Liberty High School

AP Macroeconomics

Mr. Lopez

Chapter Two

Thinking like an Economist

Study Guide

(73 points)

Name:\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ Period:\_\_\_\_\_

Part 1 - Key Terms & Review:

1. Inflation:
2. Deflation:
3. Capitalism:
4. Rule of Law:
5. Property Rights:
6. Entrepreneurship:
7. Free Transaction:
8. Socialism:
9. Sunk cost:
10. Microeconomics:
11. Macroeconomics:
12. Basic economic truth:
13. Scarcity:
14. Efficiency:
15. Trade-offs:
16. Opportunity cost:
17. Law of increasing cost:
18. Law of Diminishing Returns:
19. Household:
20. Business or Firm:
21. Economic models:
22. Factors of Production:
23. Land:
24. Labor:
25. Physical capital:
26. Human capital:
27. Factor Market:
28. Product Market:

Part 2 - Diagramming:

1. The Factor market:

**Household Business/Firm**

1. The Product Market:

**Household Business/Firm**

1. The Circular Flow Model (Textbook page 25):

**Factor Market**

**Household Business/Firm**

**Product Market**

1. Production Possibilities (Simplistic example):

|  |  |
| --- | --- |
| **Twinkees** | **Ding Dongs** |
|  20 | 0 |
|  |  |
|  |  |
|  |  |
|  |  |
|  |  |
|  |  |
|  |  |
|  |  |
|  |  |
|  |  |
|  |  |
| 0 | 40 |



33: Production possibilities (Reality):

Draw a realistic production possibilities graph for cars versus computers

1. Label the frontier and draw a dot at a point where underutilization would occur.
2. Assuming that a new method of production increases our possibilities, draw a new frontier and label it with a ‘.
3. Assume that a work stoppage reduces our possibilities, d=raw a new frontier and label it “.



34. Why do we only show two possibilities in a production possibilities graph?

35. Why is the production possibilities curve, curved?

36. What would be the level of unemployment in an economy operating close to the frontier?

37. Why might an economy operating close to or at the frontier have inflation?

Part 3 – Problems and Short Answer Questions:

38. Identify the parts of the circular flow diagram involved in the following transactions: (4 points)

 a. Mary buys a car from Ford for $25,000.

 b. Ford pays Jorde $5,000 per month to work on an assembly line.

1. Jorde gets a $10.00 haircut.
2. Mary receives a dividend from Ford on her preferred stock.

39. Mr. Romise owns and operates a factory producing athletic gear in Walnut Creek, CA. The production possibilities frontier. (7 points)

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



1. Use the schedule above to create a production possibilities frontier for Romise’ s athletic gear.
2. If Romise’s factory is currently producing 100 bats and 400 rackets, what is the opportunity cost of an additional 100 bats?
3. If production is currently at 300 bats and 300 rackets what is the cost of an additional 100 bats?
4. Why does the additional 100 bats in part c above cause a greater trade off that the additional production of 100 bats in part b above?
5. Suppose production is currently at 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?
6. Is the production of 200 bats and 200 rackets efficient? Explain.
7. Use the examples of bats and rackets to explain the law of increasing costs.

**“A”**



40. The production possibilities frontier “A” above shows the available trade-offs between consumption goods (those for purchase by households) and capital goods (those to be used in the production of products). Suppose two countries/nations face this identical production possibilities frontier. (5 points)

a. Suppose Decker Country choose to produce at point A, while Lamb country choose to produce at point B. Which country will experience more future growth and why?

b. In this model, what is the opportunity cost of future growth?

“B”



c. On the production possibilities frontier “B” above, illustrate the impact on growth on the production possibilities frontier. Label the new frontier with ‘ for Decker and “ for Lamb. Which country Decker or Lamb will have the greater shift in their frontier and why?

d. On the graph in “C”, below show the shift in the production possibilities curve if there was an increase in technology that affected only the production of capital goods.

e. Does the shift on “C” in part d above, imply that all additional production must be in the form of capital goods? Why?

**“C”**



Part 4- Understanding why economists think the way they do.

41. Why do 93% of economists believe that a ceiling on rents reduces the quantity and quality of housing available?

42. Why do 93% of economists believe that tariffs and import quotas reduce general economic welfare?

43. Why do 90% of economists believe that flexible and floating exchange rates offer an effective international monetary arrangement?

44. Why do 90% of economists believe that fiscal policy (actions taken by the government with regards to taxing and/or spending) has a significant simulative impact on economies with unemployment?

45. Why do 90% of economists oppose government restrictions on American businesses/firms outsourcing work to foreign countries?

46. Why do 88% of economists believe that economic growth in the United States leads to greater levels of well-being?

47. Why do 85% of economists believe that the United States should eliminate agricultural subsidies?

48. Why does Mr. Lopez disagree with regards to eliminating ALL subsidies?

49. Why do 85% of economists agree that an appropriately designed fiscal policy can increase the long run rate of capital formation?

50. Why does Mr. Lopez and many of these economists believe that higher marginal taxes on the rich will ultimately have a negative impact on capital formation?

51. Why do 85% of economists believe that state and local governments should eliminate subsidies to professional sports franchises?

52. Why do 85% of economists believe that if the federal budget is to be balanced, it should be done over the business cycle rather than yearly?

53. Why do 85% of the economists believe that the gap between Social Security funds and expenditures will become unsustainably large within the next 50 years if current policies remain unchanged?

54. Why do 84% of economists believe that cash payments increase the welfare of recipients to a greater degree than do transfers-in-kind of equal cash value?

55. Why do 83% of economists believe that a large federal budget deficit has an adverse effect on the economy?

56. Why do 83% of the economists believe that redistribution of income is a legitimate role for the government?

57. Why do 83% of economists agree that inflation is caused primarily by too much growth in the money supply?

58. Why do 82% of the economists believe that the United States should not ban genetically modified crops?

59. Why do 79% of the economists believe that a minimum wage increases unemployment among young and unskilled workers?

60. Why do 78% of economists believe that effluent taxes and marketable pollution permits represent a better approach to pollution control than imposition of pollution ceilings?

61. Why do 78% of economists believe that ethanol subsidies in the United States should be eliminated?

Part 5 – Short Answer Questions:

62. What role do assumptions play in any science?

1. What five Economic Reasoning assumptions do we acknowledge in our class?
	1. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_
	2. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_
	3. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_
	4. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_
	5. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_
2. Is a more realistic model always better?
3. Why does a production possibilities graph have a negative slope 9slope down to the right)?
4. Why is a production possibilities graph actually bowed outward?
5. What are the two subfields in economics and which is more likely to be a building block of the other?
6. What is an example of a normative statement that an economist might make?
7. When an economist makes a normative statement, is he/she more likely to be acting as a scientist or as a policy advisor?
8. Which statements are more testable, positive or normative statements?
9. Name two reasons why economists disagree?
10. Name two economic propositions for which more than 90 percent of economists agree?

Part 6 – True or False

1. \_\_\_\_\_\_\_Economic models must mirror reality or they are of no value.
2. \_\_\_\_\_\_\_Assumptions make the world easier to understand because they because they simplify reality and focus our attention.
3. \_\_\_\_\_\_\_It is reasonable to assume that the world is composed of only one person when modeling international trade.
4. \_\_\_\_\_\_\_When people act as scientists, they must try to be objective.
5. \_\_\_\_\_\_\_If an economy is operating on its production possibilities frontier, it must be using its resources efficiently.
6. \_\_\_\_\_\_\_If an economy is operating on its production possibilities frontier, it must produce less of one good if it produces more of another.
7. \_\_\_\_\_\_\_Points outside the production possibilities frontier are attainable but inefficient.
8. \_\_\_\_\_\_\_If an economy were experiencing substantial unemployment, the economy is producing inside the production possibilities frontier.
9. \_\_\_\_\_\_\_The production possibilities frontier is bowed outward because the trade-off between the production of any two goods is constant.
10. \_\_\_\_\_\_\_An advance in production technology would cause the production possibilities curve to shift outward.
11. \_\_\_\_\_\_\_Macroeconomics is concerned with the study of how households and firms make decisions and how they interact in specific markets.
12. \_\_\_\_\_\_\_The statement, “An increase in inflation tends to cause unemployment to fall in the short run” is normative.
13. \_\_\_\_\_\_\_When economists make positive statements, they are more likely to be acting as scientists.
14. \_\_\_\_\_\_\_Normative statements can be refuted with evidence.
15. \_\_\_\_\_\_\_Most economists believe that tariffs and import quotas usually reduce general economic welfare.

Part 7 – Additional Critical thinking on Opportunity Cost

1. Suppose a student is passing their classes in Video Productions and Economics but struggling in French class. If this student is required to be absent for one of these classes, what are two opportunity cost considerations that the student should consider and which class should they miss?
2. You manage a factory with ten employees that produces paper or paper clips. If you decide to reduce production of paper to increase that of paper clips, how would opportunity cost influence your decision as to which worker(s) to use producing paper clips? Why might the opportunity cost of using various workers differ?
3. Suppose that as the manager of this factory you are being required to dismiss two workers. How might you make this decision? If these two workers have a similar value in the production of paper what opportunity cost might you also consider in this decision?
4. You are watching the evening news in Madrid, Spain. The show features a discussion on the pros and cons of free trade (lack of restrictions to international trade). For balance, there are two economists present – one in support of free trade and another opposed. Your roommate comments that “those economists have no idea of what is going on. They cannot agree on anything. One says free trade will make us rich. The other says it will drive us into poverty. If experts cannot agree how is the average person ever to know if free trade is good”. (3 points)
	1. Can you give your roommate any insight into why economists might disagree on this issue?
	2. Suppose you discover that 93% of economists believe that free trade is generally good for the economy. Could you give a more precise answer as to why economists might disagree on this issue?
	3. What if you later discovered that the economists who opposed to free trade worked for a labor union? Would that help you explain why there appears to be a difference of opinion on this issue.