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ECON 201—Montgomery College  
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## **EXAM 3 (FINAL)**

### **Practice Exam A**

- There are 110 possible points on this exam. The test is out of 100.
- You have two hours 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. ___ Aggregate demand  | A. A problem for both monetary and fiscal policy                                      |
| 2. ___ Capitalism  | B. A problem for fiscal policy only   |
| 3. ___ CPI   | C. A problem for monetary policy only   |
| 4. ___ Diminishing marginal returns                                    | D. Explains why countries should converge   |
| 5. ___ Effectiveness lag   | E. Explains why inequality is desirable   |
| 6. ___ Efficient market hypothesis                                     | F. Explains why the best guess of the price of gold tomorrow is the price of gold now |
| 7. ___ Liquidity trap  | G. Explains why opportunity cost is important   |
| 8. ___ Short run aggregate supply                                      | H. Measures changes in the price level  |
| 9. ___ Socialism   | I. Shifts if car prices increase  |
| 10. ___ <i>That Which Is Seen and That Which Is Not Seen</i> (Bastiat) | J. Shifts if raw material prices increase   |
|  | K. When individuals own the means of production                                       |
|  | L. When the government owns the means of production                                   |
|  | M. When no one owns the means of production   |

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

3 points each.

11. In May 2014, the Commerce Department reported that the United States trade deficit shrank 3.6% earlier that year in March.<sup>1</sup> All other things being equal, which of the following would then be true?
- GDP decreased
  - The capital account decreased
  - The capital account increased
  - A & C
  - None of the above
12. One can argue the internet made prices less sticky. Which of the following would **clearly** be a logical explanation for this?
- Consumer expectations are less likely to change
  - Menu costs are lower
  - Contracts last a longer amount of time
  - A & B
  - None of the above

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<sup>1</sup> <http://www.reuters.com/article/2014/05/06/us-usa-economy-idUSBREA450GW20140506>

13. If the reserve ratio is 20% and the MPS is 0.1, what is the monetary multiplier?
- 1.25
  - 5
  - 10
  - 20
  - None of the above
14. Economists often debate the size of the fiscal multiplier, particularly when there's a recession. What is the significance of this debate?
- A large fiscal multiplier means unemployment will stay high.
  - A large fiscal multiplier implies there will be a lot of inflation.
  - A large fiscal multiplier ensures fiscal policy will be very effective.
  - B & C
  - None of the above
15. Which of the following people are unemployed (according economists' definition of unemployment)?
- Jadzia, who was just arrested for stealing maple syrup but really wants a job.
  - Kaida, who is afraid of going outside; while she wants a job, she hasn't bothered looking due to her phobia.
  - Piri, who works part time at McDonald's and is actively looking for a full time position?
  - B & C
  - None of the above
16. Suppose there is a sudden drop in the price level, resulting in deflation. Who is hurt by this change?
- Abigail, who just took out a student loan at a fixed rate.
  - Bansi, who has \$25,000 in his savings account.
  - Cala, who just signed a five-year contract which locks her salary in at \$40,000 a year.
  - B & C
  - None of the above
17. Suppose a new law makes it less likely workers with a high risk of back injuries, such as furniture movers and coal miners, will suffer those injuries. According to compensating differentials, what will happen?
- Workers who have those jobs will be paid less.
  - Fewer people will want those kind of jobs.
  - The price level will decrease.
  - The unemployment rate for people who work those jobs will increase.
  - None of the above

18. 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
19. 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
20. Which of the following would cause the U.S. AD to shift right?
- The government spends more, funded by increasing taxes.
  - Incomes in China, Europe, and other countries fall due to a recession.
  - Scientists discover a new energy source which can be implemented immediately.
  - A & B
  - None of the above
21. Which of the following is usually *not explicitly* included in GDP (ignore trade)?
- Cat food
  - Haircuts
  - Live chickens
  - A & C
  - None of the above
22. Which of the following is an example of human capital?
- An engineer's knowledge of all of the plots and characters of the *Harry Potter* novels.
  - A carpenter's tools.
  - A musician's understanding of how to play her violin.
  - A & C
  - None of the above
23. In October 2015, Deborah Friedell of the *London Review of Books* called into question Donald Trump's claims that he's an excellent businessperson:<sup>2</sup>

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<sup>2</sup> <http://www.lrb.co.uk/v37/n20/deborah-friedell/tycooniest>

Bloomberg puts Trump's current net worth at \$2.9 billion, Forbes at \$4.1 billion. The *National Journal* has worked out that if Trump had just put his father's money in a mutual fund that tracked the S&P 500 and spent his career finger-painting, he'd have \$8 billion.

- The author is using what opportunity cost to illustrate that Trump isn't that great at business. What is Trump's opportunity cost of going into business?
- a. \$2.9 billion
  - b. \$5.1 billion
  - c. \$8 billion
  - d. \$10.9 billion
  - e. There is not enough information provided to tell
24. What was the most important cause of the Great Depression?
- a. The collapse of the stock market
  - b. An increase in the money supply
  - c. Unregulated capitalism
  - d. The cartelization of industries
  - e. None of the above

**Part III: Short Answer.** *Answer the following.*  
12 points each.

25. We discussed several weaknesses of fiscal policy. Name and *briefly* describe two weaknesses.

1. \_\_\_\_\_.

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2. \_\_\_\_\_.

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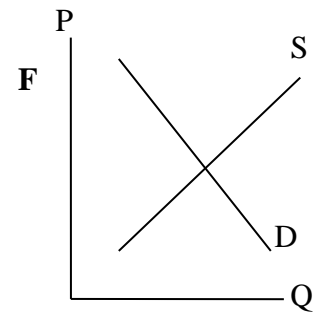
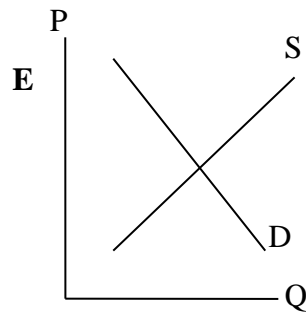
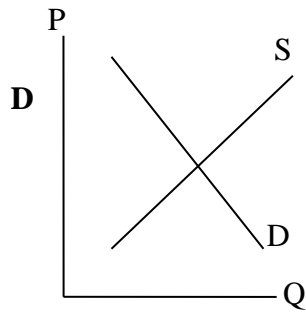
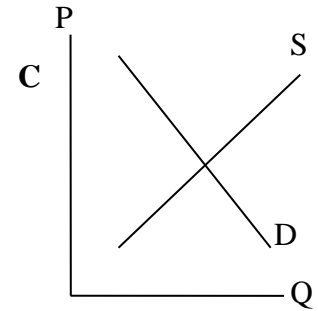
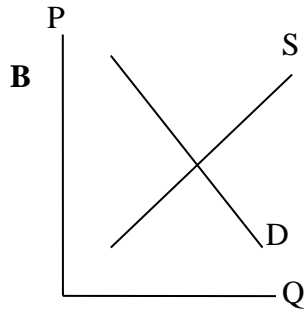
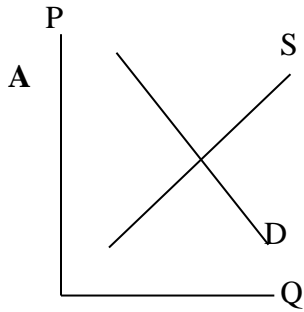
26. Consider four countries and their production options, as indicated by the table below. Who has a comparative advantage in beef and who has a comparative advantage in sugar? Remember to show your work.

	<i>Argentina</i>	<i>Brazil</i>	<i>Chile</i>	<i>Peru</i>
<i>Beef (thousands of lbs)</i>	600	1,200	6	75
<i>Sugar (thousands of lbs)</i>	200	1,500	10	50

27. Using the diagrams below, illustrate the effects of the following (2 points each).

a. The market for rainforest tourism after the profitability of palm oil increases (note most palm oil is grown on former rainforest land).

- b. The market for chocolate chips after the creation of a wonderful new chocolate chip cookie recipe.
- c. The market for bicycles after the price of gasoline falls.
- d. The market for vacations after the invention of travel website (e.g. Expedia).
- e. The market for cars after incomes rise.
- f. The market for clothes after it becomes easier to legally own property.



28. Consider the AD/AS diagram of an economy below.
- Illustrate the short-run effect of expansionary monetary policy at equilibrium (as illustrated in the diagram);
  - Illustrate the long-run effect of the monetary policy in (a) (in other words, what happens in the long-run when the Fed attempts such policies when they are not necessary);
  - On the lines below, explain the role of the monetary multiplier in this analysis.

You should label each effect to make it clear what part of the graph answers which part of the question.

