationship between the price of a good and the amount that buyers are willing and able to purchase at various prices.				