Discussion 2

Important Topics

- Comparative Advantage

- Global Production Possibility Frontiers (PPF)

- Technology Change and PPFs

- Determinants of Demand

Problems

Exercise 1 (Opportunity Costs and Global PPFs) Alice builds 2 tables in 6 hours and 3 chairs in 2 hours. Bob builds 1 table in 2 hours and builds 2 chairs in 3 hours. Fill in the table below in terms of the amount of time it takes to build each unit:

	Tables	Chairs	OC tables	OC chairs
Alice				
Bob				

(a) Who has comparative advantage in tables? In chairs?

(b) What is the smallest number of tables that Alice will accept in trade from Bob for a chair?

(c) Suppose Alice and Bob must make exactly nine chairs during a twelve hour work day, how many tables will they be able to finish in addition to the nine chairs?

(d) Now suppose they each have six hours. Draw the PPFs for both Alice and Bob (chairs on the horizontal axis). What is the marginal rate of transformation (MRT) for Alice and Bob?

(e) Combine the two PPFs (global PPF).

(f) What happens if we have more than 2 persons? How do you think the global PPF changes?

Exercise 2 (Non-linear Production Possibility Frontier) Use this graph to answer the following questions:
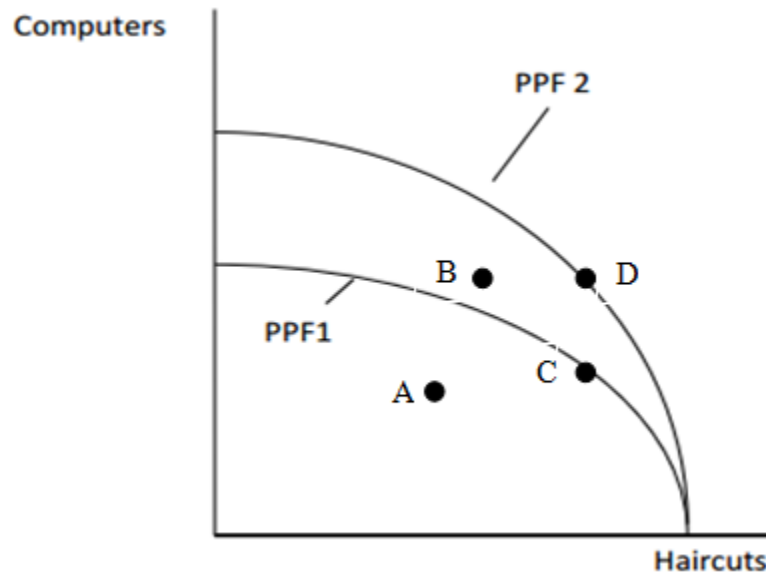
(a) If the US's production possibility starts out at PPF1, which points are feasible? which points are feasible and efficient?

(b) Now the PPF shifts out to PPF2, what does this tell us about how production has changed for haircuts and computers?

(c) How will the shift from PPF1 to PPF2 affect the opportunity cost for producing haircuts?

Exercise 3 (Determinants of Demand) Consider the case of Five Guys on State Street. They know that they face a downward sloping demand for regular cheeseburgers. The manager hires you to predict the following scenarios. Make a graph showing the changes described and identify which determinant of demand is invoked in each scenario.

(a) The reduction of the price in cheeseburgers will lead to a _____ in the demand curve of cheeseburgers.

(b) A new campaign for weight loss identify cheeseburgers to be very unhealthy food, this advertisement will lead to a _____ in the demand curve of cheeseburgers.

(c) The price of French fries decreases, this will lead to _____ of the demand of cheeseburgers.

(d) The price of Wendy's cheeseburgers decreases, this will lead to a _____ the demand curve of cheeseburgers.