

1. Classify each of the following statements as positive or normative. Explain.
 - a. Society faces a short-run tradeoff between inflation and unemployment.
 - b. A reduction in the rate of growth of money will reduce the rate of inflation.
 - c. The Federal Reserve should reduce the rate of growth of money.
 - d. Society ought to require welfare recipients to look for jobs.
 - e. Lower tax rates encourage more work and more saving.
2. In Wednesday's lecture I claimed that the Law of Comparative Advantage applies even when the rancher has an absolute advantage in producing both meat and potatoes. We used the following data on the farmer's and rancher's production:

	Time to make 1 oz.	
	Meat	Potatoes
Farmer	60 mins	15 mins
Rancher	20 mins	10 mins

- a. Assume the farmer and rancher do NOT trade and that each spends 4 hours a day making meat and 4 hours making potatoes. How many ounces of meat does each person produce? How many ounces of potatoes? What is the total amount of meat and the total amount of potatoes produced?
 - b. Now assume they arrange to trade. The farmer produces only potatoes (the product for which she has a comparative advantage), and the rancher spends 6 hours a day on meat and 2 hours a day on potatoes. What does each person produce over the course of 8 hours?
 - c. Suppose they trade 5 oz. meat for 15 oz. potatoes. How much meat and how much potatoes does each have to consume? How does this compare to the amounts they had before trade was allowed?
3. (McEachern p. 47, #14) You have the following information concerning the production of wheat and cloth in the United States and the United Kingdom:

	Labor hours required to produce 1 unit	
	U.K.	U.S.A.
Wheat	2	1
Cloth	6	5

- a. What is the opportunity cost of producing a unit of wheat in the U.K.? In the U.S.A.?
- b. Which country has an absolute advantage in producing wheat? In producing cloth?
- c. Which country has a comparative advantage in producing wheat? In producing cloth?

- d. Which country should specialize in producing what? In producing cloth?
 - e. (additional question) What would be an exchange rate of wheat for cloth that both countries would agree to? Explain why this rate of exchange would be a “good deal” for each country.
4. You and your friends have access to three computers, and you decide that in your spare time you would like to start a small business. You figure you can use these computers to either make electronic greeting cards or web videos that will be used to promote Trinity.
- a. Suppose all three computers are the same (same speed, same amount of memory, etc...). Each computer is capable of making 10 greeting cards or 2 web videos per hour. Suppose you work 8 hours per day and your firm can devote its resources to producing web videos, greeting cards, or any combination of the two. Graph the daily production possibilities frontier for your firm. Put the number of greeting cards produced on the y-axis and the number of web videos produced on the x-axis. How is the opportunity cost of producing an additional web video shown on this graph?
 - b. Now suppose (more realistically) that the three computers aren't the same in terms of speed and memory. There is now a “slow” computer which can make 1 video per hour, a “fast” computer which can make 2 videos per hour, and a “super-fast” computer which makes 4 videos per hour. However, the speed does not affect how many greeting cards can be produced: all three can still make 10 per hour. Graph the new production possibilities frontier for your firm.
 - c. How does this graph illustrate the law of increasing opportunity cost?
 - d. What happens to the PPF if the number of computers doubles (i.e., you have two “slow,” two “fast,” and two “super-fast” computers)?