

Business economics solutions mba

Life



Obviously the writer is confused. Government subsidies come from government revenues and taxpayers are the source of tax revenues. It may be true that local property taxes that fund the junior high school are not being used for the lunches, but the federal government's funds do come from taxpayers across the country, including those in the town with the Junior high. This example helps support the saying, " There anti no such thing as a free lunch! " 2-3 Critically analyze: " Wants aren't insatiable. I can prove it. I get all the coffee I want to drink every morning at breakfast. Explain: " Goods and services re scarce because resources are scarce. " Analyze: " It is the nature of all economic problems that absolute solutions are denied us. " It may be that you get all the coffee you want on a particular morning, but will that satisfy your wants forever? Not if you want coffee in the future. Therefore, even your desire for coffee is insatiable over time. Goods and services are the product of resources. If resources were abundant without limit, then we would not have a scarcity of the products they produce. Economic problems are problems of relative scarcity? wants exceed resources in the relative sense.

We cannot absolutely solve all of our economic problems; that is, satisfy all of everyone's wants and needs. If all our wants were completely fulfilled, nothing would have a price? why pay for anything if you've got everything already? And if there were no unfulfilled wants there would be no economic resources? why pay for an input when you've got all the outputs you could ever need? The fact that totally free goods and services do not exist provides support for the notion that total fulfillment of our wants is impossible.

2-that are economic resources? What are the major functions of the entrepreneur?

Economic resources are of four main types: labor, land (natural resources), real capital (machines, factories, buildings, etc. ,) and entrepreneurs.

Economic resources are also called factors of production or inputs in the productive process. As these names imply, economic resources are required to produce the outputs desired by society. Since CE retain outputs are desired, they command a price and so, therefore, do economic resources.

This can lead to some things being economic resources in some circumstances but not in others. Water in the middle off lake, for example, is not an economic resource: Anyone can have it free.

But the same water piped to a factory site is no longer free: Its movement must be paid for by taxes or by a specific charge. It is now an economic resource because the factory owner would not pay for its delivery unless the water was to be used in the factory's production. These four types of resources are highlighted in the circular flow diagram where the type of income accruing to each type of resource is shown. Entrepreneurs are risk-takers: They coordinate the activities of the other three inputs for profit? or loss, which is why they are called risk-takers.

Read what will happen if the government sets the price for potatoes at point B?

Entrepreneurs sometimes manage companies that they own, but a manager who is not an owner is not necessarily an entrepreneur but may be performing some of the entrepreneurial functions for the company.

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Entrepreneurs are also innovators, or perhaps inventors, and profits help to motivate such activities. 2-5 (Key Question) Why is the problem of unemployment a part of the subject matter of economics? Distinguish between locative efficiency and productive efficiency. Give an illustration of achieving productive, but not locative, efficiency.

Economics deals with the "limited resources? unlimited wants" problem. Unemployment represents valuable resources that could have been used to produce more goods and services? to meet more wants and ease the economizing problem. Locative efficiency means that resources are being used to produce the goods and services most wanted by society. The economy is then located at the optimal point on its production possibilities curve where marginal benefit equals marginal cost for each good. Productive efficiency means the least costly production techniques are being used to produce wanted goods and services.

Example: manual typewriters produced using the least-cost techniques but for which there is no demand. 2-6 (Key Question) Here is a production possibilities table for war goods and civilian goods:

Type of Production	ID
Automobiles	16
Production Alternatives	18
	112
	10
	14
Rockets	130
	127

a. Show these data graphically. Upon what specific assumptions is this production possibilities curve based? B. If the economy is at point C, what is the cost of one more automobile? One more rocket? Explain how this curve reflects c. What must the economy do to operate at some increasing opportunity costs. Point on the production possibilities curve? A) See curve DECCA. The assumptions are full employment and productive efficiency, fixed supplies of resources, and fixed technology. [pick] (b) 4. 5 rockets; . 33

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automobiles, as determined from the table. Increasing reflected in the concave-from-the-origin shape of the opportunity costs curve. This means the economy must give up larger and larger amounts of rockets to get constant added amounts of automobiles? and vice versa. (c) It must obtain full employment and productive efficiency. 2-7 What is the opportunity cost of attending college?

In 2000, nearly 80% of college-educated Americans held Jobs, whereas only about 40% of those who did not finish high school held Jobs. How might this difference relate to opportunity costs? The opportunity cost of attending college (and of doing anything else) consists of the income forgone while attending college (and of doing anything else such as enjoying leisure) and the value of the goods that the student or the student's parents sacrifice in order to pay tuition and buy books, and other items necessary for college but not necessary otherwise.

Those who are college-educated have the potential of earning more income than those who did not finish high school. The opportunity cost (sacrifice of goods and services) of not working is much greater for those with the higher earning potential. 2-8 Suppose you arrive at a store expecting to pay \$100 for an item, but learn that a store two miles away is charging \$50 for it. Would you drive there and buy it? How does your decision benefit you? What is the opportunity cost of your decision?

Now suppose you arrive at a store expecting to pay \$6000 for an item, but learn that it costs \$5950 at the other store. Do you make the same decision as before? Perhaps surprisingly, you should! Explain why. Driving to the

other store to save \$50 goes involve some cost in terms of time and inconvenience. However, for most of us the time it takes to drive two miles would be worth \$50. For example, if it takes about ten minutes extra time and a negligible amount of gasoline (unless your time is worth \$300 an hour, or \$50 per each ten-minute period), it would benefit you to drive to the other store.

While in the second case, \$50 may seem like less compared to the \$6000 total price, for you the \$50 is still a \$50 savings, exactly the same as in the first case. Therefore, you should apply the same reasoning. Is the \$50 benefit from driving the extra two miles worth the cost? The conclusion should be the same in both cases. 2-9 (Key Question) Specify and explain the shapes of the marginal-benefit and marginal- cost curves and use these curves to determine the optimal allocation of resources to a particular product.

If current output is such that marginal cost exceeds marginal benefit, should more or less resources be allocated to this product? Explain. The marginal benefit curve is downward sloping, MBA falls as more of a product is consumed because additional units of a good yield less satisfaction than previous units. The marginal cost curve is upward sloping, MS increases as more off product s produced since additional units require the use of increasingly unsuitable resource. The optimal amount of a particular product occurs where MBA equals MS. If MS exceeds MBA, fewer resources should be allocated to this use.

The resources are more valuable in some alternative use (as reflected in the higher MS) than in this use (as reflected in the lower MS). 2-10 (Key Question) Label point G inside the production possibilities curve you have drawn for question 6. What does it indicate? Label point H outside the curve. What does this point indicate? What must occur better the economy can attain the level to production indicated by point indicated unemployment, productive inefficiency, or both. H is at present unattainable. Economic growth? through more inputs, better inputs, improved technology? must be achieved to attain H. -11 (Key Question) Referring again to question 6, suppose improvement occurs in the technology of producing rockets but not in the production of automobiles. Draw the new production possibilities curve. Now assume that a technological advance occurs in producing automobiles but not in producing rockets. Draw the new production possibilities curve. Now draw a production possibilities curve that reflects technological improvement in the reduction of both products. See the graph for question 2-6. APPC shows improved rocket technology. APPC shows improved auto technology.

APPC shows improved technology in producing both products. 2-12 Explain how, if at all, each of the following affects the location of the production possibilities curve. Standardized examination scores of high school and college students decline. B. The unemployment rate falls from 9 to 6 percent of the labor force. C. Defense spending is reduced to allow government to spend more on healthcare. D. A new technique improves the efficiency of extracting copper from ore. A) Assuming scores indicate lower skills, then productivity should fall and this would move the curve inward. B) Should not

affect location of curve. Production moves from inside the curve toward frontier. (c) Should not affect location of curve. Resources are allocated away from one type of government spending toward another (health (d) The curve should shift outward as more production is possible with care). Existing resources. 2-explain: " Affluence tomorrow requires sacrifice today. " This quote refers to the fact that economic growth and a rising standard of living in the future require investment today. Society can choose to consume all of its income today, or it can set aside some of it for investment purposes.

Productive resources that go for investment goods today, e. G. , new factories, machines, equipment, are obviously not being used for producing consumer goods. Therefore, consumption is being sacrificed today so that investment goods can be produced with some of today's resources. 2-14 Suppose that, based on a nation's production possibilities curve, an economy must sacrifice 10, 000 pizzas domestically to get the one additional industrial robot it desires, but can get that robot from another country in exchange for 9, 000 pizzas.

Relate this information to the following statement: " Through international specialization and trade, a nation can reduce its opportunity cost of obtaining goods and thus 'get outside its production possibilities curve. " The message of the production possibilities curve is that an individual nation is limited to the combinations of output indicated by its production possibilities curve. International specialization means directing domestic resources to output which a nation is highly efficient at producing.

International trade involves the exchange of these goods for goods produced abroad. Specialization and trade have the same effect as having more and better resources or discovering improved production techniques. The output gains from greater international specialization and trade are the equivalent of economic growth. 2-15 Contrast how a market system and a command economy try to cope with economic scarcity. A market system allows for the private ownership of resources and coordinates economic activity through market prices.

Participants act in their own self-interest and seek to maximize satisfaction or profit through their own decisions regarding consumption or production. Goods and services are produced and resources are supplied by Hoover is willing to do so. The result is competition and widely dispersed economic The command economy is characterized by public ownership of nearly all power. Property resources and economic decisions are made through central planning. The planning board, appointed by the government determines production goals for each enterprise.

The division of output between capital and consumer goods is centrally decided based on the board's long-term priorities. 2-16 Distinguish between the resource market and product market in the circular flow model. In what way are businesses and households both sellers and buyers in this model? What are the flows in the circular flow model? The resource markets are where the owners of the resources (the households) sell their resources to the buyers of the resources (businesses). In the product markets, businesses sell the goods and services they have produced to the buyers of the goods and services, the households.

Households (individuals) either own all economic resources directly or own them indirectly through their ownership of business corporations. These households are willing to sell their resources to businesses because attractive prices draw them into specific resource markets. Businesses buy resources because they are necessary for producing goods and services. The interaction of the buyers and sellers establishes the price of each resource. In the product market, businesses are the sellers and householders are the buyers; their role in the market has been reversed. Each group of economic units both buys and sells.

One flow is the flow of real goods and services (including resource services) and the other flow is the flow of money (money income, consumption expenditures, revenue, production costs). 2-17 (Last Word) Which two of the six reasons listed in the Last Word do you think are the most important in explaining the rise in participation of women in the workplace? Explain A poll taken in a class of 60 college freshman gave the first three your reasoning. Reasons (women's rising wage rates, expanded job accessibility, and changing preferences and attitudes) nearly all the votes.

Each of these explanations received about one third of the votes. Surprisingly, not a single student voted for "declining birth rates" as a reason for the rise in the number of women in the workforce. The consensus of the class was that the last three explanations (declining birth rates, using divorcerates, and stagnating male earnings) were the effects, rather than the cause of more women joining the workforce. Because wage rates are higher the opportunity cost of raising children has risen. Women have

chosen to bear fewer children, because they are now relatively more expensive.

Similarly, women who have a higher earning capacity find the opportunity cost of getting a divorce reduced. Finally, male earnings may have stagnated partially because of the entrance of large numbers of well-educated women into the workforce, increasing the competition for the available jobs.

Individual Markets: Demand and Supply 3-1 Explain the law of demand. Why does a demand curve slope downward? What are the determinants of demand? What happens to the demand curve when each of these determinants changes? Distinguish between a change in demand and a change in the quantity demanded, noting the cause(s) of each.

As prices change because of a change in supply for a commodity, buyers will change the quantity they demand of that item. If the price drops, a larger quantity will be demanded. If the price rises, a lesser quantity will be demanded. The demand curve slopes downward because of the substitution and income effects. When the price of a commodity decreases relative to that of substitutes, a buyer will substitute the now cheaper commodity for those whose prices have not changed. At the same time, the decreased price of the commodity under discussion will make the buyer wealthier in real terms.

More can be bought of this commodity (as well as of others whose prices have not changed). Thus, the substitution and income effects reinforce each other: More will be bought of a normal (or superior) commodity as its price decreases. On a graph with price on the vertical axis and quantity on the

horizontal, this is shown as a demand curve sloping downward from left to right. The fundamental determinant of demand is the price of the commodity under consideration: a change in price causes movement along the commodity demand curve. This movement is called a change in quantity demanded.

Decreased price leads to movement down the demand curve: There is an increase in quantity demanded. Increased price leads to movement up the demand curve: There is a decrease in quantity demanded. In addition, there are determinants of demand, which are factors that may shift the demand curve, i. e. , cause a " change in demand. " These are the number of buyers, the tastes (or desire) of the buyers for the commodity, the income of the buyers, the changes in price of related commodities (substitutes and complements), and expectations of the buyers regarding the future price of the commodity under discussion.

The following will lead to increased demand: more buyers, greater desire for the commodity, higher incomes (assuming a normal good), lower incomes (assuming an inferior good), an increased price of substitutes, a decreased price of complements, and an expectation of higher future prices. This increased demand will show as a shift of the entire demand curve to the right. The reverse of all the above will lead to decreased demand and will show as a shift of the entire demand curve to the left. 3-2 (Key Question) What effect will each of the following have on the demand for product B? A. Product B becomes more fashionable. B.

The price of substitute product C falls. C. Income declines and product B is an inferior good. D. Consumers anticipate the price of B will be lower in the near future. Price of complementary product D falls. F. Foreign tariff barriers on B are eliminated. E. The Demand increases in (a), (c), (e), and (f); decreases in (b) and (d).

3-3 Explain the following news dispatch from Hull, England: "The fish market here slumped today to what local commentators called a 'disastrous level'? all because of a shortage of potatoes. The potatoes are one of the main ingredients in a dish that tigers on almost every cafe menu? fish and chips [French fries]. The shortage of potatoes either meant they were not available in the required quantities at any price (i.e., that the quantity demanded greatly exceeded the quantity supplied at the market price, for that is how a "shortage" is defined) or that there was an exceptional scarcity of potatoes so that their price was far above normal. In any event, the restaurants could not get enough potatoes at what they considered profitable prices. Fish and chips are complements. The sharp increase in the price of potatoes (because of decreased supply) has led to a decreased demand for fish and to a subsequent drop in its price to "a disastrous level."

3-4 Explain the law of supply. Why does the supply curve slope upward? What are the determinants of supply? What happens to the supply curve when each of these determinants changes? Distinguish between a change in supply and a change in the quantity supplied, noting the cause(s) of each. As prices rise because of increased demand for a commodity, producers find it more and more profitable to increase the quantity they offer for sale; that is, the supply curve will slope upward from left to right. Clearly, firms would rather sell at a higher price than at a lower price.

Moreover, it is necessary for firms to demand a higher price as they increase production. This comes about because as they produce more and more, they start to run up against capacity constraints and costs rise. At any given time, a plant has a given size. As production increases, the firm will need to add an extra shift and then a third shift, both perhaps at higher wages. It may run out of warehouse space and have to rent at higher cost from another firm. It may have to pay extra to get increasingly urgent raw material, and so on. A major determinant of supply is the price of the commodity. As price increases, the quantity supplied increases. An increase in price causes a movement up a given supply curve. A decrease in price causes a movement down a given supply curve. The non-price determinants of supply are: resource (input) prices, technology, taxes and subsidies, prices of other related goods, expectations, and the number of sellers. If one or more of these change, there will be a change in supply and the whole supply curve will shift to the right or the left.

The following will cause an increase in supply: a decrease in resource (input) prices; improved (lower cost) technology; a decrease in business taxes, an increase in subsidies to business; a decrease in the price of another commodity that this firm was making, provided that commodity is a substitute in production (the firm can switch from the now lower priced one to our commodity); an expectation of lower prices in the future; and an increase in the number of sellers. The increase in supply caused by the noted change in one or more of the above will cause the entire supply curve to shift to the right.

More will now be supplied at any given price. Alternatively expressed, any given amount will now be supplied at a lower price. The reverse of any or all the above changes in the determinants of demand will cause a decrease in demand and will be shown as a shift of the supply curve to the left. Less will now be supplied at any given price. Alternatively expressed, any given amount will now be supplied at a higher price.

3-5 (Key Question) What effect will each of the following have on the supply of product B?

- A. A technological advance in the methods of producing B.
- B. A decline in the number of firms in industry B.
- C. An increase in the price of resources required in the production of B.
- D. Expectation that the equilibrium price of B will be lower in the future than it is currently.
- E. A decline in the price of product A, a good whose production requires substantially the same techniques as does the production of B.
- F. Levying of a specific sales tax upon B.
- G. The granting of a 50-cent per unit subsidy for each unit of B produced.

Supply increases in (a), (d), (e), and (g); decreases in (b), (c), and (f).

6 " In the corn market, demand often exceeds supply and supply sometimes exceeds demand. " " The price of corn rises and falls in response to changes in supply and demand. " In which of these two statements are the terms " supply' and " demand" used correctly? Explain. In the first statement " supply' and " demand" are used incorrectly. Supply and demand are both schedules or curves that intersect where quantity supplied and quantity demanded are equal. One cannot talk of curves that intersect as exceeding or not exceeding each other. Supply and/or demand can change (the entire curves can shift).

Each time this happens, it will create a new intersection of the two curves that will lead to changes in the equilibrium quantity and price of corn. Thus, the terms "supply" and "demand" are used correctly in the second statement.

3-7 (Key Question) Suppose the total demand for wheat and the total supply of wheat per month in the Kansas City grain market are as follows:

Thousands of bushels	Price per bushel	Supplied	Demanded	Surplus (+)	Shortage (-)
140	\$3.40	172	173	0	-1
149	\$4.90	177	179	2	0
160	\$7.00	160	160	0	0
175	\$13.70	160	175	0	15
180	\$14.60	160	180	0	20

a. What will be the market or equilibrium price?

What is the equilibrium quantity? Using the surplus-shortage column, explain why your answers are correct.

B. Graph the demand for wheat and the supply of wheat. Be sure to label the axes of your graph correctly. Label equilibrium price "P" and the equilibrium quantity "Q."

c. Why will \$3.40 not be the equilibrium price in this market? Why not \$4.90? "Surpluses drive prices up; shortages drive them down." Do you agree?

D. Now suppose that the government establishes a ceiling price of, say, \$3.70 for wheat. Explain carefully the effects of this ceiling price. Demonstrate your answer graphically.

What might prompt the government to establish a ceiling price? Data from top to bottom: -13; -7; 0; +7; +14; and +21. [pick] (a) $P = \$4.00$; $S_q = 75,000$. Equilibrium occurs where there is neither a shortage nor surplus of wheat. At the immediately lower price of \$3.70, there is a shortage of 7,000 bushels. At the immediately higher price of \$4.30, there is a surplus of 7,000 bushels. (See Graph top of next page.) (b) Quantity (thousands) to bushels. (c) Because at \$3.40 there will be a 13,000 bushel shortage which

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will drive price up. Because at \$4.90 there will be a 21,000 bushel surplus which will drive the price down.

Quotation is incorrect; just the opposite is true. D) A \$3.70 ceiling causes a persistent shortage. This product may be a necessity and the government is concerned that some consumers might not be able to afford it. 3-8 (Key Question) How will each of the following changes in demand and/or supply affect equilibrium price and equilibrium quantity in a competitive market; that is do price and quantity rise, fall, remain unchanged, or are the answers indeterminate, depending on the magnitudes of the shifts in supply and demand? You should rely on a supply and demand diagram to verify answers. A.

Supply decreases and demand remains constant. B. Demand decreases and supply remains constant. C. Supply increases and demand is constant. D. Demand increases and supply increases. E. Demand increases and supply is constant. F. Supply increases and demand decreases. G. Demand increases and supply decreases. H. Demand decreases and supply decreases. (a) Price up; quantity down; (b) Price down; quantity down; (c) Price down; quantity up; (d) Price indeterminate; quantity up; (e) Price up; quantity up; (f) Price down; quantity indeterminate; (g) Price up, quantity indeterminate; (h) Price indeterminate and quantity down. 9 " Prices are the automatic regulator that tends to keep production and consumption in line with each other. " Explain. When demand increases, prices rise. This induces producers to increase the quantity supplied as they move up their supply curves toward the new (higher) equilibrium point. The same happens in reverse when demand decreases. When supply increases, prices drop. This induces buyers to

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increase the quantity demanded as they move down their demand curves toward the new (lower) equilibrium point.

The same happens in reverse when supply decreases. In each case, it is the change in price caused by the change in demand or supply that brings about the change in quantity supplied (in the case of a change in demand) and a change in quantity demanded (in the case of a change in supply). Thus, price is the automatic regulator that keeps production and consumption in line with each other. 3-10 Explain: " Even though parking meters may yield little or no net revenue, they should nevertheless be retained because of the rationing function they perform. Even parking meters that charge, say, 25 cents an hour do perform a useful parking-spot-rationing function: When the hour is up, the car owner must either move the car or rush out to feed the meter to avoid eating a ticket. In this case it is not money or ration coupons that ration the parking space but the timing device on the meter. 3-11 Use two market diagrams to explain now an increase in state subsidies to public colleges might affect tuition and enrollments in both public and private colleges.

The state subsidies to public colleges shift the supply curve of the public colleges to the right, thus reducing tuition and increasing enrollments in these institutions. The decreased cost of public college education leads to some substitution away from the private colleges, where the enrollment demand curve shifts to the left. The final result is a lower cost of tuition in both public and private colleges. (See Figure 3-c.) 3-12 Critically evaluate: " In comparing the two equilibrium positions in Figure 3-AAA, I note that a larger amount is actually purchased at a higher price.

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This refutes the law of demand. " The key point here is that the second equilibrium occurs after demand has increased, that is demand has shifted because of a change in determinants, which has caused buyers to want more at every price compared to the original demand curve and schedule. Each equilibrium price refers to a different demand situation. Therefore, the fact that more is purchased at a higher price when demand increases does not refute the law of demand. Note that on the second demand curve and schedule, more would still be purchased at a lower price. -13 Suppose you go to a recycling center and are paid 25 cents per pound for your aluminum cans. However, the recycling center charges you \$. 20 per bundle to accept your old newspapers. Use demand and supply diagrams to portray both markets. Can you explain how different government policies with respect to the recycling of aluminum and paper might account for these different market outcomes? The equilibrium price of aluminum cans is not only higher than that for newspapers, but the price of newspapers is actually negative, meaning that the demand is very low relative to the supply.

The demand is so low that the equilibrium quantity is at a negative price and consumers pay to have the papers " purchased. " Diagrams (a) and (b) illustrate the two situations. (One might even suggest that there is a current abundance of old newspapers, and the demand is for environmental quality rather than for old newspapers. However, this complicating idea will probably confuse students and is probably not worth mentioning unless a student raises the issue.) Various government policies could cause these different market outcomes.

For example, requiring the use of recycled aluminum in can production could raise its demand; requiring refundable deposits on cans at the time of purchase could give them a value not given to newspapers; giving tax breaks for the use of recycled aluminum and not for recycled newspapers would also encourage demand for aluminum and not for newspapers. 3-14

Advanced analysis: Assume that the demand for a commodity is represented by the equation $P = 10 - .5Q_d$ and supply by the equation $P = 2 + .5Q_s$, where Q_d and Q_s are quantity demanded and quantity supplied, respectively, and P is price.