

Principles of Economics ECO 2201

1st Test

Fall 2001

Dr. Olsh

Name _____

ANSWER SHEET

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Multiple Choice

1. Todd owns a truck that he values at \$2,000. Susan, who does a lot of hauling, values the truck at \$6,000. If these two get together, which of the following will most likely occur?
 - a. Todd will sell the truck for \$1,500.
 - b. Susan will buy the truck for \$7,000.
 - c. The truck will be sold at a price greater than \$2,000 but less than \$6,000, and both parties will benefit.
 - d. This is a trick question because the same truck cannot have different values to different people.
2. The production possibilities curve illustrates the basic principle that
 - a. an economy's capacity to produce increases in proportion to its population.
 - b. if all the resources of an economy are in use, more of one good can be produced only if more of another is produced.
 - c. an economy will automatically seek that level of output at which all of its resources are producing at the maximum output.
 - d. you can only produce more of one good if you produce less of another good, and if your use of resources is efficient.
3. With time, which one of the following strategies would most likely result in an outward shift in the production possibilities curve of an economy?
 - a. passage of legislation reducing the workweek to 30 hours
 - b. instituting a tax policy encouraging consumption at the expense of capital investment
 - c. instituting a tax policy encouraging capital investment at the expense of consumption
 - d. an increase in the marginal income tax rate, which would reduce the work effort of individuals
4. Which of the following factors would cause the demand curve for a normal good to increase (shift to the right)?
 - a. an increase in the price of the good
 - b. a decrease in the price of the good
 - c. an increase in the price of a substitute good
 - d. an increase in the price of a complementary good
5. *Ceteris paribus*, an increase in the price of a good will cause the
 - a. quantity demanded of the good to increase.
 - b. quantity supplied of the good to decrease.
 - c. producer surplus derived from the good to increase.
 - d. supply of the good to increase.

6. If both the supply and demand for computer games decrease, the equilibrium
 - a. price of the games is indeterminate, and the equilibrium quantity will increase.
 - b. price of the games is indeterminate, and the equilibrium quantity will decrease.
 - c. price of the games will decrease, and the equilibrium quantity will decrease.
 - d. price of the games will decrease, and the equilibrium quantity is indeterminate.

7. Which of the following would most likely decrease the price of chicken?
 - a. lower prices of grains used to produce chicken feed
 - b. higher prices for beef, a substitute for chicken
 - c. unusually hot weather that kills millions of fryer chickens before they are ready for market
 - d. an increase in consumer income

8. Which of the following will most likely increase the price of personal computers?
 - a. imposing an excise tax on personal computers
 - b. a technological change that reduces the production costs of personal computers
 - c. an increase in the price of software, a complementary good used with personal computers
 - d. the expectation that the price of personal computers will decrease during the next six months

9. Suppose gasoline prices increase sharply during the next six months. If the situation persists, the reduction in quantity demanded in response to the higher prices will
 - a. drive gasoline prices sharply higher.
 - b. drive gasoline prices sharply lower.
 - c. be larger in the short run than in the long run.
 - d. be larger in the long run than in the short run.

10. When a conflict arises in a major oil-exporting area of the world, such as the Middle East, the price of gasoline already in the storage tanks at local gas stations usually increases. Which of the following best explains this occurrence?
 - a. Gas station owners anticipate consumers will buy more gasoline as gasoline prices increase.
 - b. Gas station owners are gouging the consumer.
 - c. Gas station owners anticipate higher replacement costs for their supply of gasoline and, therefore, raise their prices in response to this higher expected cost.
 - d. A decline in consumer demand forces the gas station owners to raise their prices to maintain profit margins.

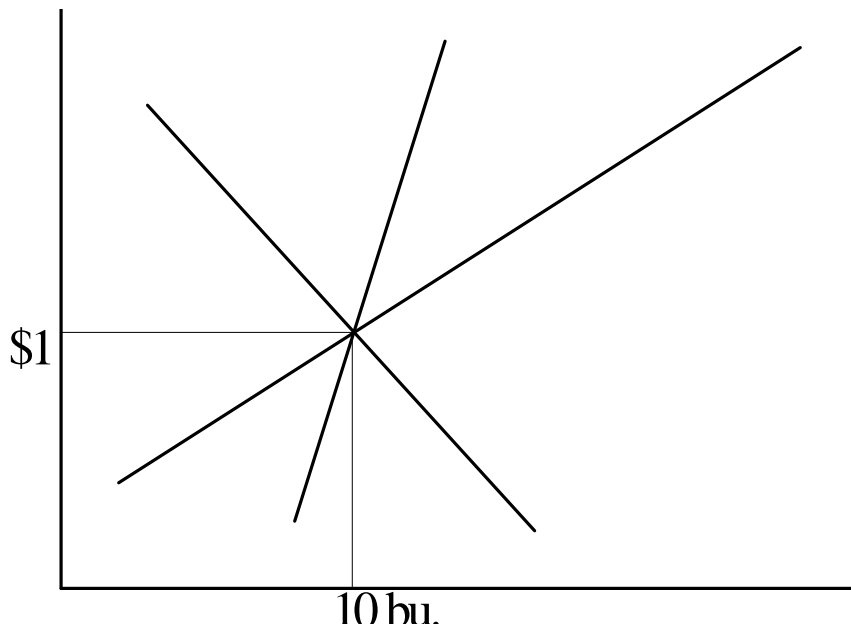
11. Which of the following events would cause the interest rate to fall?
 - a. Congress passes legislation that reduces tax incentives for savings.
 - b. Business decision makers become more optimistic about future economic conditions and seek to expand plant capacity.
 - c. The fraction of the population that is in the prime saving ages falls.
 - d. None of the above.

12. With time, an increase in the dollar price of foreign currency would cause
- the nation's imports to increase and the exports to decrease.
 - the nation's exports to increase and the imports to decrease.
 - both imports and exports to decrease.
 - both imports and exports to increase.
13. Which of the following will most likely result from rent controls that reduce rent below market equilibrium?
- Shortages and black markets will develop.
 - The quality of existing housing will improve.
 - The future supply of rental housing will increase rapidly because the controls bring about excess demand.
 - Discrimination against minorities and persons with unconventional lifestyles will decline in the housing market.
14. A politician was recently quoted as saying, "Our country can only reach full employment by raising the minimum wage, which would cause the demand for products to increase . . . and eventually cause production to expand." His analysis overlooks the fact that
- minimum wage legislation increases costs of production and creates an excess supply of unskilled labor.
 - automation is the prime cause of unemployment in both the short and long runs.
 - full employment can only be reached by increasing real wages.
 - minimum wage legislation may increase the employment of low-skilled workers, but this will be offset by an equal reduction in the employment of skilled workers.
15. Which of the following statements is false?
- In both black and normal markets, supply and demand determine price.
 - The quality of products sold in black and normal markets are similar.
 - For otherwise identical products, the price of products in black markets tends to be higher than in normal markets.
 - The rate of violence is higher in black markets than in normal markets.
16. Suppose an excise tax is imposed on X and Y. The demand for good X is highly elastic, while the demand for good Y is highly inelastic. The deadweight loss will be
- equally negligible in both cases.
 - equally significant in both cases.
 - more significant for good X than good Y.
 - more significant for good Y than good X.
17. The Laffer curve indicates
- an inverse relationship always exists between tax revenues and tax rates.
 - an increase in tax rates can sometimes lead to a decrease in tax revenues.
 - the government can sometimes correct for market failure.
 - a positive relationship always exists between tax revenues and tax rates.

18. If admission to a Reba McEntyre concert in a football stadium is lowered from \$60 to \$40 and attendance increases from 25,000 to 35,000, the price elasticity of demand for attending the concert is approximately
- 0.25.
 - 0.5.
 - 0.83.
 - 1.2
19. For which one of the following goods would you expect the demand to be most elastic?
- gasoline
 - premium gasoline
 - unleaded gasoline
 - Exxon unleaded gasoline
20. If the price of apples increases, total expenditures on apples will decline if
- there are few substitutes for apples.
 - the supply of apples is inelastic.
 - the demand for apples is elastic.
 - apples are a normal good.

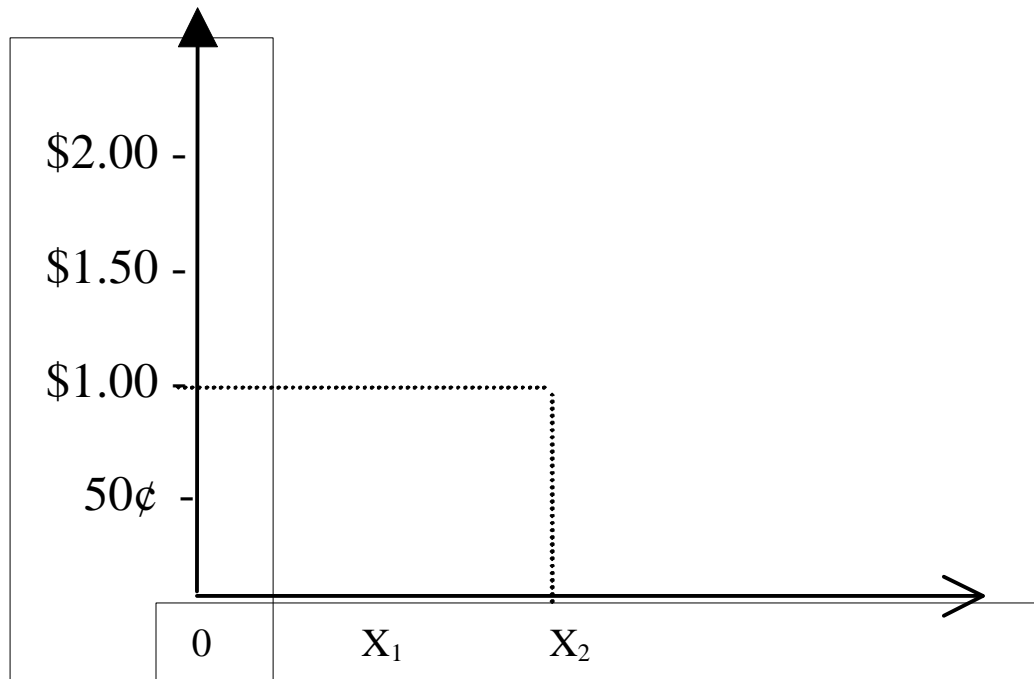
II. Problems/Analysis

1.



- a) Doing your work in the diagram above, begin by precisely labelling the constructs. Use D_1 for demand, S_{sr} for short-run supply, and S_{lr} for long-run supply. Next, show the adjustment, over time, that results from this particular increase in demand to D_2 , that is, every point on the demand (D_1) is pushed up vertically by exactly \$1.00.
- b) In the space provided below, verbally describe (in precise language of the discipline) what has happened in the above diagram.

2.

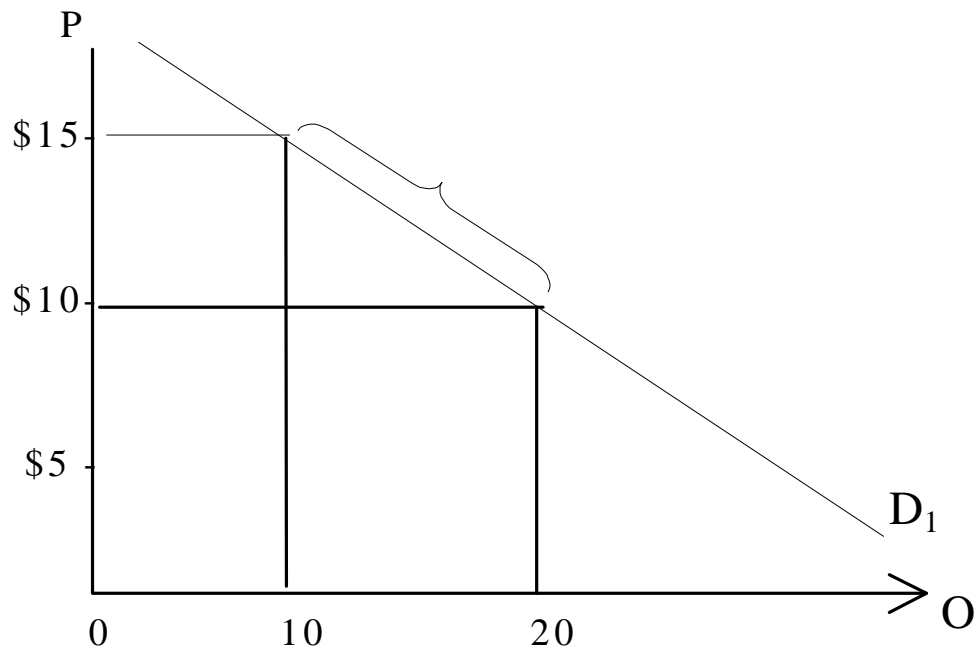


a) Doing your work in the diagram above, begin by constructing the demand curve (note: when price is \$1.50, quantity demand is zero; when price is \$1.00, quantity demanded is X_2). Next construct the supply curve (note: when price is zero, quantity supplied is X_1 ; when price is \$1.00, quantity supplied is X_2). Having carefully labelled the constructs, fill in the blanks: the demand curve is relatively _____, and the supply curve is relatively _____.

b) Now in the diagram above, impose a 50¢ per unit specific tax. You may use any **one** of the three techniques described in class. But you must show initial equilibrium, new equilibrium, dead-weight loss, and government revenue. To complete this problem, fill in the blank: it would have helped the analysis if it were known whether the government legislation specified the buyer or the seller as the payer of the tax.

_____ (**Yes**, more information is always helpful; **No**, political-legal B.S. doesn't help.)

3.



Analyze price elasticity conditions on the arc designated in the above diagram.

a) using "total revenue" analysis

b) using the arc elasticity formula

4. Economics X and Z are the same in every respect save that economy X denotes substantially more of its resources to capital formation. Use two well-labelled diagrams appropriate to making a comparison of a) the current situation and b) prospects for the future. Having completed the diagrams, explain, in a few sentences, what is revealed in the comparison.

Please sign the following: I have neither given, nor received unauthorized aid on this piece of work, nor have I knowingly tolerated any violation of the Honor Code.
