Name: \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

Econ 304—Bethany College

**Exam 01**

* There are 110 possible points on this exam. The test is out of 100.
* You have one hour to complete this exam, but you should be able to complete it in less than that
* Please turn off all cell phones and other electronic equipment.
* You are allowed a calculator for the exam. This calculator cannot be capable of storing equations. This calculator cannot double as a cell phone.
* Be sure to read all instructions and questions carefully.
* Remember to show all your work.
* Recall basic logic. “Water is wet” is a true statement. “Water is wet and leopards have stripes” is a false statement.
* *Please print clearly and neatly.*

**Part I: Multiple Choice.** *Choose the best answer to the following.*

4 points each.

1. In the long run, how much profit does a firm in a perfectly competitive industry make?
	1. Zero accounting profit
	2. Zero economic profit
	3. A positive accounting profit which is also equal to their opportunity cost
	4. B & C
	5. None of the above
2. Which of the following is ***not*** an assumption of Walrasian equilibrium?
	1. Everyone produces based on their opportunity cost
	2. No one has price setting power
	3. Prices are stable
	4. A & C
	5. None of the above
3. Leon Walras is famous for his work in developing which economic concept?
	1. Pareto efficiency
	2. General equilibrium theory
	3. Edgeworth boxes
	4. A & C
	5. None of the above
4. Which of the following is an example of a Pareto improvement?
5. Burning down a house no one knew even existed.
6. Taxing the wealthy and giving to the poor (since the wealthy value an additional dollar less).
7. Playing your favorite music excessively loudly.
8. A & C
9. None of the above
10. What do all points on a contract curve have in common?
11. All points are Pareto efficient
12. All points are Pareto improvements
13. All points have the same MRS
14. B & C
15. None of the above
16. If total cost is 4+Q2 and total revenue is 3Q, what is the optimal amount of Q?
17. 0.25
18. 0.67
19. 1.50
20. 4.00
21. None of the above
22. If a new hire discovers he can lessen his workload without penalty by exaggerating how long it takes to complete a project and starts doing so, this is an example of:
	1. Moral hazard
	2. Adverse selection
	3. Why firms monitor workers
	4. A & C
	5. None of the above
23. Which of the following is a problem with Nozick’s Entitlement Theory of Justice?
	1. People like different things.
	2. There is a danger that you discourage hard work.
	3. A government can’t maintain a court system.
	4. A & B
	5. None of the above

**Part II: True/False.** *Answer true or false, and justify your answer.*

10 points each.

1. Edgeworth boxes make different assumptions of indifference curves which is why some indifference curves are concave.

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1. If the only way to signal wealth is by purchasing a nice house and the price of houses decreased, in the long run more people would be able to signal wealth.

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1. Without skeptics, ordeals ensured a completely just and efficient justice system in the Middle Ages.

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**Part III: Short Answer.** *Answer the following.*

16 points each.

1. Sketch the contract curve of the Edgeworth Box below. If Alpha is an owner of a successful company that gets many subsidies from the government, where should we prioritize the allocation under Nozick, Rawls, and Utilitarianism (assume Beta is a middle class plumber)?

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Waterα

Powerα

0

100

0

100

Powerβ

Waterβ

100

100

0

0

**0**

**4**

**6**

**10**

**0**

**5**

**8**

**11**

**6**

**3**

**1**

**9**

1. We discussed many reasons why the American healthcare system is screwy. Suppose the U.S. switched to a government health system (the government pays for healthcare for everyone in the manner of Medicare). Discuss a way this would be better than the current system (excluding the Affordable Healthcare Act) and a way this would be worse.

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1. In the market for lemons, Akerlof used these utility functions…

$$U\_{1}=M+\sum\_{i=1}^{N}x\_{i}; U\_{2}=M+\frac{3}{2}\sum\_{i=1}^{N}x\_{i}, $$

…to construct these equations…

$$μ=^{p}/\_{2}$$

$$S\_{1}=^{pN}/\_{2} , p\leq 2$$

$$D\_{1}=^{Y\_{1}}/\_{p} , ^{μ}/\_{p}>1$$

$$D\_{1}=0 , ^{μ}/\_{p}<1$$

$$S\_{2}=0$$

$$D\_{2}=^{Y\_{2}}/\_{p} , ^{3μ}/\_{2}>p$$

$$D\_{2}=0 , ^{3μ}/\_{2}<p$$

Where S and D are the demand and supply curves, p is price, μ is average quality, and Y is income. Write Akerlof’s conclusion (as in, write the combined demand curves for the different relations between p and μ). Suppose we assume that people aren’t good at remembering the good cars they’ve encountered but the bad ones stick out in their minds. In other words, “average quality” for our purposes is lower than a uniform distribution would normally suggest. Suppose μ=¼p rather than μ=½p. Find the combined demand curves under these circumstances. Has Akerlof’s conclusion changed? Why or why not?