

Name: _____
ECON 201—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.

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| 1. ___ Allocatively efficient | A. Explains why politicians change their political platform when the electorate changes. |
| 2. ___ Comparative advantage | B. Explains why trade is so desirable. |
| 3. ___ Convergence | C. On the production possibilities frontier |
| 4. ___ Fundamental Theorem of Exchange | D. Only individuals act |
| 5. ___ Law of one price | E. Predicts all countries will be equally wealthy. |
| 6. ___ Median voter theorem | F. Predicts all goods will have the same cost of production. |
| 7. ___ Methodological individualism | G. Predicts that the best person to produce is the person who sacrifices the least for a unit of production. |
| | H. Requires transportation costs to be low. |
| | I. Socially optimal bundle |

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

4 points each.

8. Suppose the Gini ratio increases. Which of the following possible explanations could justify such a change?
- The rich get richer while the poor get poorer and everyone else is the same.
 - The rich get richer while everyone else makes the same amount of money.
 - Everyone gets equally poorer.
 - A & B
 - All of the above
9. Which of the following is an example of rent dissipation?
- Three airplane manufacturers each spending \$100 million, competing to try to get an overly lucrative \$300 million government contract.
 - Stacy buys a hot dog from a hot dog vendor.
 - Randy loses his job and cannot afford to pay his rent.
 - One wealthy person gets a \$10,000 raise and, at the same time, twenty poor people see their pay cut by \$500.
 - None of the above.
10. According to compensating differentials, which of the following jobs should pay the most?

- a. Coal miner
 - b. Dancer
 - c. Dog walker
 - d. B or C; it's hard to tell which
 - e. It is impossible to tell with the information provided.
11. Suppose San Diego had the comparative advantage in medical devices. What does that mean?
- a. San Diego can make the most medical devices.
 - b. San Diego can make the highest quality medical devices.
 - c. San Diego is better at making medical devices compared to its ability to provide tourism.
 - d. San Diego can make the cheap, lowest quality medical devices.
 - e. None of the above
12. Is the trade deficit debt?
- a. Yes, because the money that leaves the country must be paid back.
 - b. Yes, because any resources used beyond what the country could employ must come from somewhere.
 - c. No, because utility is increasing.
 - d. No, because no borrowing had to occur to create it.
 - e. None of the above
13. The theory of convergence relies on what idea?
- a. Diminishing marginal productivity of capital
 - b. Diminishing marginal productivity of education
 - c. Diminishing marginal utility of education
 - d. B & C
 - e. None of the above
14. The founder of public choice, Nobel laureate James Buchanan, described it as “politics without romance.” Why?
- a. Because it assumes politicians 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
15. Which of the following is a zero-sum game?
- a. Soccer
 - b. War
 - c. Economic growth
 - d. A & B
 - e. All of the above

16. What does a point to the right of an economy's production possibilities frontier indicate?
- The economy can produce more of the good on the x-axis but no more of the good on the y-axis.
 - The economy can produce more of the good on the y-axis but no more of the good on the x-axis.
 - If the economy produced at that point, it would be allocatively efficient but not productively efficient.
 - If the economy produced at that point, it would be productively efficient but not allocatively efficient.
 - None of the above
17. In "Toward a Theory of Property Rights," Economist Harold Demsetz argued private property rights appear when the benefits of establishing such rights exceed the costs of establishing them. For example, city roads are not private property because the benefits of making them private are small (better maintenance and less traffic) compared to the logistical cost of denying non-owners their use. Yet we discussed that the key reason poor countries have trouble developing is the lack of private property. Economic growth in these areas would be a huge benefit! What would explain this apparent contradiction?
- Poor countries have private property; the problem is that it's not legally recognized.
 - While the benefits of society may be large, the costs to those who could make it easy to legally own that property are also large.
 - While the benefits of society may be large, the benefits to those who could make it easy to legally own that property are relatively small.
 - B & C
 - All of the above
18. Which concept explains why production possibilities frontiers are concave?
- Diminishing marginal returns
 - Absolute advantage
 - Law of one price
 - They're not; they are convex.
 - None of the above
19. Why does the balance of payments tell us about the trade deficit?
- Trade deficits occur within countries so it's not a big deal.
 - The trade deficit is half of the problem: the other half is the net loss of investment.
 - The trade deficit is the result of distinguishing capital flows with the flow of goods and services.
 - A & C
 - None of the above

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

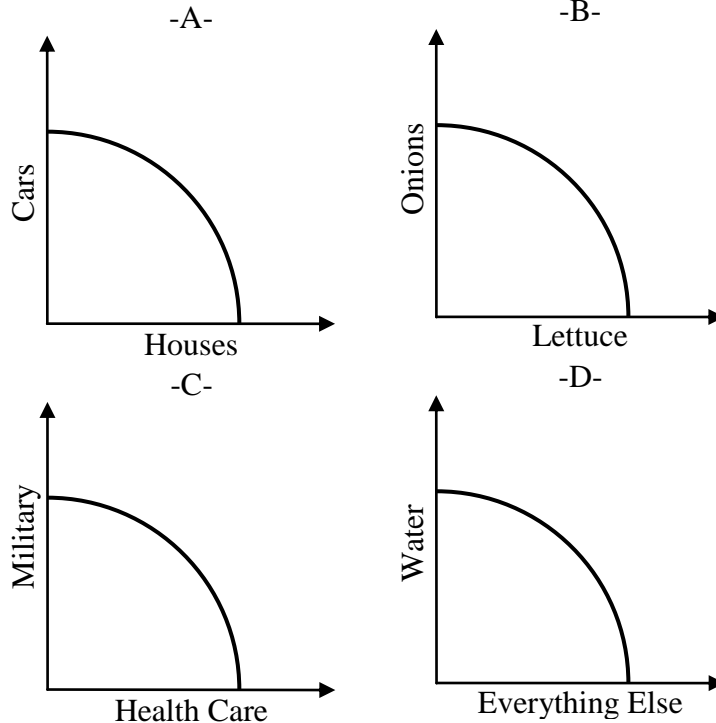
16 points each.

20. Consider the following table of maximum capacities and determine which state has the comparative advantage in coal and in corn. For each good, also determine which state is the runner-up for comparative advantage.

State	Coal (tons)	Corn (tons)
Maryland (MD)	100	175
West Virginia (WV)	120	30
Virginia (VA)	300	200
Delaware (DE)	3	15
Pennsylvania (PA)	250	750

21. Using the provided diagrams, illustrate the effects of the following (4 points each).

- New technology makes it easier to harvest trees for lumber.
- There's a terrible drought.
- More people enter the country.
- Poor pipes result in contaminated water.



22. Use the following information to construct a production possibilities frontier. Use the diagram provided, making sure to label each part of your production possibilities frontier. Be sure it's to scale!

Kingdom	Food (tons)	Stone (tons)
The North	10	50
The Vale	40	60
The Reach	80	80
The Riverlands	70	10

