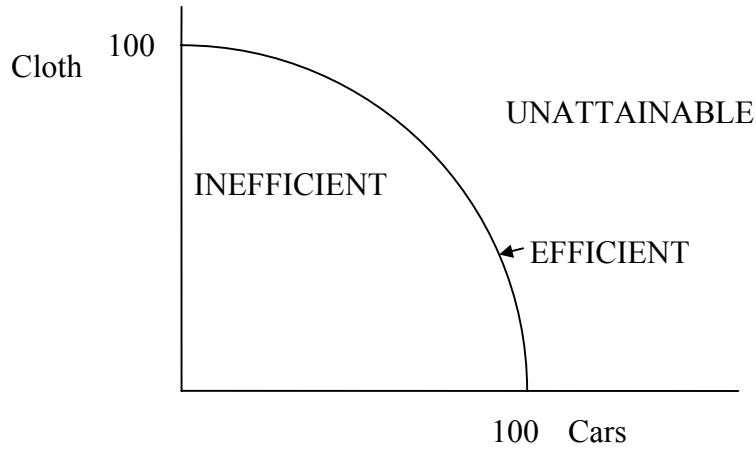


Problem Set #2 Answers - Economics 2106H, John Turner

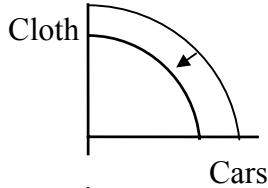
1.



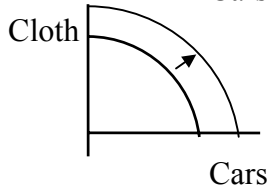
(a) See above.

(b) Moving along the PPF (from left to right) involves devoting more resources of the economy to the production of cars and less to the production of cloth. The opportunity cost of producing more cars is the foregone production of cloth. Moreover, this “opportunity cost” increases as more of a good is produced, which causes the PPF to be bowed out.

(i)

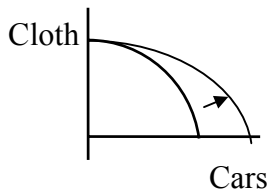


(ii)

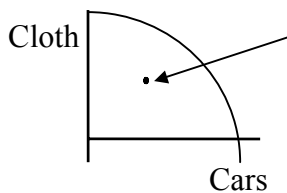


This graph assumes the production of cars uses cloth.

(iii)



(iv)

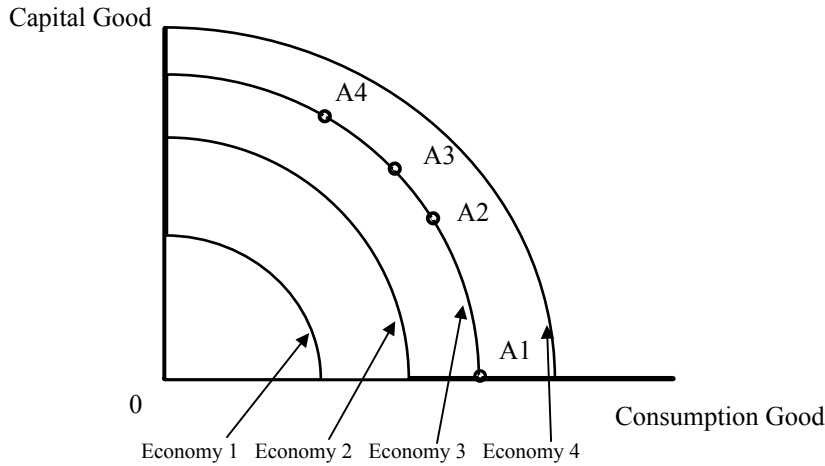


PPF remains the same, this point is the cloth-cars point of production

2.

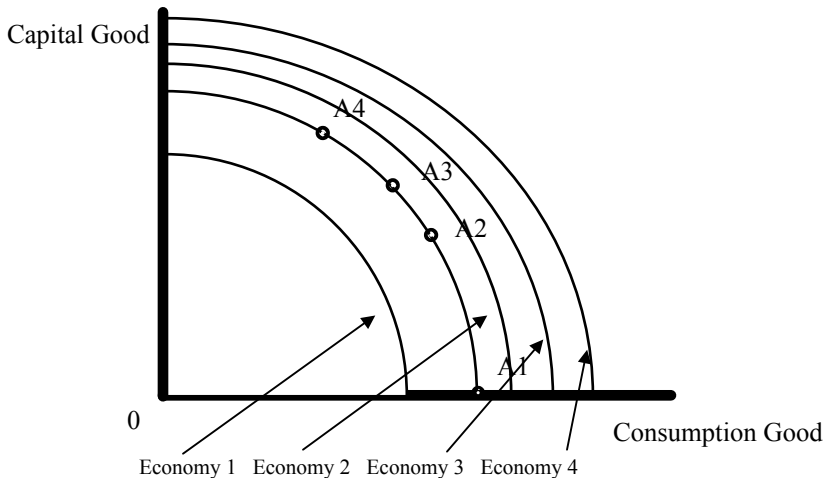
- (a) Moving from point A to B means the economy devotes more resources to the production of bread and less to the production of cars. The opportunity cost is 25 cars.
- (b) Yes, the economy could produce 100 cars and 100 loaves of bread, but the economy would not be using resources efficiently (this would occur during a recession)
- (c) No

3.



Note: Economy 4 is the only economy that grew since they saved the most and replaced the worn out capital goods with more than the 100 that was needed for the PPF to remain the same. Economy 3 saved and invested exactly the 100 capital goods that was required to maintain the same PPF. Economy 1 is shown with the smallest PPF since they saved nothing. Since the 100 capital goods are worn out after 1 year this economy has no capital goods to produce anything for the future. If production requires some capital to produce goods then this PPF would be just a dot at (0,0). The above PPF assumes that some production takes place with no capital since there is still labor to produce goods (although production is quite small).

4.



The PPFs are further to the right than they were in problem 3 because the depreciation is no longer 100%, but is rather 50%. Note that the arc with the dots representing A1, A2, etc... is the original PPF. The sequence of the PPFs has not changed. However, as the PPF is demonstrative of the potential of the economy to produce goods, and the number of goods in the second period is greater in this problem than in number 4 (due to the reduction in the rate of depreciation), the curves have shifted up and to the right.