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ECON 201—Montgomery College  
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## EXAM 1

- There are 110 possible points on this exam. The test is out of 100.
- You have one class session 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. ___ Scarcity                     | A. What you must give up                             |
| 2. ___ Total cost                   | B. When you proceed if the benefits exceed the costs |
| 3. ___ Margin                       | C. Why demand slopes down                            |
| 4. ___ Opportunity cost             | D. Change in total                                   |
| 5. ___ Marginal cost                | E. Required for there to be a market                 |
| 6. ___ Rationality                  | F. The loss because of an additional action          |
|                                     | G. The loss because of all the actions/items         |
|                                     | H. The gain from an additional action/item           |
|                                     | I. Assumption of human behavior                      |
| 7. ___ Diminishing marginal utility |  |

**Part II: Multiple Choice.** Circle the letter that corresponds to the best answer.

4 points each.

8. What barriers to efficiency does a socialist economic system face?
  - a. Decision-makers don't understand how capitalism works
  - b. Decision-makers don't know what each part of the economy needs
  - c. Decision-makers don't care what's the most efficient use of resources
  - d. B & C
  - e. None of the above
  
9. People engage in an activity until:
  - a. Marginal benefit equals marginal cost
  - b. Marginal benefit equals marginal profit
  - c. Marginal benefit equals opportunity cost
  - d. A & B
  - e. None of the above
  
10. The demand for shoes would shift to the right if:
  - a. A shoe factory was destroyed.
  - b. Tennis became more popular.
  - c. Gasoline prices continued to climb.
  - d. B & C
  - e. None of the above.

11. Consider this quote from Nobel Laureate F.A. Hayek:

If we were to apply the unmodified, uncurbed, rules of the micro-cosmos (i.e. of the small band or troop, or of, say, our families) to the macro-cosmos (our wider civilisation), as our instincts and sentimental yearnings often make us wish to do, *we would destroy it*. Yet if we were always to apply the rules of the extended order to our more intimate groupings, *we would crush them*. So we must learn to live in two sorts of world at once.

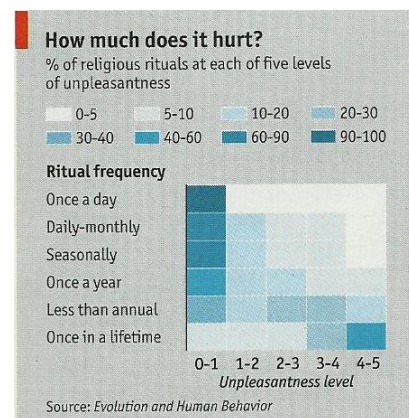
—F. A. Hayek, *The Fatal Conceit* (1988) [Original Emphasis]

What are these “two sorts of world” Hayek is referring to?

- The Law of Demand versus the Law of Supply
  - Communism versus market systems
  - What you do versus what you give up
  - Wealthy versus poor countries
  - None of the above
12. Which of the following explains why a college degree increases earning potential?
- A college education signals you are friendly and sociable
  - A college education increases your productivity
  - A college education demonstrates that you are a hard worker
  - B & C
  - None of the above
13. According to the signaling theory for why more education leads to a higher income, if this class was famously difficult, which students would be better off?
- All students would be better off because they would learn so much more.
  - Only the best students would be better off.
  - Only the students planning to be economists would be better off.
  - No students would be better off, but no one would be worse off.
  - All students would be worse off.

14. This graph illustrates the work of psychologists Harvey Whitehouse and Quentin Atkinson, as published in the April 23-29 2011 issue of *The Economist*. The “unpleasantness” of religious rituals (0 is low, 5 is high) is along the x-axis. How often the religion requires the ritual to be preformed is along the y-axis. What economic concept does this diagram represent?

- Opportunity cost
- A supply curve
- A demand curve
- A & C
- None of the above



15. Craig the Confident Capitalist heard about a new low-priced keyboard on the radio which will enable users to type 50% faster than with standard keyboards. Craig is a smart man. He knows copper is used in keyboards and assumes most people will focus on investing in the company that makes the keyboards rather than the component parts. But Craig invests all his savings in copper a few hours after he hears the news. What crucial mistake did Craig make?
- He didn't diversify his portfolio
  - He didn't consider that most people already have keyboards
  - He waited too long to invest
  - A & C
  - None of the above
16. Which of the following individuals are *clearly not* rational?
- A mother giving her child a toy after he throws a temper tantrum.
  - A young woman eating a cheeseburger.
  - A wealthy couple buying a used car without closely inspecting it.
  - All of the above.
  - None of the above.
17. In 2011, the U.S. Senate voted to end ethanol subsidies. If the bill passed, what happens in the market for corn? (Ethanol is made from corn.)
- The demand curve will shift, causing the price of corn to rise.
  - The supply curve will shift, causing the price of corn to rise.
  - The supply curve will shift, causing the price of corn to fall.
  - B & C
  - None of the above
18. Describe crony capitalism.
- Prices are determined by the state. Major companies are owned mostly by individuals but the companies are subject to government regulation.
  - Prices are determined by the market. Major companies are owned by individuals and these individuals often work with the government to construct business-friendly (but not market-friendly) regulations. Competition is restricted.
  - Prices are determined by the state. Major companies are owned mostly by the government. There is a great deal of government regulation.
  - Prices are determined by the market. Major companies are owned mostly by the government and, therefore, little formal government regulation.
  - None of the above
19. Which of the following is/are *not* capital?
- A video game
  - A delivery van
  - Electricity
  - A & C
  - None of the above

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

16 points each.

20. The vast majority of the time, capitalism encourages people to use resources efficiently. We discussed related ideas required to make this model of private ownership work efficiently. Describe these requirements and explain why each is so important for encouraging people to use resources efficiently.

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21. Using the provided diagrams, illustrate the effects of the following (4 points each). Remember: do *not* shift more than one curve.

- a. The local roofing market after a hurricane hits a city.
- b. The market for computers after the microchip was invented.
- c. The market for bread after the price of pastrami falls.
- d. The market for bread after the price of bagels fall.

