Youngberg

Econ 280

**Homework 01—Key**

Answer all the following on a ***typed, stapled*** (if applicable)separate sheet of paper. Make sure that you justify your answers, use your own words, and show your work. All questions are equally weighted.

1. Perhaps the largest transformation of human society was the transition from hunter-gathering (foraging) to farming. Farming enable people to generate large quantities of food which meant not everyone had to spend their day looking for sustenance. Dedicated priests, soldiers, porters, and craftsmen all appeared. They gathered in towns, which grew over time. They traveled to other towns to trade. They became safer and wealthier. Employing ideas from both Adam Smith and David Ricardo, explain how farming made society wealthier. Also explain how larger towns and trading with other towns further expanded that wealth.

*Farming enabled specialization of labor. Smith would draw attention to how these once-foragers would not have to switch from producing food to carrying food or to defending oneself against violent rivals. They, therefore, would not have to spend time switching implements (from hoe to basket to weapon), could develop the muscle memory to be more efficient at their jobs, and are more likely to develop labor saving devices (e.g. a stronger sword or better tools).*

*Ricardo would point out that specialization enables people to focus on tasks they are naturally best at. The smartest people might be craftsmen or priests; the most charismatic might be leaders; and the strongest might be porters or soldiers. With specialization, there is less natural talent wasted.*

*As towns grew and traded with others, the extent of the market increased, allowing even greater specialization. Note how specialization leads to even more specialization as larger cities need dedicated police officers and other occupations to facilitate additional expansion. In addition, explorers, shipwrights, and other transportation-related occupations enable extending the market to distant lands.*

1. Sanjay’s majoring in psychology when he takes his first economics class. So enamored with the discipline, he wants to change his major. However, he’s already taken several psychology classes. “I’ve gotten this far,” he says after much consideration, “so I might as well keep majoring in psychology.” Briefly describe what mistake Sanjay is making. Be sure to mention and define the relevant technical terminology when answering this question.

*Sanjay’s considering a sunk cost—a cost which cannot be recovered—in determining if he should continue on his current path. Because sunk costs cannot be retrieved, it shouldn’t be considered. Regardless of what he chooses, that time will not be available.*

*Note this is different from choosing to finish the psychology major because there are fewer classes he would have to take. Wanting to spend less is a reasonable consideration. Not wanting to “waste” something is not a reasonable consideration.*

1. Describe a time in your life when you made a specialized investment (it would be helpful to review the definition of “specialized investment” from the lecture notes). Also indicate which kind of specialized investment it is closest to. Justify your answer.

*For me, a specialized investment I made was when I traveled to here to interview for the job I now have. This is a specialized investment because my interactions with the Bethany community was not just so they could learn about me, but so I could learn about them. This investment (which both of us paid part of) was needed before either party made an exchange of offering and accepting a job. Since this investment was about each party gaining information about the other, human capital is the most appropriate kind of specialized investment this is.*

*As students of Bethany College, you also made a similar investment. Before the exchange of tuition-for-education took place, you had to fill out many forms and applications, a dedicated asset since those filled-out forms were only acceptable at Bethany. Many of you might have visited the school as well. Since this focused on learning about Bethany, it was human capital. It is also possible that you did specific activities in high school because you thought Bethany would find them impressive. In that case, that is a dedicated-asset: while others might find it impressive, you did it for Bethany.*

1. For each of the following goods, indicate if the demand is more elastic or inelastic than the good in parenthesis. Justify your answer with ***no more*** than two sentences (one sentence should suffice).
	1. Textbooks from the campus bookstore before the internet (versus textbooks from the campus bookstore after the internet)

*Inelastic because it was more difficult to find substitutes for the campus bookstore before the internet. The internet drastically reduced search costs for book shopping.*

* 1. Lunch when you’re very hungry (versus lunch when you’re not hungry)

*Inelastic because you are less willing to shop around for food when you are very hungry.*

* 1. A large house (versus a small apartment in the same area)

*Elastic because the house will cost more than the apartment. Since it will take up a bigger share of your income to buy a large house, you are more willing to hunt for a better deal.*

* 1. Fruit (versus food)

*Elastic because there are many more substitutes for fruit than there are for food in general.*

* 1. A car today (versus a car next year)

*Inelastic because buying a car today doesn’t leave much time to shop around but you’d have plenty of time to find a good deal if you had a whole year to get a bargain.*

1. Suppose, at a price of $10 each, the market demands 3,000 pies. Using the arc price elasticity method calculate elasticity for each of the following price and quantity combinations and indicate if the result is elastic, inelastic, or unit elastic.
	1. P = $5; Q = 7,500

*[(7,500 – 3,000)/((7,500 + 3,000)/2)] / [(5 – 10)/((5 + 10)/2)]*

*(4,500/5,250) / (-5/7.5)*

*-1.286, elastic*

* 1. P = $11; Q = 2,800

*[(2,800 – 3,000)/((2,800 + 3,000)/2)] / [(11 – 10)/((11 + 10)/2)]*

*(-200/2,900) / (1/10.5)*

*-0.724, inelastic*

* 1. P = $8; Q = 3,750

*[(3,750 – 3,000)/((3,750 + 3,000)/2)] / [(8 – 10)/((8 + 10)/2)]*

*(750/3,375) / (-2/9)*

*-1.000, unit-elastic*

* 1. P = $2; Q = 10,000

*[(10,000 – 3,000)/((10,000 + 3,000)/2)] / [(2 – 10)/((2 + 10)/2)]*

*(7,000/6,500) / (-8/6)*

*-0.808, inelastic*