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ECON 202—Montgomery College  
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## EXAM 2

- 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. ___ Adverse selection       | A. Combats adverse selection  |
| 2. ___ Loss aversion           | B. Combats moral hazard   |
| 3. ___ Piece rates             | C. Example: going on a date with someone who turns out to be rude.  |
| 4. ___ Reference point         | D. Example: offering bonuses if employees sell more financial products to customers only to discover many sales are fraudulent. |
| 5. ___ Screening               | E. Example: using the number of Facebook friends your friend have to determine if you're well-liked.                            |
| 6. ___ Tournaments             | F. Example: working hard to make sure someone is punished for a minor violation   |
| 7. ___ Unintended consequences | G. Not a good system if one person is much more talented than others.   |
|                                | H. Not a good system if output is hard to measure.  |
|                                | I. Utility of gain < disutility of loss   |

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

4 points each.

8. Game designer Mark Rosewater once noted there are two types of game mechanics: up mechanics and down mechanics. Up mechanics are bundled with tools that are a little harder to get but allow the player a new ability. Down mechanics are bundled with tools which are cheaper but come with a hindrance. Players strongly prefer up mechanics. Which concept predicts this preference?
- Elasticity
  - Endowment effect
  - Comparative advantage
  - Price discrimination
  - None of the above
9. Some economists suggest that that price of popcorn at the movies is a form of price discrimination: the movie experience is a tied good composed of tickets and popcorn. Those who really value the experience of the movies pay more because such people tend to get popcorn. If the price of popcorn is *not* a form of price discrimination, which fact would challenge the theory?
- The theater has a monopoly on selling popcorn
  - The popcorn gets cold very quickly (it cannot be resold)
  - The theater needs to clean up after popcorn eaters (the costs aren't uniform)
  - A & B
  - None of the above.

10. Which of the following is an example of moral hazard?
- Carelessly pulling out of a parking spot, knowing that insurance will pay any damages you cause to other cars.
  - Going to see a movie you know will be terrible.
  - Hiring an employee that, unbeknownst to you when you hired him, isn't smart enough to do the job well.
  - B & C
  - None of the above
11. If a good is elastic, it is most likely due to:
- Its low price
  - Its large number of complements
  - Its large number of substitutes
  - B & C
  - None of the above
12. US Highway 12 is part of a crucial two-lane artery from the seaports in Washington State to the tar sands in Canada. Extracting oil from the tar sands requires very large equipment: transporting it takes up both lanes of US 12. In August of 2010, Idaho granted ConocoPhillips a road permit which allowed it to transport four oil processing units. Without this permit, ConocoPhillips would have to transport those units a much longer distance to get to their destination. If no permits for US 12 were allowed, how would that affect the elasticity of which curve in the market for oil?
- The supply curve would become more elastic
  - The supply curve would become less elastic
  - The demand curve would become more elastic
  - A & C
  - None of the above
13. Former judge Andrew Napolitano argued in March of 2014 that President Lincoln buying up all the slaves in the South and setting them free would have been cheaper (both in lives and money) than fighting the Civil War.<sup>1</sup> At the time, the international slave trade was abolished by an act of Congress; no slaves were imported into the United States. Assume this was strongly enforced. Based on this information, would such slave redemption be more successful or less successful than modern-day slave redemption (as we discussed in class)?
- More successful because the supply of slaves was more elastic then
  - More successful because the supply of slaves was less elastic then
  - Less successful because the supply of slaves was more elastic then
  - Less successful because the supply of slaves was less elastic then
  - They would be equally unsuccessful

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<sup>1</sup> Ignore the fact that when the Civil War began, both sides believed it would be a short war and thus comparing the cost of the entire war with the cost buying up all the slaves is a comparison that is only relevant in hindsight.

14. Imagine you work at a movie theater that offers student discounts. To demonstrate they are eligible of the discount, customers must show a student ID. This is pure price discrimination; students are not less expensive to serve compared to other patrons of the theater. Suppose a man in his 40s shows his obviously expired student ID. Is it a smart business decision to accept it and give him the discount?
- No, because the discount is for students and he's not a student.
  - No, because if he's in his 40s, he can surely afford to pay full price.
  - Yes, because it will show other customers how seriously you take your discounts.
  - Yes, because he's demonstrating he is sensitive to price.
  - None of the above
15. During an interview Steve Cole, a sales manager at a car dealership, revealed that he considers how much the customer appears to know about the car when he's negotiating a price. Ignorant people tend to pay a premium on their car. How is this "ignorance premium" explained with price discrimination?
- People who don't bother to research probably don't want a car that much.
  - People who do research probably know that gas is very expensive and thus require a cheaper car.
  - People who don't bother to research are probably less sensitive to price.
  - A & C
  - None of the above
16. Los Angeles has a comparative advantage in movie making because:
- It has high tariffs on movies made elsewhere in the US.
  - It has a low opportunity cost for making movies.
  - It has the most productive capacity in the US.
  - B & C
  - None of the above
17. What is the relationship between flexibility of production and elasticity of supply and why?
- Greater flexibility means more elastic supply because producers can easily leave low-priced production and enter high-priced production.
  - Greater flexibility means more elastic supply because it becomes easier to find substitutes for inputs of production.
  - Greater flexibility means less elastic supply because it cuts into the time allowed to produce something.
  - Greater flexibility means less elastic supply because it would require more inputs to be that flexible, thus it's harder to adapt to changing prices.
  - None of the above

18. Consider the following table of maximum capacities. Who has the comparative advantage in furs?

	<i>Maximum Gold</i>	<i>Maximum Furs</i>
<i>House Lannister</i>	500	100
<i>House Stark</i>	30	60
<i>House Targaryen</i>	15	10
<i>House Baratheon</i>	200	300

- a. House Lannister
  - b. House Stark
  - c. House Targaryen
  - d. House Baratheon
  - e. It is impossible to tell with the information provided
19. Which of the following would cause the elasticity of supply of robots in Pittsburgh to decrease?
- a. Other cities get smaller
  - b. Other cities get larger
  - c. Pittsburgh gets larger
  - d. A & C
  - e. None of the above

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

16 points each.

20. Using the accompanying table of maximum capacities and the graph below, indicate which country has a comparative advantage in beer and which country has a comparative advantage in wine. Be sure to show your work.

	Wine (Barrels)	Beer (Kegs)
France	1800	500
England	800	800
Germany	400	1700

*Don't forget the last questions on the back!*

