

Questions 1 – 2 refer to the following information:

- There are two organizations in the world, the Red Cross (RC) and the New York Mafia (NYM). There are two productive activities, collecting donations and laundering money.
- If the RC completely specializes in collecting donations, they can collect 5 a year. If the RC completely specializes in laundering money, they can produce 10 units of money laundering a year.
- If the NYM completely specializes in collecting donations, they can collect 30 a year. If the NYM completely specializes in laundering money, they can produce 30 units of money laundering a year.
- Either organization can produce any linear combination of the endpoints described above. That is, connect the dots. (E.g. NYM can produce 15 units of each good)

1. Who is the low cost producer of laundering money?
 - a. RC, because they can produce the least of them
 - b. NYM, because they can produce the most of them
 - c. NYM, because they must sacrifice only 1 donation to make a unit of money laundering
 - d. RC, because they must sacrifice only ½ a donation to make a unit of money laundering**
 - e. Neither, because they both have the same cost of producing

2. Who has a comparative advantage in collecting donations?
 - a. RC, because they can produce the least of them
 - b. NYM, because they can produce the most of them
 - c. RC, because they are the low cost producer of them
 - d. NYM because they are the low cost producer of them**
 - e. Both (a) and (c) are correct

3. As you know, marijuana is currently illegal to consume and illegal to produce. Suppose that marijuana was made legal to consume and legal to produce. Ceteris paribus, as a result of this change, what would happen to the equilibrium price and quantity, respectively, of marijuana?
 - a. change in an uncertain direction, decrease
 - b. change in an uncertain direction, increase**
 - c. decrease, increase
 - d. increase, change in an uncertain direction
 - e. increase, increase

4. “Cool Whip” and “Pistol Whip” are substitutes. (Homer: Yum, Pistol Whip.) Ceteris paribus, if the price of “Cool Whip” increases, which of the following will happen?
 - a. the demand for “Pistol Whip” will fall
 - b. the demand for “Pistol Whip” will rise**
 - c. the supply of “Pistol Whip” will rise
 - d. the price of “Pistol Whip” will fall
 - e. both (a) and (d)

5. Suppose that many consumers are displeased to find out that many famous micro-brewery beers are brewed under contract as some major breweries. For instance, Sam Adams and Pete’s Wicked Ale are brewed at Stroh and Genesee. Ceteris paribus, what effect should this news have on the equilibrium price and quantity for "micro-brewery" beers?
 - a. price rises, quantity rises
 - b. price falls, quantity rises
 - c. price rises, quantity falls
 - d. price falls, quantity falls**
 - e. price falls, quantity changes in an uncertain direction

6. “Pre-owned Q-tips” are an inferior good. Ceteris paribus, if the income of consumers falls, what will happen to the equilibrium price and quantity, respectively, of “pre-owned Q-tips”?
- rises, rises**
 - rises, changes in an uncertain direction
 - rises, falls
 - falls, rises
 - falls, falls
7. “Sweatshop labor” is an input for the production of Nike shoes. If the price of “sweatshop labor” falls, the equilibrium price and quantity of Nike shoes, respectively, will
- rise, rise
 - rise, fall
 - fall, rise**
 - fall, fall
 - none of the above
8. Which of the following would cause an increase in the supply of “Wonder Woman Underoos”?
- an increase in the price of an input in Wonder Woman Underoos production
 - an improvement in the technology of Wonder Woman Underoos production**
 - an invisible jet crash which destroys a Wonder Woman Underoos factory
 - all of the above
 - only (a) and (b)
9. Which of the following would likely be an example of physical capital?
- a share of IBM stock
 - a college education
 - an acre of farmland
 - a delivery van**
 - all of the above

Questions 10 - 11 refer to the following: Richard and Gervase are on the Survivor Island. Richard somehow sews together 1000 pairs of pants. Richard, thankfully keeps 400 pairs for himself (and wears them?), then sells the remaining 600 pairs of pants to Gervase for \$1 a piece. Gervase then uses all 600 pairs of pants purchased from Richard to make fancy suits, all of which he sells back to Richard for \$750.

10. If the transactions specified in the intro are the only transactions and all of them take place in 1998, what is GDP on the island?
- \$750**
 - \$1000
 - \$1150
 - \$1550
 - \$1750
11. Suppose that Richard sews and sells the pants to Gervase in 1998, but that Gervase does not make or sell the leisure suits until 1999. If these are the only transactions that take place in each year, GDP in 1998 and 1999 (respectively) are
- \$600, \$150**
 - \$600, \$750
 - \$1000, \$150
 - \$1000, \$750
 - \$400, \$750

12. Two neighbors, Richie and Fonzie, had previously been cooking their own meals, but decide on the following arrangement. Richie will make the same meals he had been making, but will sell them to Fonzie for \$1000. Fonzie will sell the same meals he had been making, but will sell them to Richie for \$500. What will be the change in GDP from this new arrangement? (Assume there are no intermediate goods and all transactions will be reported to government statisticians in charge of calculating GDP).

- GDP will not change
- GDP will increase \$500
- GDP will increase \$1000
- GDP will increase \$1500**
- GDP will decrease

Question 13 refers to the following scenarios:

Scenario A	Scenario B
Income = \$100	Income = \$400

13. Which of the following is true?
- Scenario B is always preferred to Scenario A
 - Scenario A is always preferred to Scenario B
 - Either scenario may be preferred, depending on the levels of prices in each scenario**
 - None of the above
 - Getting colder – don't pick me

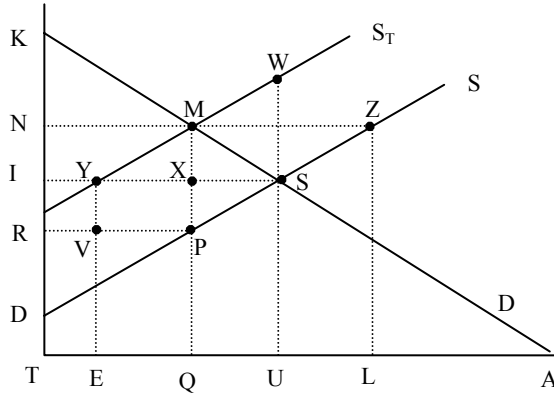
Questions 14 – 15 are based on the following, which will enable you to calculate the Jackson Family Price Index. Whenever you calculate the price level, use the **GDP Deflator Price Index**. Special thanks to Justin Timberlake.

	<u>Base Year</u>		<u>Current Year</u>	
	Price	Quantity	Price	Quantity
Pasties	\$4	2	\$7	2
Noses	\$4	0	\$3	2
Lawyers	\$4	3	\$8	2

14. The price level in the current year is
- $\$24 / \$36 = 0.667$
 - 1.0
 - $\$30 / \$24 = 1.25$
 - $\$36 / \$24 = 1.5$**
 - $\$38 / \$20 = 1.9$
15. Real GDP in the current year is
- \$18
 - $\$18 / 6 = 3$
 - $\$36 / 1 = \36
 - $\$36 / 1.5 = \24**
 - $\$36 / 1.9 = \18.95
16. Between the base year and the current year there has been
- inflation of approximately 25%
 - deflation of approximately -33%
 - inflation of approximately 50%**
 - inflation of approximately 90%
 - no change in the price level

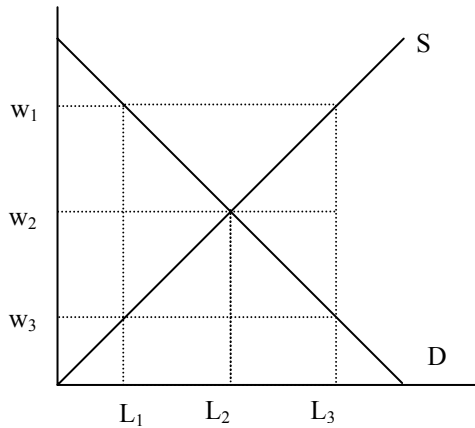
17. If the economy were on the “wrong side” of the Laffer Curve, which of the following would result?
- an increase in the tax rate would result in an increase in tax revenue
 - a decrease in the tax rate would result in a decrease in tax revenue
 - an decrease in the tax rate would result in an increase in tax revenue**
 - both (a) and (b)
 - none of the above

Question 18 refers to a per-unit tax levied on suppliers of labor, and illustrated below.



18. What area would describe the revenue collected as result of imposing the tax?
- TISU
 - RIXP
 - RNMP**
 - INMX
 - DIS

Question 19 refers to the following diagram, which illustrates the market for low-skilled workers.



19. If a law was passed that mandated a minimum wage at w_1 , what would be the resulting change in the number of unemployed persons?
- there would be no change in number of unemployed
 - the number of unemployed persons would increase by the quantity L_1
 - the number of unemployed person would increase by the quantity L_2
 - the number of unemployed persons would increase by the quantity $(L_2 - L_1)$
 - the number of unemployed person would increase by the quantity $(L_3 - L_1)$**

20. If the price level in 1815 was 2.0 and the price level in the year 1900 was 1.8, then we would say that on balance, between 1815 and 1900
- there was inflation
 - there was deflation**
 - there might have been inflation or deflation, depending on the change in real GDP between those years
 - there was inflation if real GDP rose during that period by more than approximately 10.1%
 - none of the above

Question #21 only is extra credit – there is no penalty for guessing

	Glasses of Lemonade	and	Bags of Peanuts
Harpo's Plan (H)	0		10
Groucho's Plan (G)	8		8
Chico's Plan (C)	4		3
Zeppo's Plan (Z)	16		2
Edgar's Plan (E)	20		0

21. Who definitely has an inefficient plan?
- G
 - C**
 - G and C
 - G, C, and Z
 - G, C, Z, and H

Short Answer (You are required to answer all short answer questions)

1. (5 pts) Below is an excerpt from an article in the 2/13/2003 edition of The Greenville News, written by Cindy Landrum, Education Writer.

Gas prices in South Carolina hit record levels Thursday...The average price of a gallon of...gas in the Greenville area was \$1.54.4 — higher than any other time since the AAA Carolina began tracking prices two decades ago..."

Let's suppose that AAA Carolina began tracking gasoline prices (two decades ago) in 1982. Here is some additional information that wasn't included in the article. The price level in 1982 was 1.00 and the price level in 2003 was 2.00 (roughly). The price of a gallon of gas in 1982 was \$1.28 and was \$1.54 in 2003.

Were gas prices at an inflation-adjusted all time high in 2003? Very briefly show me how you arrived at this result.

$$\text{Real price of gas in 1982} = \$1.28 / 1 = \$1.28 \quad (\text{in 1982 } \$)$$

$$\text{Real price of gas in 2003} = \$1.54 / 2 = \$0.77 \quad (\text{in 1982 } \$)$$

So the real price of gas is higher in 1982. Gas price is not at an all time high.

Or if you'd rather convert into 2003 \$...

$$\$1.28 * (\text{Price level in 2003} / \text{Price level in 1982}) = \$1.28 * (2 / 1) = \$2.56 \quad (\text{in 2003 } \$)$$

Compare this to \$1.54 (already in 2003 \$)

So the real price of gas is higher in 1982. Gas price is not at an all time high.

Or the average price has doubled between 1982 and 2003, while the price of gas has not doubled...

2. (6 pts) Often in Economics 212 textbooks, the production possibilities curve (PPC) curve is shown as a curve (rather than a straight line). Explain why this is the case. A few sentences at most.

As we produce more of a good, we have to use resources that are less suited for the production of that good. As a result, as we produce more of a good, the opportunity cost of producing that good increases.

You can also say as we add in more individual's PPCs, we will have many kinks in society's PPC and the PPC will approximate a smooth curve. However, you have to mention that people have different productive abilities.

3. (9 pts) The information below will enable you to draw the PPC for American Idolville, which has only three residents. There are only two productive activities: producing scathing criticisms (SC), and producing unnecessary encouragement (UE). The information below reveals the endpoints of each individual's PPCs. For example, Simon can produce 10 SC and 0 UE, or 0 SC and 20 UE, or any linear combination of the two, for instance 5 SC and 10 UE (connect the dots).

	<u>SC</u>		<u>UE</u>
Simon	10	or	20
Paula	10	or	30
Randy	5	or	5

Draw society's PPC. Be sure to put SC on the vertical axis and UE on the horizontal axis. Label the four "important" points -- tell me how many SC and UE are being produced at each of them.

You should find a nice outward bowed curve just as you did on the homework.

(25 SC, 0 UE) endpoint
 (15 SC, 30 UE) kink
 (5 SC, 50 UE) kink
 (0 SC, 55 UE) endpoint

As we start with all SC and no UE, we first switch Paula into UE production, then Simon, => then Randy.

As we start with all UE and no SC, we first switch Randy, then Simon, then Paula.

I'll bring a picture on Friday.