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ECON 201—Montgomery College
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EXAM 1

Practice Exam A

- 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. ___ Balance of payments | A. Assumption of human behavior |
| 2. ___ Diminishing marginal utility | B. Change in total |
| 3. ___ Lorenz curve | C. Explains why the trade deficit is only half of what's going on. |
| 4. ___ Margin | D. Required for there to be a market |
| 5. ___ Opportunity cost | E. Represents the actual distribution of income or wealth. |
| 6. ___ Rationality | F. The gain from an additional action/item |
| 7. ___ Scarcity | G. What you must give up |
| | H. When you proceed if the benefits exceed the costs |
| | I. Why demand slopes down |

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 prioritize what's the most efficient use of resources
 - d. B & C
 - e. None of the above

9. 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?
 - a. It increases productivity
 - b. It increases total utility
 - c. It decreases waste
 - d. A & C
 - 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.

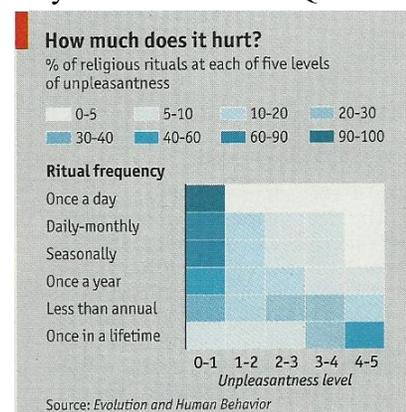
—F. A. Hayek, *The Fatal Conceit* (1988) [Original Emphasis]

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

- a. The Law of Demand versus the Law of Supply
 - b. Communism versus market systems
 - c. What you do versus what you give up
 - d. Wealthy versus poor countries
 - e. None of the above
12. 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?
- a. You might be interested in investing in European companies.
 - b. You might be interested in purchasing stock in a U.S. company.
 - c. You might be interested in buying U.S. government bonds.
 - d. B & C
 - e. None of the above
13. The founder of public choice, Nobel laureate James Buchanan, described it as “politics without romance.” Why?
- a. Because it assumes political actors aren’t benevolent.
 - b. Because it assumes government and businesses won’t cooperate (they’re not “in love” with each other).
 - c. Because it assumes political actors are inherently evil.
 - d. A & C
 - e. None of the above

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?

- a. Opportunity cost
- b. A supply curve
- c. A demand curve
- d. A & C
- e. None of the above



15. One way to tell if a policy is the result of rent seeking is determining if the policy makes society better off as a whole or not. Why would that criteria matter?
- Rent seeking is the act of desperate people. If society is made better off, then it can't be rent seeking because desperate people exploit society. They can't improve it.
 - Improving society requires that people are sometimes charged more than they need to be; that encourages people to start producing who otherwise wouldn't be.
 - Rent for housing is too high; if there are even more renters, then society can't be better off.
 - If society is made better off then the policy is definitely rent; you have to charge rent to incentivize people to build apartment buildings.
 - 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. In the third season of the superhero television show *Invincible*, the title character refuses to associate work with anyone who has done terrible things. He insists that he can save people without compromising his beliefs. Another, more experienced, character responded with: "We can be the good guys or the guys who save the world. Not both." Invincible refuses to see the wisdom of that response. Which economic idea best capture's Invincible's mistake?
- The Fundamental Theorem of Exchange
 - The Nirvana Fallacy**
 - The Lump of Labor Fallacy
 - Focusing on total benefit/cost instead of marginal benefit/cost.
 - Focusing on absolute instead of comparative advantage.

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. We discussed how prices solve the twin problems of knowledge and incentives that socialism can't overcome. But socialist economies had prices (set by central planning). Why do prices in capitalist economy work, but not in a socialist economy?

21. Using the provided diagrams, illustrate the effects of the following (4 points each). Remember: do *not* shift more than one curve.
- The local roofing market after a hurricane hits a city.
 - The market for computers after the microchip was invented.
 - The market for bread after the price of pastrami falls.
 - The market for bread after the price of bagels fall.

