

# Essentials of economics assignment



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If this is so, there WOULD be a net gain in human welfare by such as redistribution. The problem, however, is In comparing one person's happiness with another: happiness is not something that lends itself to measurement.

4. Which of the following are macroeconomic issues, which are microeconomic ones and which could be either depending on the context? (a) Inflation. (b) Low wages in certain service industries. (c) The rate of exchange between the pound and the Euro. (d) Why the price of cabbages fluctuates more than that of cars. (e) The rate of economic growth this year compared with last year. (f) The decline of traditional manufacturing industries.

A) Macro. It refers to a general rise in prices across the whole economy. (b) Micro. It refers to specific industries (c) Either. In a world context, it is a micro issue, since it refers to the price of one currency in terms of one other. In a national context it is more of a macro issue, since it refers to the Euro exchange rate at which all UK goods are traded internationally. This is certainly a less clear-cut division than in (a) and (b) above. ) (d) Micro. It refers to specific products. (e) Macro. It refers to the general growth in output of the economy as a whole. (f) Micro (macro in certain contexts). It is micro because it refers to specific industries. It could, however, also help to explain the macroeconomic phenomena of high unemployment or balance of payments problems.

6. When you made the decision to study economics, was it a 'rational' decision (albeit based on the limited information you had available at the time)?

What additional information would you like to have had in order to ensure that your decision was the right one? You will have to answer this one for yourself! The amount of care taken by prospective students to find out about

their courses and what they entail differs enormously from one student to another. Your decision would be a rational one if you did your best to weigh up the advantages and disadvantages of alternative courses, and chose the one that seemed to have the best balance of advantages over disadvantages.

The sorts of information that might have helped you make the right decision include: talking to students who are already studying economics, reading about the subject, talking to teachers/student advisers, finding out about the sort of jobs you can do with an economics qualification. A problem for many students applying for courses is that they are already studying for exams (e.g. A levels) and that the time spent researching courses is time that could have been spent studying: in other words, the opportunity cost of the research may be a poorer A level result. 8. Imagine that a country can produce just two things: goods and services.

Assume that over a given period it could produce any of the following combinations:

Units of goods	Units of services
10	79
20	74
30	65
50	58
60	35
70	19
80	
90	
100	

(a) Draw the country's production possibility curve. (b) Assuming that the country is currently producing 40 units of goods and 70 units of services, what is the opportunity cost of producing another 10 units of goods? (c) Explain how the figures illustrate the principle of increasing opportunity cost. (d) Now assume that technical progress leads to a 10 per cent increase in the output of goods for any given amount of resources. Draw the new production possibility curve.

How has the opportunity cost of producing extra units of services altered? (a)

See the continuous line in Diagram 1. 1 below. (b) 5 units of services.

Producing another 10 units of goods means producing a total of 50 units of goods. Thus, referring to the table, production of services has to be reduced from 70 units to 65 units: a sacrifice of 5 units of services. (c) Each additional 10 units of goods produced involves an increasing sacrifice of services. Thus increasing production of goods from 0 to 10, to 20, to 30, to 40, etc. Involves a sacrifice of 1 (80-79), then 2 (70-77), then 3 (77-74), then 4 (74-70), etc. Units of services.

Similarly, increasing the production of services involves an increasing sacrifice of goods. This can be seen by starting at the right-hand end of the table and moving to the left. Smaller and smaller increases in services are obtained for each extra 10 units of goods sacrifice: in other words, for each extra units of services obtained, more and more goods must be sacrificed.

(d) See the dashed line in Diagram 1. 1 below. The opportunity cost of producing extra services has increased (by 10 per cent): in other words, each extra unit of services produced involves a sacrifice of 10 per cent more goods than previously.

Introduction: Boxes Box 1. 1 : The opportunity costs of studying economics 1.

What might prevent you from making the best decision? Lack of knowledge.

You will not know just how much benefit you will gain from the textbook until you have read it, taken your exams or had your assignments marked!

Another cause of making poor decisions is the lack of care taken in making

them. 2. If there are several other things you could have done, is the

opportunity cost the sum of all of them? No. It is the sacrifice of the next best

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alternative. 3. Why is the cost of food, entertainment, etc. Not included as opportunity costs?

Because you would buy food anyway. If, however, food were being provided free of charge by your parents if you lived at home, but you had to pay for it if you went to university or college, then food would be an opportunity cost to you. 4. Make a list of the benefits of higher education. The benefits to the individual include: increased future earnings; the direct benefits of being more educated; the pleasure of the social contacts at university or college. 5. Is the opportunity cost to the individual of attending higher education different from the opportunity costs to society as a whole?

Yes. The opportunity cost to society as a whole would include the costs of providing tuition (staffing costs, materials, capital costs, etc. ). On the other hand, the benefits to society would include benefits beyond those received by the individual. For example, they would include the extra profits employers would make by employing the individual with those qualifications. Box 1. 2: Green economics 1. Should all polluting activities be banned? Could pollution ever be justified? Explain your answer. Most economists would argue that many polluting activities ought to be allowed to continue.

It might be wise to ban certain very seriously polluting activities, or those where the effects of pollution are not known. In other cases, however, economists argue that governments should attempt to weigh up whether the full marginal benefit to society from the polluting activity (i.e. The extra production of desirable goods and services) is greater or less than the full marginal cost to society, where that marginal cost includes the

environmental damage done by the pollution. Of course, this will require measuring the pollution damage: something that is not always easy to do.

Economists generally argue that if the marginal Cost to society from production (including the pollution damage) exceeds the marginal benefit, then production should be cut back; but if the marginal benefit exceeds the original cost, production should be increased. Chapter 1 2. Why do the prices of fresh vegetables fall when they are in season? Could an individual farmer prevent the price falling? Because supply is at a high level. The increased supply creates a surplus which pushes down the price. Individual farmers could not prevent the price falling.

If they continued to charge the higher price, consumers would simply buy from those farmers charging the lower price. 4. The number of owners of mobile phones has grown rapidly and hence the demand for mobile phones has also grown rapidly. Yet the prices of mobile phones have fallen. Why? 1 The costs of manufacture have fallen with improvements in technology and mass-production economies. 2. Competition from increased numbers of manufacturers has increased supply and driven prices down. 6. This question is concerned with the supply of oil for central heating.

In each case consider whether there is a movement along the supply curve (and in which direction) or a shift in it (and whether left or right). (a) New oil fields start up in production. (b) The demand for central heating rises. (c) The price of gas falls. (d) Oil companies anticipate an upsurge in demand for central heating oil. E) The demand for petrol rises. (f) New technology decreases the costs of oil refining. (g) All oil products become more

expensive. (a) Shift right. (b) Movement up along (as a result of a rise in price). (c) Movement down along (as a result of a fall in price resulting from a fall in demand as people switch to gas-fire central heating). (d) Shift left (if companies want to conserve their stocks in anticipation of a price rise). (e) Shift right (more of a good in joint supply is produced). (f) Shift right. (g) Movement up along.

8. On separate demand and supply diagrams for bread, sketch the effects of the following: (a) a rise in the price of wheat; (b) a rise in the price of butter and margarine; (c) a rise in the price of rice, pasta and potatoes. In each case, state your assumptions.

(a) The supply curve will shift to the left: the price of bread will rise and the quantity sold will fall. Wheat is used to make flour, which is used to make bread. If wheat goes up in price, this will increase the cost of producing bread and hence shift the supply curve (upward) to the left.

(b) The demand curve will shift to the left: the price of bread will fall and the butter and margarine are complements for bread. If they go up in price, less 'bread-and-butter' will be consumed.

(c) The demand curve will shift to the right: the price of bread will rise and the quantity sold will rise.

Rice, pasta and potatoes are substitutes for bread. If they go up in price, less of them will be purchased and more bread will be purchased instead.

10. If both demand and supply change, and if we know which direction they have shifted but not how much, why is it that we will be able to predict the direction in which either price or quantity will change, but not both? (Clue: consider the four possible combinations and sketch them if necessary: (a) D left, S left; (b) D right, S right; (c) D left, S right; (d) D right, S left. ) D left, S left: quantity falls, price may rise or fall.

D right, S right: quantity rises, price may rise or fall. D left, S right: price falls, quantity may rise or fall. D right, S left: price rises, quantity may rise or fall.

Chapter 1: Boxes Box 1 . 2: Free-market medicine in Russia 1. In a market economy would you expect higher prices to lead to lower or higher Output?

Higher prices, unless merely the result of higher costs of production, will encourage firms to produce more: the quantity supplied will increase. If, however, the higher prices were merely part of a general rise in prices and costs (I. E. Inflation), then firms would not be encouraged to produce more. .

Would increased competition tend to reduce or increase inequality? Initially, the exposure of the Russian economy to market forces led to growing inequality. There were much greater opportunities for some people to make profits, and some grew very rich. At the other end of the income scale there was much less job security and much greater scope for employers to pay low wages, especially given the larger number of people unemployed. Over time, however, if competition continues to grow, this will help to prevent firms pushing up prices and making massive profits.

Increased competition may also help to create more jobs and help those at the bottom end of the income scale. Even so, inequality is likely to remain substantially higher than under communism. Box 1. 3: Getting satisfaction 1.

How will your marginal utility from the consumption of electricity be affected by the number of electrical appliances you own? For a 'rational' consumer will not be affected. The rational consumer would consume electricity up to the point where its marginal utility equaled its price.

Since the price of electricity is given, the marginal utility will be the same, irrespective of the number of appliances owned. (With more appliances and



hence more electricity consumed, the consumer's total utility from electricity will be higher. ). In practice, people are likely to pay little or no attention to the specific utility gained from the extra electricity used to run an appliance more. A major reason for this is that it is virtually impossible to separate the utility from the electricity from the utility from the appliance itself. 2.

How will your marginal utility from the consumption of butter depend on the amount of margarine you consume? The more margarine you consume, the lower will be the marginal utility from butter. The reason is that margarine and butter are substitutes. The more you consume of either, the less will be the additional satisfaction of additional units of either. 3. If a good were free, what would your marginal utility be from consuming Zero. As long as your marginal utility were positive, you would consume more. You would only stop when additional units gave you no further satisfaction: 1. . When  $MUM = 0$ .

Box 1. 4: The UK housing market 1. Draw supply and demand diagrams to illustrate what was happening to house prices (a) in the second half of the 1970s; (b) in the early 1980s. (a) Demand was rising rapidly. There was thus a continuing rightward shift in the demand curve for houses and a resulting rise in the equilibrium price. (b) Demand was falling. The leftward shift in the demand curve for houses led to a fall in the equilibrium price. 2. Are there any factors on the supply side that influence house prices? Yes.

Although they are less important than demand-side factors, they are, nevertheless important in determining changes in house prices. The two most important are the expectations of the construction industry. If house building firms are confident that demand will continue to rise, and with it house prices, they are likely to start building more houses. The resulting

increase in the supply of houses (after the time taken to build them) will help to dampen the rise in prices. The other major supply-side factor is speculation by house owners.

If people think that prices will rise in the near future and are thinking of selling their house, they are likely to delay selling and wait until prices have risen. This (temporary) reduction in supply will help to push up prices even further.

Box 1. 5: The heyday of the auction

1. What are the advantages of on-line auctions to (a) purchasers; (b) sellers? (a) Purchasers gain by having easy access to a wide range of products, which are likely to be at lower prices than in shops, thanks to the competition and lack of costs associated with running retail outlets. (b) Sellers gain by being guaranteed a sale at the best possible price, while cutting down on handling costs. It also overcomes the problem of not knowing what is the best price to charge.

2. In what ways do firms using traditional 'menu-based' pricing respond to an increase in demand for their product? Initially they will probably not raise the price (given the costs of adjusting price lists and labels), but simply draw more from stocks or purchase more from their suppliers. If the increased demand persists, they may then consider raising their price.

Chapter 2

2. Which of the following will have positive signs and which will have negative ones? (a) price elasticity of demand; (b) income elasticity of demand (normal DOD); (c) income elasticity of demand (inferior good); (d) cross elasticity of demand (with respect to changes in price of a substitute good); (e) cross elasticity of demand (with respect to changes in price of a complementary good); (f) price elasticity of supply. (b), (d), (f): positive. (a),

(c), (e): negative. 4. How might a firm set about making the demand for its brand less elastic?

Designing it and advertising it so that consumers will believe (rightly or wrongly) that there is no close substitute for it. 6. Why are both the price elasticity of demand and the price elasticity of supply likely to be greater in the long run? Demand: if the price of a good rises, then, the longer the time period, the longer consumers have time to find alternative products. Supply: if the price of a good rises, more firms will be attracted into the industry and existing firms will be encouraged to expand.

Both of these take time. 8. Redraw each of Figures 2. 10-2. 13, only this time assume that it was an initial shift in supply that caused price to change in the first place. See Diagram 2. 1 10. Give some examples of decisions you have taken recently that were made under conditions of uncertainty. With hindsight do you think you made the right decisions? An example would be an item you purchased that you had never consumed before: maybe because you had seen it advertised.

You might then subsequently regret the purchase if it does not live up to your expectations. Another example would be a part-time job. Only when you have started doing the job do you find out how onerous it is to do.

Diagram 2. 1 Speculation: initial shift in the supply curve 12. Think of two things that are provided free. In each case, identify when and in what form a shortage might occur. In what ways are/could these shortages be dealt with? Are they the best solution to the shortages?