

Chapter 2

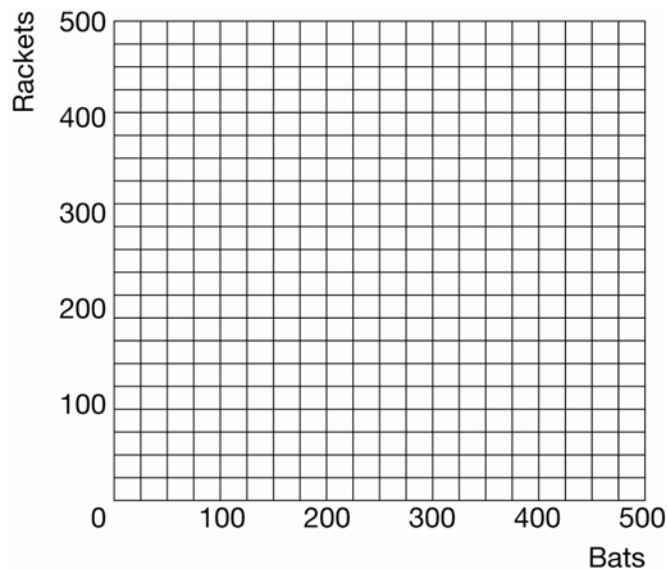
1. Identify the parts of the circular-flow diagram immediately involved in the following transactions.
 - a. Mary buys a car from Jaguar for £40,000.
 - b. Jaguar pays Joe £2,500/month for work on the assembly line.
 - c. Joe makes £10 worth of calls on his Vodafone mobile phone.
 - d. Mary receives £1,000 of dividends on her Vodafone shares.
2. The following table provides information about the production possibilities frontier of Athletic Country.

Exhibit 1

Bats	Rackets
0	420
100	400
200	360
300	300
400	200
500	0

- a. In Exhibit 2, plot and connect these points to create Athletic Country's production possibilities frontier.

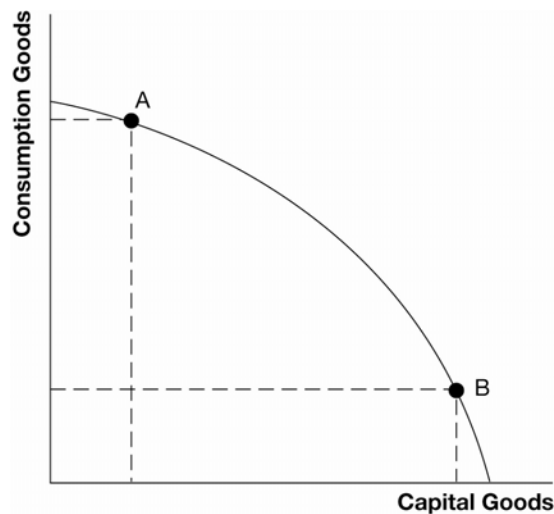
Exhibit 2



- b. If Athletic Country currently produces 100 bats and 400 rackets, what is the opportunity cost of an additional 100 bats?

- c. If Athletic Country currently produces 300 bats and 300 rackets, what is the opportunity cost of an additional 100 bats?
 - d. Why does the additional production of 100 bats in part (c) cause a greater trade-off than the additional production of 100 bats in part (b)?
 - e. Suppose Athletic Country is currently producing 200 bats and 200 rackets. How many additional bats could they produce without giving up any rackets? How many additional rackets could they produce without giving up any bats?
 - f. Is the production of 200 bats and 200 rackets efficient? Explain.
3. The production possibilities frontier in Exhibit 3 shows the available trade-offs between consumption goods and capital goods. Suppose two countries face this identical production possibilities frontier.

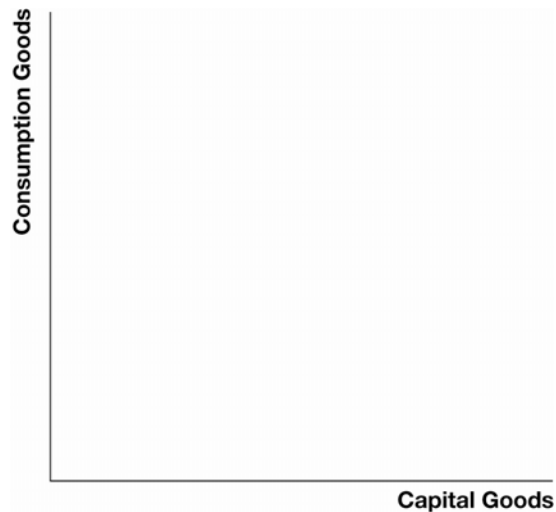
Exhibit 3



- a. Suppose Party Country chooses to produce at point A while Parsimonious Country choose to produce at point B. Which country will experience more growth in the future? Why?
- b. In this model, what is the opportunity cost of future growth?

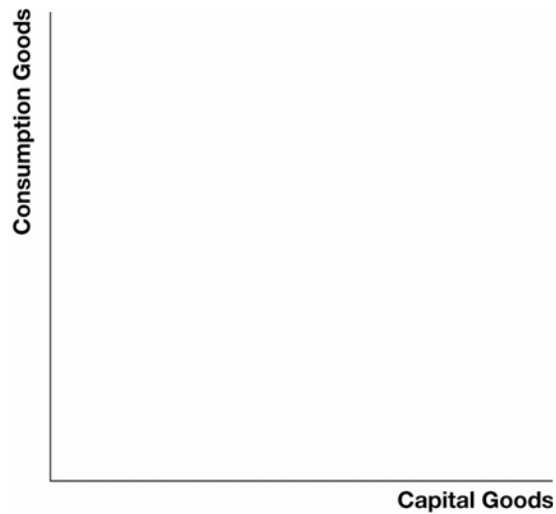
- c. Demonstrate in Exhibit 4 the impact of growth on a production possibilities frontier such as the one shown above. Would the production possibilities frontier for Parsimonious Country shift more or less than that for Party Country? Why?

Exhibit 4



- d. On the graph in Exhibit 5, show the shift in the production possibilities curve if there was an increase in technology that only affected the production of capital goods.

Exhibit 5



- e. Does the shift in part (d) above imply that all additional production must be in the form of capital goods? Why?