

**-Old Test Questions-**

# **Introduction to Economics**

**ECO 2000**

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**Fall, 2007**

1. (20 points) Draw a production possibilities curve showing the trade-off between expenditures on consumption goods and expenditures on investment goods. Choose and label a point A somewhere on the curve. Now label another point B on the curve that shows more investment than at point A. What is the opportunity cost of the higher investment? Show that opportunity cost on your graph of the production possibilities curve.
2. (10 points) If an individual invests \$1000, continues reinvesting any earnings, and can earn a 10 percent rate of return on the investment, how long will it take for the individual's investment to grow to \$8000? For full credit, explain how you got your answer.
3. (10 points) Describe the tax advantage of a Roth IRA. Are the advantages of a Roth IRA greater for a younger person or an older person? Why?
4. (10 points) Who invented money? How did it come to be used as a medium of exchange in the economy? You can get full credit on this question simply by repeating the phrase we used in class to describe how the use of money originated.
5. (10 points) Our use of language enables us to communicate, laying the foundation for all of our social interactions, including economic interactions. Who invented language? How did it come to be used as a method of communication? You can get full credit on this question simply by repeating the phrase we used in class to describe how language originated.
6. (10 points) The market economy is a miraculous organization for allowing people to cooperate in their economic endeavors, and has generated a huge amount of prosperity world-wide in places where it is used. Who came up with the idea of the market economy? You can get full credit on this question simply by repeating the phrase we used in class to describe how the market economy originated.
7. (15 points) Why is it that diamonds, which are not very useful, are expensive to buy, whereas water, which is useful and essential for life, is so inexpensive? Use a graph to help illustrate your answer.
8. (5 points) Approximately what percentage of the American population is poor, according to the government's poverty statistics? How has this percentage changed over the past 30 years?
9. (5 points) The main contributor to the growth in individual incomes has been rising labor productivity. What is the most important factor that has caused labor productivity to rise?
10. (20 points) Adam Smith and David Ricardo viewed the process of economic growth differently. Briefly explain their views on the causes of economic growth. Which view of the growth process do you believe is more accurate?
11. (10 points) What feature of the federal tax code has the biggest effect on health care expenditures, and what effect does it have?
12. (10 points) Briefly discuss two unintended consequences of drug prohibition.

13. (15 points) After Hurricane Andrew hit Miami, many buildings were damaged, and owners of homes and businesses wanted to buy building materials to make repairs. Draw a graph, using the supply and demand framework, to show how the market for plywood was affected by the hurricane. What happened to the price and quantity of plywood? A carefully-drawn graph is sufficient to answer this question.
14. (15 points) In the Fall of 2005 Hurricanes Katrina and Rita damaged several oil wells in the Gulf of Mexico and shut down a number of gulf coast oil refineries. Explain how this disruption in oil production caused by these hurricanes affected the market for gasoline. Use a graph to show your answer.
15. (15 points) After Hurricanes Katrina and Rita disrupted oil supplies in the Fall of 2005, causing higher gasoline prices, the state of Hawaii imposed price controls on the retail price of gasoline, keeping gasoline in Hawaii below the market equilibrium level. Explain the effects you would expect from the gasoline price controls on the market for gasoline in Hawaii. Use a graph to illustrate your answer.
16. (15 points) Florida has a policy against "price gouging" after natural disasters. Assume that after a hurricane hits the state, sellers of plywood are prevented from raising their prices above the price that prevailed prior to the hurricane. Use a graph to explain how this price gouging policy that prevents the price of plywood from rising will affect the market for plywood after a hurricane.
17. (10 points) Define the term "market failure." List three problems that could arise to cause market failure.
18. (10 points) What is the major difference between government farm policy in the United States and in New Zealand?
19. (10 points) The book argues that three main factors were responsible for allowing Japanese auto companies to gain a substantial share of the U.S. market. What were those factors?
20. (5 points) What is the single most important factor that determines whether a firm is able to maintain monopoly power in a market?
21. (15 points) New York City has had rent controls since World War II. The rent controls hold the rental price of New York apartments below the market equilibrium rent. Using a graph, show the effect of the rent control law on the market for apartments in New York.
22. (10 points) Briefly describe the role of profits and losses in an economy.
23. (15 points) The minimum wage law keeps the wages of unskilled labor above the market equilibrium wage that would exist in the absence of the law. Use a graph to show the effect of the minimum wage law on the market for unskilled labor.
24. (15 points) From time to time, freezes in central Florida damage the orange crop. Explain how such a weather event will affect the market for fresh oranges, using a diagram to help explain your answer.
25. (15 points) After terrorists flew hijacked airliners into New York's World Trade Center towers on September 11, 2001, people became apprehensive about flying on airlines because they were concerned about the possibility of more hijackings in the future. Explain how the apprehension of potential airline travellers affected the market for airline tickets. Use a graph, and show the effects on the quantity of tickets sold and the price.

26. (15 points) Travel by train is a substitute for travel by airline. Explain how the airline hijackings described in the previous problem affected the market for passenger train travel. Use a graph, and show the effects on the quantity and price of train travel.
27. (10 points) Briefly explain the efficient markets hypothesis, and explain the implications of the hypothesis as applied to stock market prices.
28. (15 points) Since the 1920s, federal farm programs have supported the prices of agricultural products in the United States. The dairy program, for example, held the price above the market equilibrium price for dairy products, and then committed the federal government to buy dairy products that farmers could not sell at the government-mandated price. Use a graph to show the effects of this type of price support program.
29. (10 points) The table to the right gives the consumer price index (CPI) for various years, rounded off slightly to make computations easier. Assume that a business buys a factory in 1980 for \$1 million, and sells the factory in 2000 for \$3 million. What would the 1980 purchase price of the factory been, calculated in 2000 dollars (after adjusting for inflation)? Show your work to receive full credit. After adjusting for inflation, did the seller receive more or less money for the factory than he paid for it in 1980?
- | YEAR | CPI |
|------|-----|
| 1970 | 30  |
| 1980 | 40  |
| 1990 | 80  |
| 2000 | 130 |
30. (15 points) The table to the right gives the consumer price index (CPI) for various years, rounded off slightly to make computations easier. Assume that you bought a car in 2000 for \$20,000, and your father tells you that he bought a car very much like the one you bought for \$10,000 in 1980. After adjusting for inflation, did your car cost more or less than the car your father bought?
- | YEAR | CPI |
|------|-----|
| 1970 | 50  |
| 1980 | 80  |
| 1990 | 100 |
| 2000 | 120 |
31. (15 points) The table to the right gives the consumer price index (CPI) for various years, rounded off slightly to make computations easier. Assume that someone buys a house in 1970 for \$50,000, and sells the house in 2000 for \$200,000. What would the 2000 sales price of the house been, calculated in 1970 dollars (after adjusting for inflation)? Show your work to receive full credit. After adjusting for inflation, did the seller receive more or less money for the house than he paid for it in 1970?
- | YEAR | CPI |
|------|-----|
| 1970 | 30  |
| 1980 | 40  |
| 1990 | 80  |
| 2000 | 130 |
32. (15 points) The table to the right gives the consumer price index (CPI) for various years, rounded off slightly to make computations easier. Assume that a business buys a warehouse in 1970 for \$100,000, and sells the warehouse in 2000 for \$400,000. What would the 2000 sales price of the warehouse been, calculated in 1970 dollars (after adjusting for inflation)? Show your work to receive full credit. After adjusting for inflation, did the seller receive more or less money for the warehouse than he paid for it in 1970?
- | YEAR | CPI |
|------|-----|
| 1970 | 30  |
| 1980 | 40  |
| 1990 | 80  |
| 2000 | 130 |
33. (10 points) Some critics have argued that environmental regulations have become too stringent, and that less costly methods of environmental protection could be used. Briefly discuss two cost-reducing measures that could be used in place of the current set of regulations.

34. (10 points) A study on factors affecting the payoff to a college education found that there is a slight earnings advantage for graduates of colleges with better reputations. However, it named three other factors that make an even larger difference to the earnings of graduates. Name two of those factors.
35. (10 points) A study on factors affecting the payoff to a college education found that there is a slight earnings advantage for graduates of colleges with better reputations. However, it named three other factors that make an even larger difference to the earnings of graduates. Name those three factors.
36. (10 points) A century ago in the American West, buffalo were hunted almost to extinction. Meanwhile, the cattle population grew substantially. Pradoxically, people were killing more cattle than buffalo. Explain why the buffalo population declined while the cattle population grew.
37. (15 points) In the late 1800s buffalo in the American West were nearly hunted to extinction. Meanwhile, the cattle population in the American West grew substantially. However, many more cattle were being slaughtered than buffalo. Why was it that the cattle population was growing and the buffalo population was shrinking, even though we were killing more cattle than buffalo?
38. (5 points) People can increase their wealth in two ways. What are they?
39. (10 points) In the past year, Russia has had an inflation rate of about 300 percent. What has caused this inflation? Use the equation of exchange to help explain your answer.
40. (10 points) In the past year, Brazil has had an inflation rate of about 20 percent. What has caused this inflation? Use the equation of exchange to help explain your answer.
41. (10 points) Is unemployment in Western Europe higher or lower than it is in the United States? Give two reasons why the unemployment rate is different in Europe than it is in the United States.
42. (5 points) Assume that the unemployment rate is currently 5 percent, which is about equal to the natural rate of unemployment. Further assume that the inflation rate is about 5 percent, and that the Fed would like to lower the inflation rate to about 2 percent. What should the Fed do to lower the inflation rate?
43. (15 points) Assume that the Fed follows the policy you recommend in your answer to question 8 to lower inflation. Explain what will happen to both inflation and unemployment in the short run and in the long run. Use a graph to help illustrate your answer.
44. (10 points) About what percent of GDP is composed of government purchases of goods and services? What percent of GDP is total government expenditures?
45. (15 points) Assume that a city builds a new municipal golf course. How will the new golf course affect the market for golf clubs? Use a graph to illustrate your answer, and clearly show how the price and quantity of golf clubs will be affected.
46. (15 points) Tennis and golf are substitutes. Explain how the new golf course in the question above will affect the demand for tennis balls.
47. (15 points) What caused the Great Depression? Explain the factors that led to the Depression, and use the equation of exchange to illustrate the Depression's fundamental cause.

48. (5 points) Assume that you save \$2,000 this year, and earn a 10 percent return on your saving. If you never save any more, or withdraw any money from your savings, how long will it take for your savings to grow to equal \$16,000? Explain how you figured out your answer.
49. (10 points) Assume that there is no inflation and the nominal interest rate is 4 percent. A few years later the economy has 5 percent inflation and the nominal interest rate is 8 percent. What is the real interest rate in each case? Is the real cost of borrowing higher in the first situation or the second? Why?
50. (10 points) Over the past few months, Alan Greenspan and the Fed have lowered interest rates several times to try to help the economy. Explain (a) what the Fed actually does to lower interest rates (how do they get them to go down?) and (b) how this action will help the economy.
51. (10 points) Over the past few months, Alan Greenspan and the Fed have raised interest rates several times to try to help the economy. Explain (a) what the Fed actually does to raise interest rates (how do they get them to go up?) and (b) how this action will help the economy.
52. (15 points) The minimum wage law mandates that employers must pay their employees at least \$5.15 per hour, but some low-skilled workers would not make this much were it not for the minimum wage law. Use a graph to show the impact of the minimum wage law on those workers.
53. (15 points) Florida voters recently approved an amendment to the Florida Constitution to raise the minimum wage in the state to \$6.15 per hour, which is more than some low-skilled workers would make without this minimum wage law. Use a graph to show the impact of Florida's new minimum wage law on those workers.
54. (10 points) Why was the Federal Reserve System created? What is its primary function today?
55. (5 points) Briefly describe what Ludwig von Mises is best known for.
56. (5 points) Briefly describe what Milton Friedman is best known for.
57. (5 points) Briefly describe what Thomas Robert Malthus is best known for.
58. (5 points) Briefly describe what David Ricardo is best known for.
59. (5 points) Briefly explain why Karl Marx thought that capitalism exploited workers.
60. (5 points) Briefly describe what John Maynard Keynes is best known for.
61. (10 points) Briefly describe what government policies John Maynard Keynes thought would be most appropriate to help the economy recover from the Great Depression.
62. (15 points) What government policies did John Maynard Keynes think would be most appropriate to help the economy recover from the Great Depression? Why did he advocate these policies? Describe the effects Keynes expected from the policies he advocated.
63. (5 points) In Canada, where health care is provided by the government and paid for through taxes, the health care system has a significant hidden cost associated with it. What is this cost, and why does it exist?

64. (15 points) Golf is primarily a daytime sport, but lighted golf courses that allow nighttime play are becoming increasingly common. Explain how the lighting of golf courses will affect the market for golf balls. Use a graph to illustrate your answer, and be sure to clearly show the effect on both the price of golf balls and the quantity of golf balls exchanged.
65. (15 points) Tennis is a substitute for golf. Using the scenario from the problem above, how will the construction of lighted golf courses affect the market for tennis balls? Use a graph to illustrate your answer, and be sure to clearly show the effect on both the price of tennis balls and the quantity of tennis balls exchanged.
66. (10 points) If an individual invests \$2000, continues reinvesting any earnings, and can earn a 7 percent rate of return on the investment, how long will it take for the individual's investment to grow to \$16,000? For full credit, explain how you got your answer.
67. (10 points) What is a public good? Briefly state why the concept is important to public policy.
68. (10 points) What is an externality? Why does an externality create an inefficient use of resources? What policies can be used to reduce the inefficiency?
69. (15 points) For decades the federal government supported the prices of agricultural products in the United States, such as corn. The government set a price floor that held the price of corn above the market equilibrium price, and then committed the federal government to buy any corn that farmers could not sell at the government-mandated price. Use a graph to show the effects of this type of price support program.
70. (5 points) Why is economics sometimes called "the dismal science"?
71. (15 points) What is a cartel? Use a graph to explain how a cartel can benefit its members, and why cartels tend to fail.
72. (10 points) What is a cartel? Explain why cartels tend to be unstable.
73. (5 points) Is Microsoft a monopoly? Why, or why not?
74. (10 points) What is rent-seeking? Where did the name "rent-seeking" come from? Does rent-seeking help or hinder economic progress?
75. (10 points) A price index, such as the Consumer Price Index (CPI) shows how the overall level of prices changes over time. Briefly explain how a price index is constructed.
76. (10 points) Is it possible for total employment and the unemployment rate to both go up at the same time? As a part of the answer, explain how the unemployment rate is calculated.
77. (15 points) Assume that the Fed increases the growth rate of the money supply. How will this affect the nominal interest rate over time? Use a graph to clearly show both the short-run and long-run impacts on the nominal interest rate of an increase in the growth rate of the money supply.
78. (10 points) Economists have sometimes differed on the role that government should play in trying to guide the economy. Briefly describe the Keynesian view on economic policy that follows the ideas of John Maynard Keynes, and the monetarist view that follows the ideas of Milton Friedman.
79. (5 points) The centrally planned economies of the 20th century owed their origin to the ideas of Karl Marx, who advocated socialism to replace the capitalist system built on the market economy. Who invented the market economy, and how did it come into being?

80. (10 points) In the 20th century wages paid to American labor have risen substantially, while in some lesser-developed economies, wages remain low. Part of the reason is that people are more educated now, but even very educated workers in less-developed economies are not paid as well as in the United States. Explain why wages have risen so substantially in the United States.
81. (10 points) What is the underground economy? About how large is the underground economy relative to the total economy?
82. (10 points) What is a leading indicator? How are leading indicators used?
83. (10 points) What is structural unemployment? What types of policies can best be used to reduce structural unemployment?
84. (10 points) Our book says that Russia does not have "cowboy capitalism" like the old West in the United States 150 years ago. What are the differences between "cowboy capitalism" and the current situation in Russia?
85. (5 points) What causes physician-induced demand for health care?
86. (10 points) Briefly explain the major differences in drug policy between the Netherlands and the United States. How have these differences in policy affected drug use in the two countries?
87. (10 points) Explain how fractional reserve banking works, and how the practice of fractional reserve banking affects the size of the money supply.
88. (10 points) Compare the economic growth of Japan, Korea, and the United States since 1960.
89. (10 points) What did Adam Smith say was the most important cause of economic growth?
90. (5 points) When and where did modern economic growth begin?
91. (15 points) In the mid-1990s Russia had an inflation rate of about 300 percent, but that rate slowed to about 15 percent in the first few years of the 21<sup>st</sup> century. What caused Russia's high inflation rate in the 1990s? Why did it slow down so substantially after that? Use the equation of exchange to explain your answer.
92. (10 points) What caused the Great Depression?
93. (15 points) Assume that government policymakers want to use monetary and fiscal policy to try to reduce the inflation rate. Explain what policy tools they would use, and how each would work to slow inflation.
94. (10 points) Last year, Argentina had an inflation rate of about 70 percent. What has caused this inflation? Use the equation of exchange to help explain your answer.
95. (5 points) Which country is the world's largest debtor?
96. (15 points) College graduates earn substantially more on average than workers without a college degree. Give two different reasons why a college degree leads to higher earnings, and explain why each factor makes college graduates worth more to potential employers.

97. (15 points) Economists argue that monopolies use resources inefficiently, so reduce economic well-being. Use a graph to explain exactly what it is about the activity of monopolists that produces an inefficient outcome.
98. (10 points) What is the velocity of money? Explain the relationship between the velocity of money and the demand for holding real money balances.
99. (10 points) In the United States, most working people get their health insurance through their employers, but they obtain other types of insurance (life insurance, homeowners' insurance, auto insurance) on their own. Explain why this is the case.
100. (15 points) How does the fact that recreational drugs such as marijuana, cocaine, and heroin are illegal affect the incomes of those who sell these drugs? Would the total income of all sellers be higher or lower if these drugs were legalized? On what factors does your answer depend?
101. (15 points) Assume the economy is at the natural rate of unemployment. Use an aggregate supply-aggregate demand diagram to show how an increase in aggregate demand will affect the level of GDP and the price level in the long run.