

MIDTERM #3
May 2014

There are twenty-five multiple-choice questions, each worth ten points, and two non-multiple choice problems, each worth 25 points, for a total of 300 points. Pick the best answer for each multiple-choice question and mark it on your scantron with a number two pencil. Be sure to completely erase any incorrect answers that you change. Answer the computational and graphing problems on the test sheet. Be sure to write your name and lecture time on both the scantron and the test.

1. The additional satisfaction received from consuming one more unit of a product is known as:
 - a) diminishing marginal utility
 - b) marginal utility
 - c) total utility
 - d) natural gas and electricity utility

2. The idea that the less one consumes of a good or service, the more additional satisfaction one gets from consuming more can be explained by the economic concept of:
 - a) diminishing marginal utility
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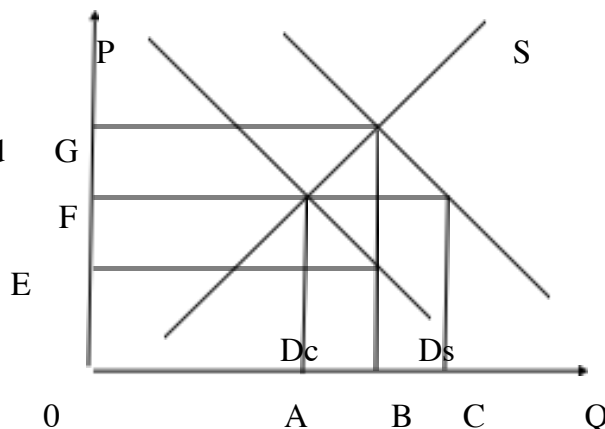
3. Which is NOT an example of a market failure?
 - a) The government cannot charge people for using a stop sign paid for by taxes.
 - b) The price of medical care has risen dramatically as a result of the introduction of sophisticated equipment and techniques.
 - c) Polio vaccines provide widespread benefits to the community as a whole as well as to the individuals who get them.
 - d) A foreclosure in a neighborhood can lower the property value of other homes.

4. The free-rider problem is when:
 - a) people jump the fare-booth or otherwise avoid paying for public transit.
 - b) people won't pay voluntarily what a public good is worth to them.
 - c) sellers of used cars know more about their condition than the buyers.
 - d) the FBI or local police put a GPS tracking system on your car without getting a court warrant.

5. Which of the following is most correct?
- a) almost all public goods are provided by the government.
 - b) almost all goods and services provided by the government are public goods.
 - c) both (a) and (b) are true.
 - d) neither (a) nor (b) is true.
6. Another example of a market failure in labor markets discussed in our microeconomics class is:
- a) why there is usually cyclical unemployment.
 - b) how monopsonies (when there is only one buyer) in the labor market can affect wages and employment.
 - c) how many workers don't know about on-the-job hazards.
 - d) the issue of private quasi-goods
7. Which would NOT be an example of an adverse selection problem?
- a) a person in ill health is more likely to buy disability insurance.
 - b) a life insurance company knows less about your family health history than the buyer of life insurance.
 - c) a person with a new car with lots of problems is more likely to sell it.
 - d) buying a product that contributes to pollution.
8. The market for education has a positive externality so that a free market will produce:
- a) less than the socially optimal amount ("too little")
 - b) the same as the socially optimal amount.
 - c) more than the socially optimal amount ("too much")
 - d) none at all.
9. A government mandate on the production or consumption of a good or service would be a good example of a response to:
- a) a negative externality.
 - b) a positive externality.
 - c) a public good.
 - d) moral hazard.
10. The "cap and trade" system could be best described as:
- a) a type of tax on pollution.
 - b) a type of direct control on pollution.
 - c) both (a) and (b)
 - d) neither (a) nor (b), it is mainly to raise revenues for the government.

11. Refer to the supply and demand graph to the right. In the graph, D_c is the demand curve based on benefits to the consumer, and D_s is the demand curve based on total or social benefits. The socially optimal quantity of production and consumption of the good or service would be:

- a) 0A
- b) 0B
- c) 0C
- d) 0G



12. Having clear property rights, a small number of parties, and almost no negotiating costs are necessary to deal with externalities by:

- a) passing a law to impose a tax.
- b) passing a law to impose a government mandate.
- c) getting a good settlement out of court after filing a lawsuit.
- d) using the Coase Theorem

13. The distribution of income in the United States is:

- a) less unequal than the distribution of income thirty years ago.
- b) more unequal than the distribution of income thirty years ago.
- c) about the same as the distribution of income thirty years ago.
- d) depends on the measure of income used for comparison.

14. The distribution of income in the United States is:

- a) less equal than the distribution of wealth.
- b) more equal than the distribution of wealth.
- c) about the same as the distribution of wealth.
- d) depends on the measure of wealth and income used for comparison.

15. The official poverty line, or OPL, was developed in the 1960s using data from the 1950s. The OPL is adjusted each year based on the change in food prices and takes into account the size of the family, but not for the greater increase in the price of housing, health care, transportation and other non-food items or the local cost of living. This leaves the OPL too low. In response to this problem, the government has:

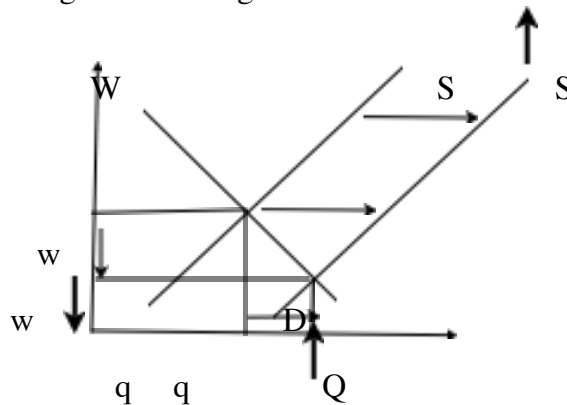
- a) developed the "Supplemental Poverty Measure"
- b) set the cut-off for social welfare programs at 130% of the OPL or more.
- c) both (a) and (b)
- d) neither (a) nor (b).

16. The Lorentz curve shows a more EQUAL distribution of income when:

- a) the area between the diagonal and the Lorentz Curve is small.
- b) the area between the diagonal and the Lorentz Curve is large.
- c) the Lorentz curve is above and to the left of the diagonal.
- d) the Lorentz curve is the same as the edges of the diagram.

17. The change in the U.S labor market as shown in the graph could be caused by:

- a) more retired people going back to work.
- b) more young people deciding to go to college full time and not work.
- c) an economic expansion in the United States.
- d) a recession in the United States



18. The idea that lowering the minimum wage would lead to more jobs is based on:

- a) the model of supply and demand
- b) the theory of efficiency wages
- c) data from studies of fast food restaurant employment
- d) the U.S. constitution

19. When there are significant differences in wages paid to two groups of workers with similar human capital, economists could explain this by:

- a) price discrimination
- b) residential segregation
- c) discrimination in access to education
- d) labor market discrimination

20. Occupational segregation, where women are crowded into only a few occupations, leads to lower wages for women by:

- a) decreasing the supply of labor in those occupations.
- b) decreasing the demand for labor in those occupations.
- c) increasing the supply of labor in those occupations.
- d) increasing the demand for labor in those occupations.

21. According to Marx, workers are paid:

- a) for the value of the product created by their labor, which is based on how much capital and raw materials that they have to work with and how much the product brings in the market.
- b) for their education, skills, experience, etc. which makes them more productive.
- c) for their labor power, or ability to work, which is based on what is needed to sustain the worker and his/her family, so that the worker get paid less than what he/she produces and the capitalists take the difference as profit.
- d) for their labor power, or ability to work, which is the absolute physical minimum needed to live on.

22. Social welfare programs differ from social insurance programs in that social welfare programs:

- a) do NOT limit participation by income and wealth (while social insurance programs DO limit participation by income and wealth).
- b) DO limit participation by income and wealth (while social insurance programs do NOT limit participation by income and wealth).
- c) are paid in kind (with goods or services) while social insurance programs pay cash.
- d) have generally higher benefit levels than social insurance programs.

23. Redistribution of income to make it more UNEqual would:

- a) increase total satisfaction of the population
- b) provide less incentives for work
- c) provide less of a consumer market for new and expensive technology
- d) decrease the total satisfaction of the population

24. Which of the following is true about Social Security (OASDI)? Social Security:

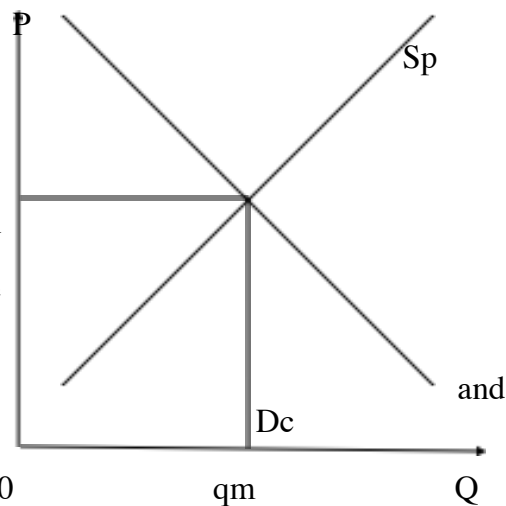
- a) Pulls few people out of poverty AND spends more than other programs.
- b) Pulls few people out of poverty BUT spends less than other programs.
- c) Pulls more people out of poverty AND spends more than other programs.
- d) Pulls more people out of poverty BUT spends less than other programs.

25. When one compares the loss of Federal tax revenues from tax deductions for home owners to the Federal government spending on subsidies for renters:

- a) high and middle income home-owners get more help from the Federal government.
- b) low income renters get more Federal government aid.
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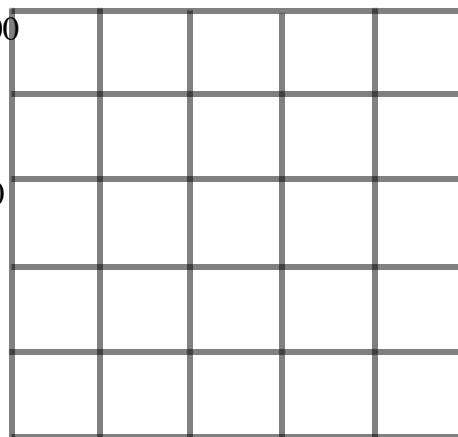
Answer all parts of questions 26 and 27 on the test sheet.

26. **Market Failures:** Use the graph to the right to show the costs of air pollution from producing and consuming gasoline. On the graph (a) draw and label the total or social cost curve - S_t - that includes the external cost; (b) show the optimum price and quantity for gasoline - p_o , q_o , - when external costs are taken into account; (c) show and label the external cost on the graph; (d) show and label the excess quantity produced by the free market as compared to the social optimum quantity; and (e) show label the government tax or subsidy (be sure to state the right one) needed to correct for the external cost in the market for gasoline. (5 points each part, 25 points total)



27. Arnold, Betty, Christine, Donald, and Elena receive incomes of \$50, \$300, \$100, \$400, and \$150. Fill in the income distribution table below, and then use this information to complete the Lorenz curve below. (25 points total)

population share (%)	income	cumulative income (%)	
top 20%	_____	100%	_____
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4th 20%	_____	bot. 40%	_____
bot. 20%	_____	bot. 20%	_____



(note bot. = bottom)

- fill in the income share based on the data above.
 - fill in the cumulative income share based on the data.
 - draw and label the line of total equality on the graph above.
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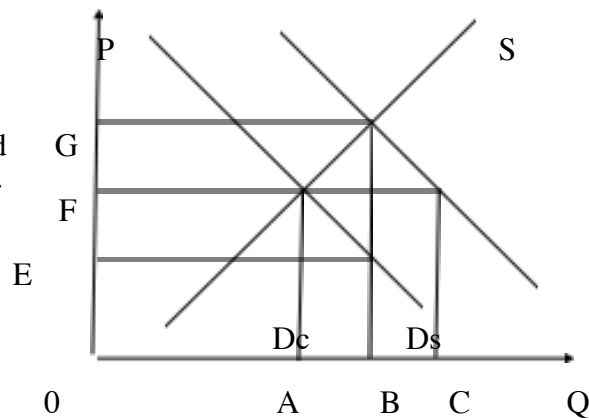
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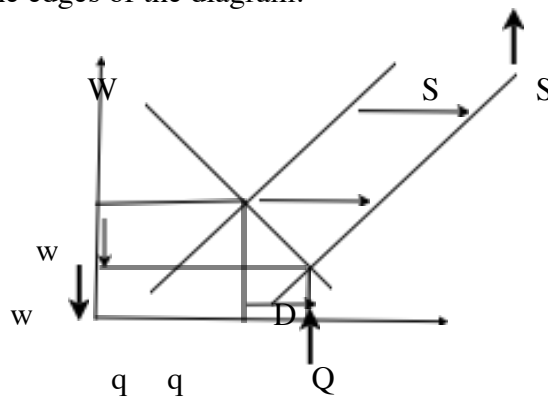
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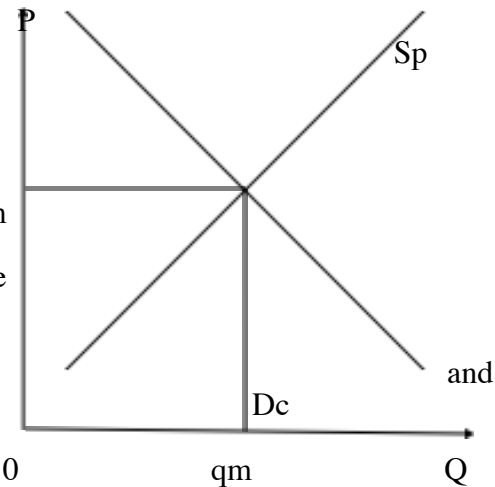
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bot. 20%	_____	bot. 20%	_____

(note bot. = bottom)

0 20 40 60 80 100
population share

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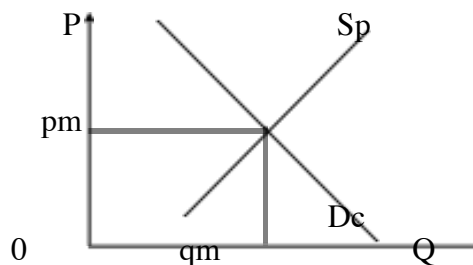


MIDTERM REVIEW #3

Midterm #3 is on May 1st. The midterm will cover the topics: consumer behavior (Ch. 6), market failures (Ch. 5, pp. 99-111 and Ch. 17, pp. 358-361); externalities and government policy (Ch. 5, pp. 104-108); wages, human capital, and discrimination (Ch. 13, pp. 267-271 and 277-281, chapter 20, pp. 424-429); economic inequality and redistribution (Ch. 20, pp. 411-424 and 428, Worldly Philosophers chapter 6). Please answer the following questions to prepare for the test. We will discuss their answers the class before the test.

1. Consumer Behavior: Text, chapter 6, page 131, question 6.
2. Public Goods: Use your understanding of the characteristics of private goods and public goods to classify the following as public goods, quasi-public goods, or private goods. (a) bread; (b) street lighting; (c) bridges. Why are public goods generally provided by the government?
3. Market Failures: Text, Ch. 17, p. 371, question 3, parts (b) and (c).

4. Market Failures: On the graph to the right, S_p is the supply curve based on cost of schools, D_c is the demand curve based on students' benefits. Show the positive externality of education with the social benefit demand curve, D_s , the external benefit, and the optimal price P_o and quantity Q_o .

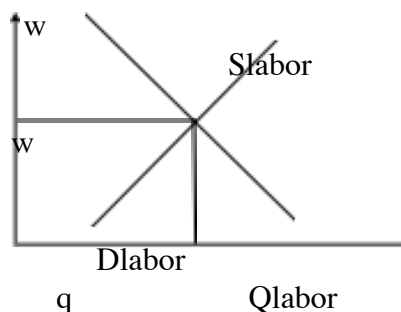


What would be the correct amount of subsidies to correct for the external benefit and achieve the social optimum? What is the price and quantity produced under a free market as compared to the social optimum?

5. Externalities: Explain the alternatives to taxes and subsidies to deal with externalities.
6. Income inequality: Text, chapter 20, page 430, question #2. How has the distribution of income in the United States changed over time? How does the distribution of wealth compare with the distribution of income in the United States?
7. Poverty: What is the official U.S. poverty line? To what extent does the official measure accurately measure poverty?

8. Labor Market: How would an increase in the number of young people going to college affect the labor market right now? Use a supply and demand diagram to explain what would happen to wages and the number of employed.

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9. Labor Market: What does the supply and demand model of the labor market say about minimum wages?

10. Labor Market: What is the theory of human capital? What is labor market discrimination? What is occupational segregation?

11. Marxist and Mainstream views: Compare and contrast the mainstream microeconomic view of wages with the Marxist view of wages.

12. Income inequality: What is the economic argument for a more equal income distribution? What is the economic argument for more unequal income distribution?

13. Redistribution: What is the difference between social insurance and social welfare programs? What are the most significant (in terms of spending and numbers of people) income redistribution program? How spending compare on social insurance and social welfare programs?

