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ECON 201—Montgomery College
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EXAM 3 (FINAL)

Practice Exam B

- 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. ___ Crony capitalism | B. A problem for fiscal policy only |
| 3. ___ Deficit spending | C. A problem for monetary policy only |
| 4. ___ Free market capitalism | D. Tells you that perfect investments are too good to be true |
| 5. ___ Implementation lag | E. Explains why voters often don't know what they're talking about. |
| 6. ___ Interest on reserves | F. Market prices are result of competition |
| 7. ___ Liquidity trap | G. Market prices influenced by the government for the benefit of privately-owned companies |
| 8. ___ Long run aggregate supply | H. Market prices are influenced by the government for the benefit of government-owned companies |
| 9. ___ Risk-return trade-off | I. Primary tool of fiscal policy |
| 10. ___ Short run aggregate supply | J. Primary tool of monetary policy |
| | K. Shape represents fundamentals of an economy |
| | L. Shape justified by sticky prices |
| | M. Shape justified by the quantity theory of money |

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

3 points each.

11. Which of the following makes prices less sticky?
- Digital price tags
 - A law establishing a minimum contract time of one year
 - An increase in government spending
 - A & B
 - None of the above
12. If the U.S. dollar depreciates, what happens in the U.S. economy?
- AD shifts
 - LRAS shifts
 - SRAS shifts
 - A & B
 - A & C

13. In our growth lectures, we discussed that more education should create a more productive workforce. But as we discussed when explaining why more education leads to a higher income, that's not entirely true. (Recall there were two theories as to why more education led to a higher income.) Which idea would challenge the notion that more education leads to a more productive work force?
- Human capital
 - The law of demand
 - Signaling
 - Convergence
 - None of the above
14. Suppose the wealthiest 1% earned twice as much income while everyone else's income stayed the same. What would happen to the Gini Ratio?
- It would increase
 - It would stay the same
 - It would decrease
 - It would either decrease or increase, depending on the details.
 - It is impossible to tell with the information provided.
15. Which of the following would *definitely* shift AD to the right?
- Increasing government spending while increasing taxes.
 - A major earthquake.
 - Incomes abroad fall.
 - A & C
 - None of the above
16. Which of the following is *not* something the Fed can do directly when it engages in monetary policy?
- Increases/decreases taxes
 - Changes the interest on reserves
 - Buys/sells government bonds
 - A & B
 - None of the above / It does all of these things directly
17. We discussed several reasons why we should be optimistic about the future of developing countries. Which of the following is "good news" for economic growth in developing countries?
- Even a "small" amount of growth, say 7%, can have a tremendous impact.
 - Poorer countries should grow faster than wealthy countries.
 - To make poor countries a lot wealthier, rich countries would have to be only a little poorer (though they would have to be poorer).
 - A & B
 - All of the above

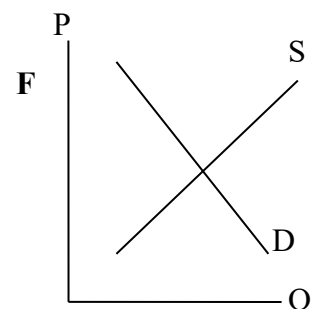
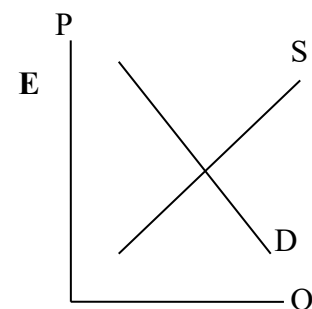
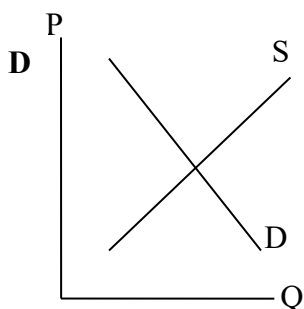
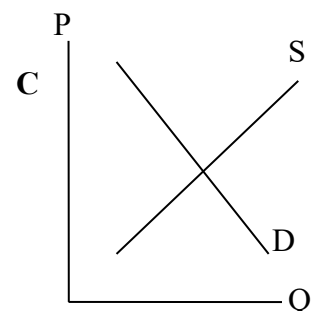
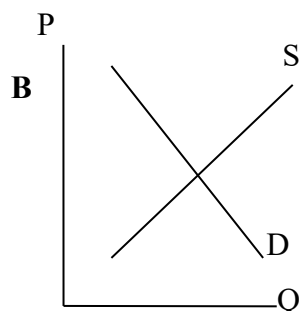
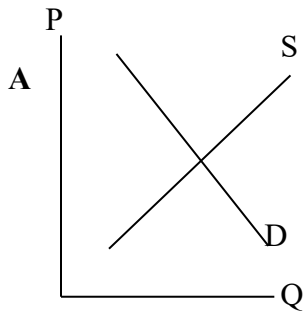
18. When does fiscal policy not work well?
- When interest rates are at or near their lower bound.
 - When productive workers stop doing private-sector work to do public-sector work.
 - When there's a lot of income inequality.
 - A & B
 - None of the above
19. Why does GDP only include *final* goods and services?
- To capture the value of the good or service produced
 - To exclude used goods or services
 - To avoid counting the same good or service twice
 - To account for goods and services produced outside of the country
 - None of the above
20. Which of the following is a true statement?
- Whenever there an unusually large number of jobs are created, the unemployment rate decreases.
 - The optimal level of unemployment is 0%.
 - The longer you're unemployed, the easier it is to find a job because it shows how eager you are.
 - A & C
 - None of the above are true statements
21. Which of the following is an example of an automatic/built-in stabilizer?
- Open market operations
 - Increase spending on NASA projects
 - Cutting taxes
 - B & C
 - None of the above
22. In *The Economic Organization of a P.O.W. Camp*, R.A. Radford explicitly described which economic concept occurring?
- Convergence
 - Gresham's Law
 - Fundamental Theorem of Exchange
 - Monetary policy
 - None of the above
23. According to the balance of payments, what happens when the American trade deficit increases?
- More U.S. dollars are circulated outside the country.
 - The U.S. exports more.
 - The relative price level in the U.S. rises.
 - A & B
 - None of the above

24. Craig the Confident Capitalist heard about a new low-priced keyboard on the radio which will enable users to type 50% faster than with standard keyboards. Craig is a smart man. He knows copper is used in keyboards and assumes most people will focus on investing in the company that makes the keyboards rather than the component parts. But Craig invests all his savings in copper a few hours after he hears the news. What crucial mistake did Craig make?
- He didn't diversify his portfolio
 - He didn't consider that most people already have keyboards
 - He waited too long to invest
 - A & C
 - None of the above

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

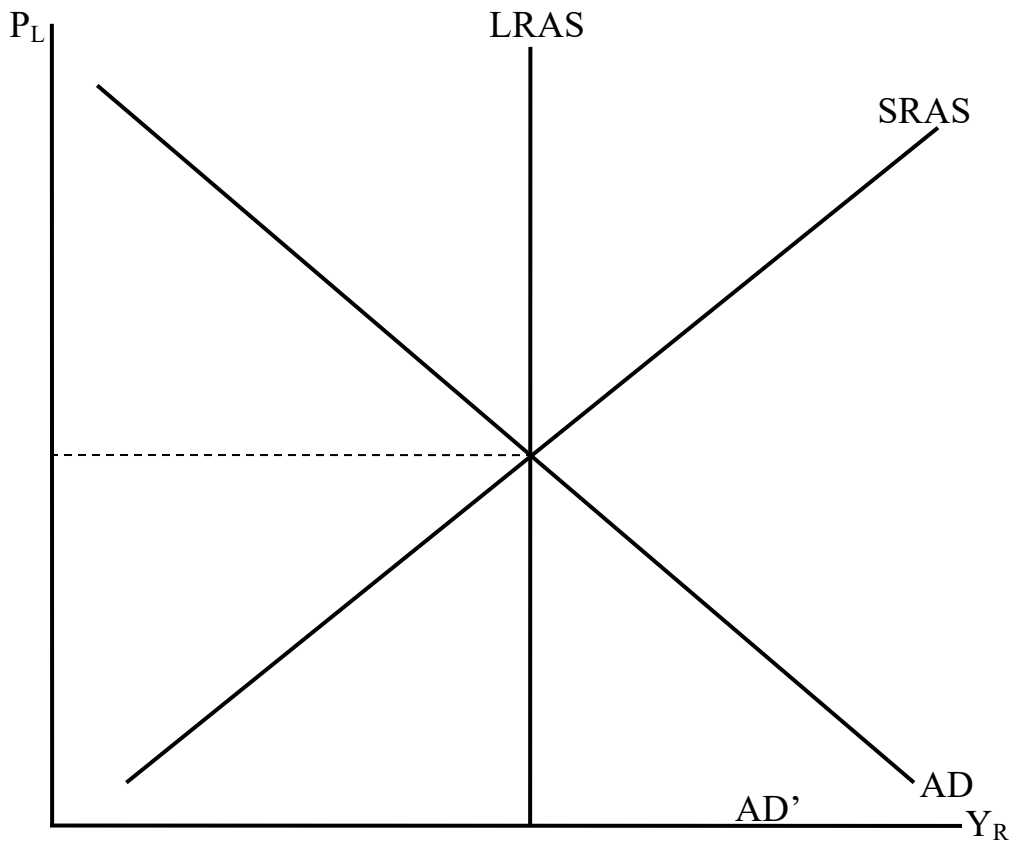
12 points each.

25. Using the diagrams below, illustrate the effects of the following. Remember: do **not** shift more than one curve.
- The market for blueberries after a new study suggests eating blueberries will help you live longer.
 - The market for cars after the price of steel decreases (cars are made mostly of steel).
 - The market for corn after the price of soybeans rises (note that soybeans and corn are grown on the same land).
 - The market for paper after the price of pens rises.
 - The market for wheat after the invention of the tractor.
 - The market for video games during an economic recovery.



27. Consider the AD/AS diagram of an economy below. Then, in this order:
- Illustrate the effect of a drop in the money supply;
 - Illustrate the effect of increasing wages and regulatory requirements;
 - On the lines below, explain what historical event you just re-created.

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



Don't forget the last question on the back!

28. Consider the AD/AS diagram of an economy below. Then:
- Illustrate the effect of a drop in expected returns on investment;
 - Illustrate the effect of a perfectly and completely corrective expansionary fiscal policy (i.e. the best case scenario for fiscal policy);
 - On the lines below, explain the role of the fiscal multiplier in this analysis.

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

