The exam contains of two sections. The first section consists of 15 multiple choice questions (45 points). The second section contains four short answer questions (30 points). All of your responses should reflect the perspective of an economist.

Please be reminded: by enrolling in this course, you have assumed the responsibilities of an active participant in UMBC’s scholarly community in which academic work and behavior are held to the highest standards of honesty and integrity. Cheating, fabrication, plagiarism, and helping others to commit these acts are all forms of academic dishonesty and are not acceptable. Academic misconduct may result in disciplinary action, including but not limited to, suspension or dismissal.

Good luck!

TOP 10 REASONS TO STUDY ECONOMICS

1. Economists are armed and dangerous: “Watch out for our invisible hands.”
2. Economists can supply it on demand.
3. You can talk about money without ever having to make any.
4. You get to say “trickle down” with a straight face.
5. Mick Jagger and Arnold Schwarzenegger both studied economics and look how they turned out.
6. When you are in the unemployment line, at least you will know why you are there.
7. If you rearrange the letters in “ECONOMICS”, you get “COMIC NOSE”.
8. Although ethics teaches that virtue is its own reward, in economics we get taught that reward is its own virtue.
9. When you get drunk, you can tell everyone that you are just researching the law of diminishing marginal utility.
10. When you call 1-900-LUV-ECON and get Kandi Keynes, you will have something to talk about.
Section I: Multiple Choice. Please circle the most appropriate answer. (80 points)

1. Economics is the study of
   a. how to fully satisfy our unlimited wants.
   b. how society manages its scarce resources.
   c. how society manages its unlimited resources.
   d. how to reduce our wants until we are satisfied.
   e. how to avoid having to make tradeoffs.

2. In making which of the following statements is an economist acting more like a scientist?
   a. A reduction in unemployment benefits will reduce the unemployment rate.
   b. The unemployment rate should be reduced because unemployment robs individuals of their dignity.
   c. The rate of inflation should be reduced because it robs the elderly of their savings.
   d. The state should increase subsidies to universities because the future of our country depends on education.
   e. None of the above. Economists study human behavior - they are not scientists.

3. Suppose two economists are arguing about policies that deal with unemployment. One economist says, “The government should fight unemployment because it is the greatest social evil.” The other economist responds, “Hogwash. Inflation is the greatest social evil.” These economists
   a. disagree because they have different scientific judgements.
   b. disagree because they have different values.
   c. really don’t disagree at all. It just looks that way.
   d. a and b.
   e. none of the above.

4. Foreign trade
   a. allows a country to have a greater variety of products at a lower cost than if it tried to produce everything at home.
   b. allows a country to avoid tradeoffs.
   c. makes a country more equitable.
   d. increases the scarcity of resources.

5. According to trade theory,
   a. if you protect domestic producers in one industry from foreign competition, then you will harm domestic producers in other industries.
   b. if you protect domestic producers in one industry from foreign competition, then there will be a net loss in economic efficiency.
   c. trade can make everyone better off.
   d. trade is a form of production.
   e. all of the above.

6. Which of the following statements is true about a market economy?
   a. Market participants act as if guided by an “invisible hand” to produce outcomes that maximize social welfare.
   b. Taxes help prices communicate costs and benefits to producers and consumers.
   c. With a large enough computer, central planners could guide production more efficiently than markets.
   d. The strength of a market system is that it tends to distribute resources evenly across consumers.
   e. none of the above statements is true.

7. If a benevolent social planner chooses to produce less than the equilibrium quantity of a good, then
   a. producer surplus is maximized.
   b. consumer surplus is maximized.
   c. total surplus is maximized.
   d. the value placed on the last unit of production by buyers exceeds the cost of production.
   e. the cost of production on the last unit produced exceeds the value placed on it by buyers.
8. An inefficient policy
   a. does more harm than good.
   b. always entails a missed opportunity to make everyone happier.
   c. will result if policy makers consider the feelings of the parties involved instead of making decisions on the basis of profit considerations alone.
   d. all of the above.
   e. a and b.

9. If nominal GDP in 2000 exceeds nominal GDP in 1999, then the production of output must have
   a. risen.
   b. fallen.
   c. stayed the same.
   d. indeterminate.

10. Which of the following would be excluded from 1999 GDP? The sale of
    a. a 1999 Mazda produced in Illinois.
    b. a lawyer’s services.
    c. a home built in 1999.
    d. paper purchased by Hallmark to make greeting cards.

The following table contains information about an economy that produces only pens and books. The base year is 1998. Use this information for questions 11 and 12.

<table>
<thead>
<tr>
<th>Year</th>
<th>Price of Pens</th>
<th>Quantity of Pens</th>
<th>Price of Books</th>
<th>Quantity of Books</th>
</tr>
</thead>
<tbody>
<tr>
<td>1998</td>
<td>$3</td>
<td>100</td>
<td>$10</td>
<td>50</td>
</tr>
<tr>
<td>1999</td>
<td>$3</td>
<td>120</td>
<td>$12</td>
<td>70</td>
</tr>
<tr>
<td>2000</td>
<td>$4</td>
<td>120</td>
<td>$14</td>
<td>70</td>
</tr>
</tbody>
</table>

11. What is the value of nominal GDP for 1999?
    a. $(3 \times 100) + (10 \times 50) = 800$.
    b. $(3 \times 120) + (12 \times 70) = 1200$.
    c. $(4 \times 120) + (14 \times 70) = 1460$.
    d. $(3 \times 120) + (10 \times 70) = 1060$.
    e. $(3 \times 100) + (12 \times 50) = 900$.

12. What is the value of real GDP for 1999?
    a. $(3 \times 100) + (10 \times 50) = 800$.
    b. $(3 \times 120) + (12 \times 70) = 1200$.
    c. $(4 \times 120) + (14 \times 70) = 1460$.
    d. $(3 \times 120) + (10 \times 70) = 1060$.
    e. $(3 \times 100) + (12 \times 50) = 900$.

13. If prices rise, people’s income from selling goods increases. The growth of nominal GDP captures this gain, while the growth of real GDP ignores it. Why then do economists prefer real GDP over nominal GDP as a measure of economic well-being?
    a. because nominal GDP excludes non-market activities.
    b. because nominal GDP does not include the value of leisure time.
    c. because real GDP is easier to compute than nominal GDP.
    d. because real GDP reflects the economy’s ability to satisfy people’s need and desires.
    e. none of the above - economists actually prefer nominal GDP over real GDP as a measure of economic well-being.
14. If there is an increase in the price of apples, the CPI will likely suffer from
   a. substitution bias, and overstate the cost of living.
   b. substitution bias, and understate the cost of living.
   c. bias due to unmeasured quality change, and overstate the cost of living.
   d. bias due to unmeasured quality change, and understate the cost of living.
   e. base year bias.

15. If inflation is 8% and the real interest rate is 3%, then the nominal interest rate is
   a. 3/8%.
   b. 5%.
   c. -5%.
   d. 11%.
   e. 24%.

Section III: Short Answer. Please write your responses in the space provided on the exam. Your answers should be concise, yet complete. (30 points)

1. What is macroeconomics?

2. Answer the following trade-related questions.
   a. Draw a graph of a country that is an importer of steel. Be sure to label all relevant features of your graph clearly.

b. Explain intuitively what happens to consumer surplus, producer surplus, and total welfare if a country in autarky opens its steel market to trade and becomes an importer of steel.
c. Comment on the following statement: “Free trade is beneficial only if your country is strong enough to stand up to foreign competition.”

3. Answer the following GDP-related questions.
   a. List the four components of GDP. Give an example of each.
   b. Suppose that Ford sells a Thunderbird from its inventory. What components of GDP (if any) would be affected?
   c. Real GDP per person in Bangladesh in 1997 was around $1000. Real GDP per person in the U.S. in 1997 was around $30,000. Does this mean that the average American has a standard of living that is 30 times greater than the average Bengali? Explain.
4. Answer the following cost of living-related questions.
   a. What is the Consumer Price Index?

   b. What is inflation?

   c. Consider the following statement. “Inflation is bad because it redistributes income arbitrarily.” As an economist, do you agree? Explain.