

Economics 2
Winter 2009

your name _____
your student i.d. _____

PRACTICE FINAL EXAM

DIRECTIONS: No calculators, books, or notes of any kind are allowed. All papers and notebooks must remain closed and on the floor at all times throughout the exam, and students are not allowed to leave the examination room until finished. Please do not turn in your exam before 9:00 a.m. Answer all questions in the space provided with the exam.

HINTS: Feel free to use either of the following formulas if you find them useful.

$$\underline{\text{Area of a triangle}} = (1/2) (\text{base}) (\text{height})$$

$$\underline{\text{Area of a trapezoid}} = (1/2) (\text{base1} + \text{base2}) (\text{height})$$

MULTIPLE CHOICE—circle the correct answer (4 points each, 200 points total)

- 1.) Which of the following best explains why a subsidy results in an inefficient use of resources?
 - a.) when firms receive the subsidy, they only pass some of it along as a cost saving to consumers but take much of it simply in the form of increased profits
 - b.) as a result of the subsidy, the marginal benefit to some consumers of receiving the good is less than the marginal cost of producing the good
 - c.) the subsidy increases producer surplus, but decreases consumer surplus by more than the increase in producer surplus
 - d.) the government has a difficult time figuring out which firms have the greatest need of getting the subsidy

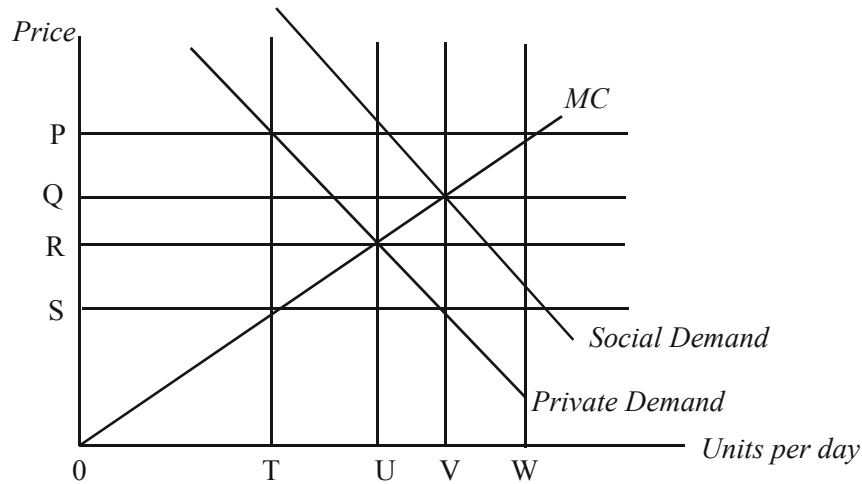
- 2.) Suppose that the demand curve for a particular good slopes down (less than perfectly elastic demand) but the supply curve is vertical (perfectly inelastic supply). Which of the following best characterizes what would happen if there were a per-unit tax placed on buyers of the good?
 - a.) the decrease in consumer surplus would be greater than the increase in government revenue
 - b.) the decrease in consumer surplus would be equal to the increase in government revenue
 - c.) the decrease in consumer surplus would be less than the increase in government revenue
 - d.) there would be no change in consumer surplus

- 3.) If a single firm buys up all the firms that used to comprise a perfectly competitive industry so as to create a monopoly,
 - a.) producer surplus would go up and consumer surplus would go up
 - b.) producer surplus would go down and consumer surplus would go down
 - c.) producer surplus would go down and consumer surplus would go up
 - d.) producer surplus would go up and consumer surplus would go down

- 4.) What would happen in a natural monopoly if the producer set price equal to marginal cost?
 - a.) the firm would maximize profit
 - b.) the firm would earn negative profit
 - c.) no one could afford to buy the product
 - d.) the price would have to fall all the way to zero

- 5.) Which of the following is the best economic justification for why consumers in the U.S. should pay a higher price for pharmaceutical drugs than consumers in Canada?
- a.) to provide an incentive for research and development of new drugs
 - b.) to help ensure a more equitable distribution of world income
 - c.) to help cover the higher physical production costs associated with producing the drug in the U.S.
 - d.) to prevent arbitrage between the two markets
- 6.) Which of the following is true of prisoner's dilemma?
- a.) if each player deviates from their dominant strategy they both would be better off
 - b.) there is no Nash equilibrium
 - c.) the Nash equilibrium is efficient
 - d.) the Nash equilibrium is asymmetric
- 7.) Circle the correct statement
- a.) a Nash equilibrium requires that each player has a dominant strategy
 - b.) a Nash equilibrium requires that each player have a dominated strategy
 - c.) a Nash equilibrium requires that no player has a dominant strategy
 - d.) none of the above
- 8.) The Coase Theorem refers to the possibility of internalizing a positive externality by using
- a.) a tax
 - b.) a subsidy
 - c.) privately negotiated side payments
 - d.) government regulation
- 9.) When the EPA issued permits to power companies to emit sulfur oxides under the Clean Air Act Amendments of 1990, the result was
- a.) the level of air pollution went up
 - b.) the level of air pollution stayed the same
 - c.) the level of air pollution went down
 - d.) none of the above

Questions 10 and 11 refer to the following diagram:



- 10.) The socially optimal level of production is given by the distance
- OT
 - OU
 - OV
 - OW
- 11.) If the goal of policy is to maximize the sum of consumer surplus, producer surplus, and government surplus, then the policy should be
- set the tax equal to QS and the subsidy equal to QS
 - set the tax equal to zero and the subsidy equal to zero
 - set the tax equal to zero and the subsidy equal to QS
 - set the tax equal to QS and the subsidy equal to zero
- 12.) The lemons model can be used to describe
- the commitment problem
 - asymmetric information
 - the principle of harvesting low-hanging fruit first
 - the health benefits of citrus products
- 13.) If the only people who buy health insurance are the ones who are already sick, it would be an example of
- adverse selection
 - moral hazard
 - the free rider problem
 - prisoner's dilemma
- 14.) The amount by which a firm's revenues could go up if it hires one more worker is called the
- marginal product
 - average product
 - value of marginal product
 - marginal cost

- 15.) When we have the number of workers hired on the horizontal axis, the marginal product of labor schedule is usually drawn as
- an upward sloping function reflecting the principle of increasing returns
 - a downward sloping function reflecting the principle of decreasing returns
 - a downward sloping function reflecting the principle of increasing returns
 - an upward sloping function reflecting the principle of decreasing returns
- 16.) If the value of marginal product is bigger than the wage, that indicates that
- the firm could increase profits by hiring more labor
 - the firm could increase profits by hiring less labor
 - the firm could increase profits by paying a higher wage
 - the firm could increase profits by paying a lower wage
- 17.) In the market for labor, the demand function describes
- the number of workers who are willing to work at each wage
 - the output of workers who are paid a given wage
 - the number of workers the firm is willing to hire at each wage
 - the compensating wage differential
- 18.) In a perfectly competitive industry, the industry-wide labor demand curve
- is given by the vertical summation of the VMP schedules for the individual firms in that industry
 - is given by the horizontal summation of the VMP schedules for the individual firms in that industry
 - is given by the average of the VMP schedules for the individual firms in that industry
 - has no necessary relation to the VMP schedules for the individual firms in that industry
- 19.) For the labor supply curve for the economy as a whole,
- the curve would be expected to slope up as a result of the income and substitution effects
 - the curve would be expected to slope down as a result of the income and substitution effects
 - the curve would be expected to slope down as a result of the income effect but slope up as a result of the substitution effect
 - the curve would be expected to slope up as a result of the income effect but slope down as a result of the substitution effect
- 20.) Which of the following is not something that contributes to human capital?
- the physical tools used by the worker
 - the worker's IQ
 - the worker's education
 - the worker's previous experience with this kind of job
- 21.) If a union results in a reduction in the number of people working in an industry, then
- the union members who continue working in the industry will gain and non-union workers in other similar industries will gain
 - the union members who continue working in the industry will lose and non-union workers in other similar industries will lose
 - the union members who continue working in the industry will lose and non-union workers in other similar industries will gain
 - the union members who continue working in the industry will gain and non-union workers in other similar industries will lose

- 22.) Economic theory predicts that an increase in the minimum wage would
- increase the total wage bill paid by firms to minimum wage workers
 - decrease the total wage bill paid by firms to minimum wage workers
 - benefit all those who are currently working at the minimum wage
 - hurt some of those who are currently working at the minimum wage
- 23.) Since 1960, the after-tax income of the richest 10% of Americans
- increased at a faster rate than the after-tax income of the poorest 10% of Americans
 - increased at about the same rate as the after-tax income of the poorest 10% of Americans
 - increased at a slower rate than the after-tax income of the poorest 10% of Americans
 - actually fell as a result of big increases in the marginal tax rate over this period
- 24.) Which of the following do you think might be the best explanation for the increase in wage inequality since 1970?
- the gap between men and women has increased
 - the gap between those with and without college education has increased
 - the Gini coefficient on before-tax wages has gone down
 - the Gini coefficient on after-tax wages has gone down
- 25.) For which of the following pairs of groups is the gap between the median income of households of the two groups the biggest?
- college-educated versus no high school diploma
 - whites versus blacks
 - men versus women
 - north versus south
- 26.) There are 10 people living on the island of Brastonia, but all of the coconuts are owned by one person (who calls himself the King of Brastonia). The Gini coefficient for the Brastonian distribution of coconuts would be
- 10
 - 1
 - 0.1
 - 0
- 27.) If rich people pay a higher dollar amount of taxes than poor people, the tax system would be described as
- progressive
 - regressive
 - proportional
 - it cannot be determined from the information given
- 28.) The primary argument for favoring a negative income tax over a means-tested welfare benefit is that the negative income tax
- implies a lower effective marginal tax rate on earned income
 - makes sure the money goes to the people who need it the most
 - protects the children if welfare parents are alcohol or drug users
 - makes sure that everybody pays their fair share of taxes, even those whose reported income is negative

29.) Which of the following do you think makes the best argument for having government regulation of workplace safety?

- a.) back in the nineteenth century before any regulation, workplaces were already very safe
- b.) compensating wage differentials give firms an incentive to make investments in safety
- c.) the costly-to-fake principle implies that some workers prefer a certain amount of risk
- d.) workers may not be fully aware of the risks

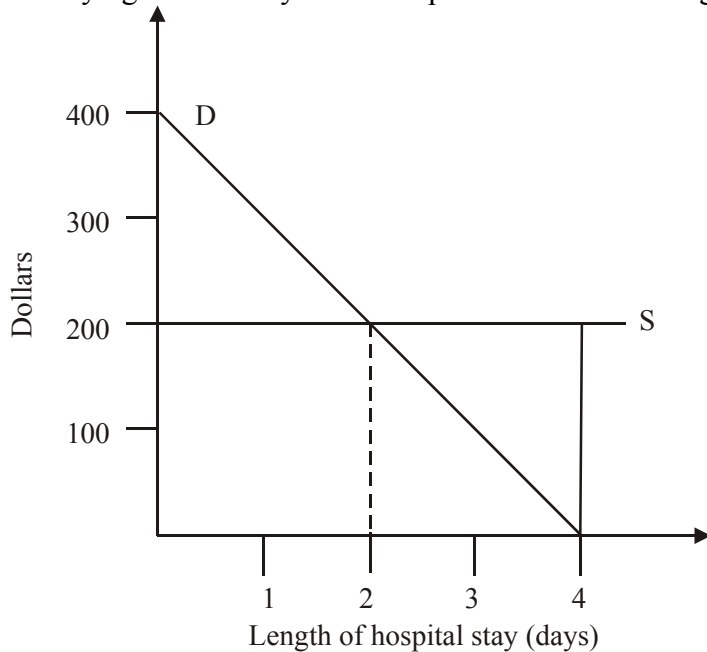
30.) Which of the following do you think makes the best argument against having government regulation of workplace safety?

- a.) back in the nineteenth century before any regulation, workplaces were already very safe
- b.) compensating wage differentials give firms an incentive to make investments in safety
- c.) the costly-to-fake principle implies that some workers prefer a certain amount of risk
- d.) workers may not be fully aware of the risks

31.) When one compares the wages of individuals who work at risky jobs with the wages of individuals who work at safe jobs, if other characteristics of the individual such as education, race, and gender are the same, studies have found that

- a.) the wages for the riskier jobs are lower, suggesting that there is substantial exploitation of workers from unsafe working conditions
- b.) the wages for the riskier jobs are about the same, suggesting that workers are poorly informed about the risks they are taking
- c.) the wages for the riskier jobs are very slightly higher, suggesting that the market values a statistical life at about \$2,500
- d.) the wages for the riskier jobs are significantly higher, suggesting that the market values a statistical life at about \$5,000,000

Questions 32-34 refer to the following diagram, in which D denotes the marginal benefit to Jasmine of staying another day in the hospital and S is the marginal cost of another day in the hospital.



- 32.) If Jasmine has full insurance that pays the complete cost of the hospital stay with no deductible, her consumer surplus will be
- a.) \$200
 - b.) \$400
 - c.) \$600
 - d.) \$800
- 33.) If Jasmine has full insurance that pays the complete cost of the hospital stay with no deductible, the deadweight social loss will be
- a.) 0
 - b.) \$200
 - c.) \$400
 - d.) \$800
- 34.) If instead Jasmine has an insurance policy with \$1,000 deductible, which requires her to pay the first \$1,000 of any hospital stay, the deadweight social loss will be
- a.) 0
 - b.) \$200
 - c.) \$400
 - d.) \$800
- 35.) In most developed countries over the last 50 years, health care expenditures as a percentage of GDP
- a.) increased and life expectancy increased
 - b.) decreased and life expectancy decreased
 - c.) decreased and life expectancy increased
 - d.) increased and life expectancy decreased
- 36.) A good that is rival and excludable is called
- a.) a public good
 - b.) a private good
 - c.) a collective good
 - d.) a commons good
- 37.) A good that is nonrival and excludable
- a.) is called a semi-public good
 - b.) is called a collective good
 - c.) is called a commons good
 - d.) is a physical impossibility
- 38.) How would you characterize the relation between the demand curve for a public good and the individual marginal willingness to pay curves?
- a.) the demand curve is the vertical summation of the individual marginal willingness to pay curves
 - b.) the demand curve is the horizontal summation of the individual marginal willingness to pay curves
 - c.) the demand curve is the average of the individual marginal willingness to pay curves
 - d.) there is no necessary relation between the demand curve and the individual marginal willingness to pay curves

- 39.) We would usually expect that a private firm
- a.) would produce more than the socially optimal quantity of a collective good
 - b.) would produce exactly the socially optimal quantity of a collective good
 - c.) would produce less than the socially optimal quantity of a collective good
 - d.) would never produce a collective good
- 40.) How could a private firm earn a profit from producing a pure public good?
- a.) by careful market studies that calculate each individual's willingness to pay
 - b.) by sale of byproducts
 - c.) by setting price equal to marginal cost
 - d.) a private firm could never profit as long as the item retained the qualities of being a pure public good
- 41.) If the income-elasticity of demand for a public good exceeds 1, it makes sense to pay for it with a tax that is
- a.) progressive
 - b.) proportional
 - c.) regressive
 - d.) distortionary
- 42.) Logrolling refers to
- a.) the practice whereby legislators support each other's pork barrel spending
 - b.) the practice of introducing many similar bills hoping that one of the versions will become law
 - c.) a recreational activity of mountain men
 - d.) the practice of attaching a controversial bill to a large appropriations bill
- 43.) Socially unproductive efforts by people to lobby Congress in support of public projects that benefit the contractor hired for the project but that are not beneficial to the public as a whole is referred to as
- a.) pork barrel politics
 - b.) logrolling
 - c.) rent seeking
 - d.) the winner's curse
- 44.) The rate at which the currencies of two countries trade with each other is called the
- a.) fixed exchange rate
 - b.) floating exchange rate
 - c.) nominal exchange rate
 - d.) real exchange rate
- 45.) If you get more European euros for one of your U.S. dollars, we say that
- a.) the euro has appreciated and the dollar has appreciated
 - b.) the euro has depreciated and the dollar has depreciated
 - c.) the euro has depreciated and the dollar has appreciated
 - d.) the euro has appreciated and the dollar has depreciated

- 46.) Let P denote the value of the consumer price index (CPI) in the U.S. and let P^* denote the value of the CPI in Mexico. If e denotes the nominal exchange rate (measured in pesos per dollar), then the real exchange rate is calculated as
- PP^*e
 - $(Pe)/P^*$
 - $P/(P^*e)$
 - $1/(PP^*e)$
- 47.) Purchasing power parity is the theory that the nominal exchange rate is determined:
- by the forces of supply and demand
 - by the real exchange rate
 - by the government's exchange rate policy
 - as necessary for the law of one price to hold
- 48.) When Bermuda decided to change the fixed exchange rate for its currency (the Bermuda dollar) from 1.00 U.S. dollars to 1.01 U.S. dollars, we say that
- the Bermuda dollar was revalued
 - the Bermuda dollar was devalued
 - the U.S. dollar was revalued
 - the U.S. dollar was devalued
- 49.) When the U.S. dollar depreciates against the Japanese yen, that usually means that
- Japanese goods become more expensive to U.S. residents and U.S. goods become more expensive to Japanese residents
 - Japanese goods become less expensive to U.S. residents and U.S. goods become less expensive to Japanese residents
 - Japanese goods become less expensive to U.S. residents and U.S. goods become more expensive to Japanese residents
 - Japanese goods become more expensive to U.S. residents and U.S. goods become less expensive to Japanese residents
- 50.) When Mexico experiences more inflation than the U.S. that tends to result in
- an appreciation of the U.S. dollar and an appreciation of the Mexican peso
 - a depreciation of the U.S. dollar and a depreciation of the Mexican peso
 - a depreciation of the U.S. dollar and an appreciation of the Mexican peso
 - an appreciation of the U.S. dollar and a depreciation of the Mexican peso

Answers:

1b 2d 3d 4b 5a 6a 7d 8c 9c 10c 11c 12b 13a 14c 15b 16a 17c 18b 19c 20a 21d 22d 23a 24b 25a
26b 27d 28a 29d 30b 31d 32d 33b 34a 35a 36b 37b 38a 39c 40b 41a 42a 43c 44c 45c 46b 47d
48a 49d 50d