UNIVERSITY OF CALIFORNIA, LOS ANGELES
Department of Economics

October 25, 2001 Cameron

Economics 1 - Midterm Exam

INSTRUCTIONS: Enter your name, student number, and signature (you may be asked to show identification). Circle your TA section, day and time. For the multiple-choice portion of the examination, transfer the letter corresponding to each of your answers to the space provided on this page. **ONLY THESE ANSWERS WILL BE COUNTED, SO DOUBLE-CHECK CAREFULLY**. Answer the rest of the questions in the spaces provided. If any pages of this exam are loose, please print your name clearly on every page. USE APPROPRIATE DIAGRAMS (MODELS) WHENEVER POSSIBLE. Allow 1 minute per point = 75 minutes.

Name:_____

Student # _____

Signature: _____

Multiple Choice
Answers (Print Clearly)
2 points each

1A M 1	Richard Scheelings	1. ____	11. ____
1B M 2	Richard Scheelings	2. ____	12. ____
1C Tu 10	Joshua Wright	3. ____	13. ____
1D Th 4	Xiang Tang (Thomas)	4. ____	14. ____
1E Tu 9	Joshua Wright	5. ____	15. ____
1F W 8	Joshua Wright	6. ____	16. ____
1G W 2	Xiang Tang (Thomas)	7. ____	17. ____
1H Th 10	Richard Scheelings	8. ____	18. ____
1I Th 9	Ching Tai	9. ____	19. ____
1J Tu 2	Xiang Tang (Thomas)	10. ____	20. ____
1K F 10	Ching Tai		

SCORING:	Multiple Choice (20@2):	_____ /40
	Short Answer (7@5):	_____ /35
	TOTAL:	_____ /75

	Labor hours needed to make one unit of		Amount produced in 40 hours	
	Cheese	Bread	Cheese	Bread
England	1	2	40	20
Spain	2	8	20	5

1. Refer to the tables shown. England has a comparative advantage in _____ and Spain has an absolute advantage in _____.
   a. bread, cheese
   b. bread, neither good
   c. cheese, both goods
   d. both goods, cheese

2. Refer to the tables shown. If England and Spain trade based on the principle of comparative advantage, England will import _____ and Spain will import _____.
   a. bread, cheese
   b. bread, bread
   c. cheese, cheese
   d. cheese, bread

3. Factors of production are
   a. inputs into the production process.
   b. weather, social, and political conditions that affect production.
   c. the physical relationships between economic inputs and outputs.
   d. the mathematical calculations firms make to determine production.

4. An increase in the price of oranges would
   a. lead to an increased supply of oranges.
   b. lead to a movement up the supply curve for oranges.
   c. lead to an increased demand for oranges.
   d. lead to a reduction in the prices of inputs used in orange production.

5. If, at the current price, there is a shortage of a good,
   a. the price is below the equilibrium price.
   b. the market can be in equilibrium.
   c. sellers are producing more than buyers wish to buy.
   d. All of the above answers are correct.

6. When the price of a good or service changes,
   a. there is a movement along a stable demand curve.
   b. demand shifts in the opposite direction.
   c. demand shifts in the same direction.
   d. supply shifts in the opposite direction.

7. Suppose the price elasticity of demand for basketballs is 1.20. A 15 percent increase in price will result in
   a. an 18 percent decrease in the quantity of basketballs demanded.
   b. a 15 percent decrease in the quantity of basketballs demanded.
   c. an 8 percent reduction in the number of basketballs demanded.
   d. a 12.5 percent reduction in the number of basketballs demanded.

8. Water shortages caused by droughts can be lessened by
a. allowing price to equate the demand for water with the supply of water.
b. restricting water usage of consumers.
c. arresting anyone who wastes water.
d. imposing tight price controls on water.

9. Which of the following is the most correct statement about tax burdens?
a. A tax burden falls most heavily on the side of the market that is elastic.
b. A tax burden falls most heavily on the side of the market that is inelastic.
c. A tax burden falls most heavily on the side of the market that is closer to unit elastic.
d. A tax burden is distributed independently of relative elasticities of supply and demand.

10. Consumer surplus is
a. the quantity of a good consumers get free.
b. the amount a consumer has to pay less the amount the consumer was willing to pay.
c. the amount a consumer is willing to pay less the amount the consumer actually pays.
d. the total value of a good to a consumer.

11. The greater the elasticities of demand and supply
a. the smaller the deadweight loss from a tax.
b. the less intrusive a tax will be on a market.
c. the greater the deadweight loss from a tax.
d. the more equitable the distribution of a tax between buyers and sellers.

12. When a country allows trade and becomes an exporter of a good,
a. both domestic producers and domestic consumers are better off.
b. domestic producers are better off, and domestic consumers are worse off.
c. domestic producers are worse off, and domestic consumers are better off.
d. both domestic producers and domestic consumers are worse off.

13. When a quota is imposed on a market
a. the supply curve (above the world price) shifts to the right by the amount of the quota.
b. the supply curve (above the world price) shifts to the left by the amount of the quota.
c. the demand curve (above the world price) shifts to the right by the amount of the quota.
d. the demand curve (above the world price) shifts to the left by the amount of the quota.

14. Which of the following is an argument for restricting trade?
a. Trade restrictions make all Americans better off.
b. Trade restrictions increase economic efficiency.
c. Trade restrictions are necessary for economic growth.
d. Trade restrictions are necessary for national security.

15. An externality exists when
a. the government intercedes in the operation of private markets by forcing the market to adjust to the balance of supply and demand.
b. markets are not able to reach equilibrium.
c. a firm sells its product in a foreign market.
d. a person engages in an activity that influences the well-being of a bystander and yet neither pays nor receives payment for that effect.

16. Air pollution creates a negative production externality. As such,
a. welfare will be enhanced when some, but not all air pollution is eliminated.
b. social welfare is optimal when all air pollution is eliminated.
c. governments should encourage all private firms to consider only private costs.
d. the free market result maximizes social welfare.

17. Emission controls on automobiles is an example of
a. a Pigovian tax on automobiles, based on how much they pollute.
b. a command-and-control policy to increase social efficiency.
c. a policy that reduces pollution by allocating resources through market mechanisms.
d. a policy to reduce congestion on urban freeways.

18. According to the Coase theorem, private parties can solve the problem of externalities if
a. the cost of bargaining is small.
b. the initial distribution of rights favors the person being adversely affected by the externality.
c. the number of parties involved is sufficiently large.
d. All of the above are true.

19. Pigovian taxes and pollution permits are similar in that
(i) in both cases, firms pay for their pollution.
(ii) both internalize the externality of pollution by making it costly to pollute.
(iii) each policy allows for a market-based solution.
a. all of the above
b. (i) and (iii) only
c. (ii) only
d. (ii) and (iii) only

20. Producer surplus measures all of the following EXCEPT
a. the amount sellers receive above the minimum they would accept.
b. the benefit to sellers of participating in a market.
c. the amount sellers are paid less the amount they were willing to accept.
d. the total value of a good to sellers.

Short Answer Questions (5 point each). Use diagrams where appropriate.

1. Imagine that you are an economist in charge of economic analysis for the Environmental Protection Agency. A United States Senate Committee makes the following pronouncement: "Air pollution regulations are too severe. Their overall costs amount to more than society is collectively willing to pay for clean air. For example, every American car buyer should not have to pay more for their automobile so that residents of Los Angeles and Houston can enjoy cleaner air." Separate this statement into its normative and positive components and identify which part(s) your agency is willing to tackle through its research and which part(s) it should pass back to politicians to evaluate.

2. In an October 12, 2001, LA Times news item entitled "Discounters Help Sales Once Again," we learned that Wal-Mart Stores, Inc. and other "value-priced" retailers posted better-than-expected sales gains after September 11. "As expected, department stores, specialty apparel sellers and luxury goods merchants took the biggest hit...." Explain this phenomenon in terms of the economic concepts of "normal" and "inferior" goods, and use appropriate diagrams to illustrate what can be expected to happen to the quantities demanded from each of these two classes of retailers when household incomes are affected by world events.

3. In an October 16, 2001, LA Times news item entitled "Bethlehem Steel Seeks Bankruptcy Protection," we learned that the U.S. steel industry cites cheap imports as one of the factors contributing to its hardships. Suppose that the "problem" of low-cost foreign steel is addressed by the US imposing an import quota on foreign steel. Use an appropriate diagram to illustrate who will gain and who will lose as a result of such a quota, and by how much. Will there be any "deadweight loss" associated with such a policy?

4. An October 15, 2001, story in the LA Times entitled "Defense of the Homeland Comes with Hefty Price Tag" notes that "...the new danger could pose shearing dilemmas for lawmakers, particularly local officials who may find themselves having to choose between school textbooks and firefighter gas masks." Using a production possibility frontier that summarizes the US's ability to produce "homeland defense" as opposed to "all other goods and services," explain the difference between the pre-September 11 scenario and the post-September 11 scenario.

5. In an LA Times story of October 2, 2001, "Rental Car Firms Hit a Bumpy Road," the reporter points out that "the unexpected flow of rental vehicles into the resale market will have an impact on new-car sales." Use a series of three demand-supply diagrams, for the rental-car market, the used-car market, and the new-car market, to illustrate how responses to the events of September 11 have been propagated through these three markets. Be sure to explain each shifting curve and its consequences.

6. An October 5, 2001, story in the LA Times was entitled "33% Drop in Teen Smoking: Two-year study finds significant decline. Experts cite cultural change, higher costs." In the story, it is reported that "In 1998, tobacco companies agreed to pay $246 billion to settle lawsuits.... That contributed to higher prices." "The average price of a pack of cigarettes went from $1.85 in the beginning of 1997 to $2.92 at the end of 1999. Several studies have found that teens are particularly sensitive to the cost of cigarettes." Use a carefully labeled demand-supply diagram for the teen smoking market to illustrate (1) the effects of tobacco companies' increased costs, and (2) the additional impact of "cultural change" regarding attitudes by teens towards smoking. (Ensure that the overall effect on equilibrium prices and equilibrium quantities is as consistent as possible with the information in the title and the quotes.)

7. Challenging question: A subsidy per unit of production of some commodity can be viewed as the "opposite" of a tax, in that it "drives a wedge" between the price paid by consumers and the price received by sellers. But a subsidy means that the price received by sellers is larger than the price paid by buyers. An October 1, 2001, story in the LA Times, entitled "House May Weigh Strict Cap on Farm Subsidies" explain some serious flaws in the current U.S. agricultural subsidy program. Use an appropriate diagram to illustrate the consequences of a hypothetical per-unit subsidy of $s on cotton output for (1) quantities of cotton produced, (2) selling prices of cotton, (3) consumer surplus, (4) producer surplus, and (5) the cost to the government of running the subsidy program. Be sure to identify the "deadweight loss" of such a program.