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ECON 201—Montgomery College

David Youngberg

**Exam 3**

* There are 110 possible points on this exam. The test is out of 100.
* You have two hours to complete this exam but you should be able to complete it in less than that
* Please turn off all cell phones and other electronic equipment.
* You are allowed a calculator for the exam. This calculator cannot be capable of storing equations. This calculator cannot double as a cell phone.
* Be sure to read all instructions and questions carefully.
* Remember to show all your work.
* Try all questions! You get zero points for questions that are not attempted.
* *Please print clearly and neatly.*

**Part I: Matching.** *Write the letter from the column on the right which best matches each word or phrase in the column on the left. You will not use all the options on the right and you cannot use the same option more than once.*

2 points each.

|  |  |
| --- | --- |
| 1. \_\_\_ Balance of payments 2. \_\_\_ Capitalism 3. \_\_\_ Command system (socialism) 4. \_\_\_ Compensating differentials 5. \_\_\_ Diminishing marginal returns 6. \_\_\_ Effectiveness lag 7. \_\_\_ Efficient market hypothesis 8. \_\_\_ Fundamental Theorem of Exchange 9. \_\_\_ Liquidity trap 10. \_\_\_ *That Which Is Seen and That Which Is Not Seen*  (Bastiat) | 1. A problem for both monetary and fiscal policy 2. A problem for fiscal policy only 3. A problem for monetary policy only 4. Explains why countries should converge 5. Explains why fun jobs should have a lower salary 6. Explains why inequality is desirable 7. Explains why the best guess of the price of gold tomorrow is the price of gold now 8. Explains why opportunity cost is important 9. Explains why the trade deficit is only half of what’s going on 10. Explains why trade is so desirable 11. When individuals own the means of production 12. When the government owns the means of production 13. When no one owns the means of production |

**Part II: Multiple Choice.** *Choose the best answer to the following.*

3 points each.

1. We’ve discussed that income equality had a greater justification than simply good feelings. What is the economic argument in favor for reallocation, ceteris paribus?
   1. It increases productivity
   2. It increases total utility
   3. It decreases waste
   4. A & C
   5. None of the above
2. Which of the following people are unemployed (according economists’ definition of unemployment)?
   1. Jadzia, who was just arrested for stealing maple syrup but really wants a job.
   2. Kaida, who is afraid of going outside; while she wants a job, she hasn’t bothered looking due to her phobia.
   3. Piri, who works part time at McDonald’s and is actively looking for a full time position?
   4. B & C
   5. None of the above
3. Suppose there is a sudden drop in the price level, resulting in deflation. Who is hurt by this change?
   1. Abigail, who just took out a student loan at a fixed rate.
   2. Bansi, who has $25,000 in his savings account.
   3. Cala, who just signed a five-year contract which locks her salary in at $40,000 a year.
   4. B & C
   5. None of the above
4. For capitalism to function, several requirements have to be met. While developing countries often lack all of these requirements, Hernando de Soto highlights that the absence of one of them is particularly important. Which one is it?
5. Owners of capital do not suffer the losses.
6. Owners of capital do not keep most of the profit.
7. Capital is largely owned by the government.
8. There are no opportunity costs.
9. None of the above
10. In May 2014, the Commerce Department reported that the United States trade deficit shrank 3.6% earlier that year in March.[[1]](#footnote-1) All other things being equal, which of the following would then be true?
11. GDP decreased
12. The capital account decreased
13. The capital account increased
14. A & C
15. None of the above
16. In theory, poor countries should catch up with wealthy countries. Why?
    1. Because poor countries have relatively little capital
    2. Because poor countries will trade more with wealthy countries
    3. Because wealthy countries tend to have stable governments
    4. A & C
    5. None of the above
17. If the Gini Ratio for a country is high, that means:
    1. That country’s average income is low compared to other countries.
    2. That country has a lot of income inequality compared to other countries.
    3. That country has a lot of income equality compared to other countries.
    4. A & B
    5. None of the above
18. Suppose you’re a bank in England, where the pound is the local currency. If you do ***not*** intend on purchasing any U.S. goods or services, why would you allow people to give you U.S. dollars in exchange for British pounds?
19. You might be interested in investing in European companies.
20. You might be interested in purchasing stock in a U.S. company.
21. You might be interested in buying U.S. government bonds.
22. B & C
23. None of the above
24. Which of the following is an example of the Fundamental Theorem of Exchange in action?
25. Jill buys her favorite snack—roasted snake with sardines—which allows the store owner to stay open.
26. Greg and Mary, a married couple, go out to eat together.
27. Homer getting a mystery box (contents unknown) as payment for work.
28. A & B
29. None of the above
30. Which of the following is an example of an automatic/built-in stabilizer?
    1. Open market operations
    2. Increase spending on NASA projects
    3. Cutting taxes
    4. B & C
    5. None of the above
31. Which of the following makes prices less sticky?
32. Digital price tags
33. A law establishing a minimum contract time of one year
34. An increase in government spending
35. A & B
36. None of the above
37. Which of the following is ***not*** *explicitly* included in GDP?
38. Cat food
39. Haircuts
40. Live chickens
41. A & C
42. None of the above
43. Which of the following is an example of human capital?
    1. An engineer’s knowledge of all of the plots and characters of the *Harry Potter* novels.
    2. A carpenter’s tools.
    3. A musician’s understanding of how to play her violin.
    4. A & C
    5. None of the above
44. From the Atlantic:[[2]](#footnote-2)

The debate about breast-feeding takes place without any reference to its actual context in women’s lives. Breast-feeding exclusively is not like taking a prenatal vitamin. It is a serious time commitment that pretty much guarantees that you will not work in any meaningful way. Let’s say a baby feeds seven times a day and then a couple more times at night. That’s nine times for about a half hour each, which adds up to more than half of a working day, every day, for at least six months. This is why, when people say that breast-feeding is “free,” I want to hit them with a two-by-four. It’s only free if a woman’s time is worth nothing.

The author is using what economic idea to illustrate the expense of breast-feeding?

1. Opportunity cost
2. Human capital
3. Increasing marginal cost
4. B & C
5. None of the above

**Part III: Short Answer.** *Answer the following.*

12 points each.

1. Consider the companies below which make up FicDex, a fictional index. The table indicates their stock price without any stock splits.

|  |  |
| --- | --- |
| **Company** | **Stock Price** |
| Jedi Tricks Unlimited | $110 |
| Big Box Retailers | $100 |
| Something Industries | $70 |
| Vague Corp | $120 |

Suppose Vague Corp issued a stock split, doubling the number of shares. Calculate the new divisor for FicDex. Remember to show all your work.

1. Consider the AD/AS diagram of an economy below.
   1. Illustrate the short-run effect of expansionary monetary policy at equilibrium (as illustrated in the diagram);
   2. Illustrate the long-run effect of that monetary policy (in other words, what happens in the long-run when the Fed attempts such policies when they are not necessary);
   3. On the lines below, explain the role of the monetary multiplier in this analysis.

You should label each effect to make it clear what part of the graph answers which part of the question.

YR

LRAS

SRAS

AD

PL

1. Using the diagrams below, illustrate the effects of the following.
2. The market for rainforest tourism after the price of palm oil increases (note most palm oil is grown on former rainforest land).
3. The market for chocolate chips after the creation of a wonderful new chocolate chip cookie recipe.
4. The market for bicycles after the price of gasoline falls.
5. The market for vacations after the invention of travel website (e.g. Expedia).
6. The market for cars after incomes rise.

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S

**A**

Q

P

D

S

**B**

Q

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D

S

**C**

Q

P

D

S

**D**

Q

P

D

S

**E**

1. Illustrate how much capital and output this economy has now. Then illustrate the effect of what would happen if there was an increase in the savings rate. Be sure to label all of the effects of this change.

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K

δ

I

Y

1. <http://www.reuters.com/article/2014/05/06/us-usa-economy-idUSBREA450GW20140506> [↑](#footnote-ref-1)
2. <http://m.theatlantic.com/magazine/archive/2009/04/the-case-against-breast-feeding/307311/> [↑](#footnote-ref-2)