

Name: _____
ECON 201—Montgomery College

EXAM 1

- There are 110 possible points on this exam. The test is out of 100.
- You have one class period 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.
- Recall basic logic. “Water is wet” is a true statement. “Water is wet and leopards have stripes” is a false statement.
- *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. ___ Compound returns | A. Tells you that you shouldn't invest in too much of the same thing |
| 2. ___ Decreasing marginal benefit | B. Why oil gets more expensive as more is taken out of the ground |
| 3. ___ Diversification | C. Tells you that perfect investments are too good to be true |
| 4. ___ Increasing marginal cost | D. Why it's possible to buy too much of a good thing |
| 5. ___ Rationality | E. Why incentives matter |
| 6. ___ Risk-return trade-off | F. Why "buy and hold" is a good strategy |
| 7. ___ Scarcity | G. Why private property must be strictly enforced |
| | H. Why you should avoid high fees |
| | I. Why there are choices |

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

4 points each.

8. In the market for electricity, what happens when the price of computers fall?
 - a. Demand shifts, causing quantity to increase
 - b. Demand shifts, causing quantity to decrease
 - c. Supply shifts, causing quantity to increase
 - d. Supply shifts, causing quantity to decrease
 - e. It is impossible to tell with the information provided

9. Employers want employees who are smart. Which of the following is a way to signal you have this trait?
 - a. Being witty and insightful during your interview.
 - b. Writing your estimation of your IQ on your resume.
 - c. Stating very confidently in your interview that you are intelligent.
 - d. A & C
 - e. None of the above

10. The "Broken Window Fallacy" references what economic idea?
 - a. Diminishing marginal utility
 - b. Cost-benefit analysis
 - c. Opportunity cost
 - d. Comparative statics (supply and demand curve shifts)
 - e. None of the above

11. If the stock price of Microsoft has been increasing steadily for a few weeks, what is most likely to happen to the stock price tomorrow according to the Efficient Market Hypothesis?
- It will continue to increase and then level off
 - It will continue to increase indefinitely
 - It will decrease slightly
 - It will decrease rapidly
 - It will stay the same / It is impossible to know beforehand
12. Which of the following is an example of someone *not* being rational?
- Tonya, who wants to buy a house and cares a lot about the interior but is not willing to take the time to even walk into a house before buying it.
 - Shanti, who is deeply afraid of mice and won't enter the rodent section of the zoo.
 - Lando, who is concerned about keeping the city he runs safe from a civil war and turns in the rebels to protect the city from the Empire. This is a decision he later regrets after the Empire unexpectedly betrays him.
 - B & C
 - All of the above
13. Which of the following is *not* a requirement for capitalism?
- Property must be strictly enforced.
 - Property must be equally distributed.
 - Owners must keep all or most of the profits.
 - A & C
 - None of the above
14. Which of the following contradicts the law of demand?
- An apartment in downtown DC has a higher rent compared to an apartment of the same size in the suburbs, but more people want the downtown apartment.
 - If the price of gold falls, causing fewer people will use gold for their engagement rings because now gold is less prestigious.
 - If the price of air travel falls, causing more people to buy air travel.
 - A & B
 - None of the above
15. According to the signaling theory of why more education leads to a higher income, what would happen if *everyone* had at least a college degree?
- People with only a college degree would make very little.
 - People with only a college degree would be less productive than people with a master's degree.
 - You would only need a college degree to earn a good income.
 - A & C
 - None of the above

16. Uber is software which allows smartphone users to purchase a ride from independent Uber drivers. As of September 2015, Uber is not yet in Scotland. But a similar app, Gett, is. Jim Edwards of Business Insider describes his experience using Gett during a particularly rainy day:¹

I tried hailing a cab through Gett and ... answer came there none! There were no cabs on the little animated map, and there were no drivers answering my call

It turns out that when there is peak demand for taxis — when it's raining or rush hour — then cab drivers are happy to take riders who hail them in the street. They don't respond to calls from Gett, which may require them to drive round the corner to where you actually are.

With Uber, when peak demand kicks in, the app sets a price surge. Uber users hate the surge because it makes rides more expensive. But drivers love it because they know they will get more money. The Uber app's price surge alerts more drivers, and more of them hit the street. That is why Uber is so reliable: There are *always* more Uber cars. Yet on Gett, the cars are maxed out when it rains.

- Edwards argues because of this, Uber will win if it competes with Gett. What economic idea *best* explains Uber's advantage?
- The law of supply
 - The law of demand
 - Normal goods
 - Efficient Market Hypothesis
 - None of the above
17. Which of the following is/are *not* an example of capital?
- The video game steel workers play when they are at home.
 - The iron that's turned into steel.
 - The trains which deliver raw materials to the steel mill.
 - A & B
 - None of the above
18. How is human capital like physical capital?
- Human capital can be sold used at a discounted price
 - Human capital lasts for years
 - Human capital is used to make other things
 - B & C
 - None of the above

¹ <http://www.businessinsider.com/gett-v-uber-which-is-better-2015-9?r=UK&IR=T>

19. In April 2012, the *New York Times* published an article challenging the assumption that breast-feeding is free; breast-feeding is incredibly time-consuming. Women who breast-feed longer than six months earn sustainably less over the course of five years than those who breast-feed less than that.²

Those longer-term nursing mothers spent more time out of the work force, or worked fewer hours, than their formula-feeding counterparts. The result of that shift in time spent on work or career stretched well beyond the months (or years) spent with a baby at the breast.

What economic idea is this article invoking to make its argument?

- a. Law of demand
- b. Opportunity cost
- c. Marginalism
- d. Law of supply
- e. None of the above

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

16 points each.

20. Consider the companies below which make up the Muppet Index, a brand-new fictional index. The table indicates their stock price without any stock splits.

Company	Stock Price
Procter and Gonzo	\$65
Wocka-Mart Stores	\$25
Walter Disney	\$40
General Electric Mayhem	\$70

Suppose General Electric Mayhem issued a stock split, doubling the number of shares. Calculate the new divisor for the Muppet Index. Remember to show all your work.

² http://parenting.blogs.nytimes.com/2012/04/03/the-true-cost-of-breast-feeding-this-milk-isnt-free/?_r=0

