ECON 306-007 Name:_____
Midterm
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Instructions: All questions are weighted equally. Answer them perfectly.

1. True/False/Depends, and explain: Economic theory conclusively demonstrates that any inefficient outcome is undesirable.

2. True/False/Depends, and explain: According to the Law of Demand, if the price of lemons increases, demand for lemons will decrease.

3. Distinguished GMU economist Gordon Tullock says, "If you really want to save as many lives as possible on the highways, you should mandate that each steering-wheel column have a steel dagger jutting out with its point just inches from the driver's heart." What assumption is Tullock making about the demand curve for careless driving?

4. Ignore whether Tullock's assumption is correct, and assume that a technological breakthrough is made that enables automobiles to achieve better crash safety ratings. Using economic theory, what predictions can you make?

5. Suppose a minimum wage is enacted that is above the market-clearing price for unskilled labor and below the market-clearing price for skilled labor. Ceteris paribus, who benefits? Who is hurt?

6. Noted GMU economist Walter Williams argues, "Short of aerial bombardment, the best way to destroy a city is through rent control." Explain what Williams means.

7. Draw a demand curve that exhibits unit elasticity.

8. A demand curve is described by the equation $Q = 10 - 2P$. Derive an expression for the price elasticity of demand.

9. True/False/Depends, and explain: any Pareto improvement is also a Kaldor-Hicks improvement.

10. What is measured by the cross-price elasticity of demand?

11. True/False/Depends, and explain: When real income increases, the demand for any good also increases.

12. True/False/Depends, and explain: For a normal good, the income effect of a price change always reinforces the substitution effect.

13. Is demand more or less elastic in the long run than in the short run? Why?

14. Al has utility described by $U_A = XY^2$. Bob has utility described by $U_B = X^{1/3}Y^{2/3}$. The have the same income and face the same prices for X and Y. In what systematic way(s), if any, will their consumption decisions for X and Y vary? Why?

15. Steve likes candy, but doesn't care one way or the other about pie. Draw a plausible indifference map for Steve for candy and pie.

16. Sarah's utility is described by $U = X^2Y + 3$. Find an expression for her marginal rate of substitution between X and Y (MU_X/MU_Y).

17. Sarah's income is 60. The price of X is 2 and the price of Y is 3. Write an expression for her income constraint or budget line.

18. Using the information from the previous two questions, how much of X and Y will Sarah consume?

19. True/False/Depends, and explain: A good may exhibit Giffen demand only if it is inferior and constitutes a small portion of the budget.

20. Eli's marginal utility of dark chocolate is 5. His marginal utility of Spanish ham is 10. The price of dark chocolate is 2, and the price of Spanish ham is 6. To maximize utility, what should Eli do?

21. True/False/Depends, and explain: When constructing a demand curve for any good, the price of other goods is constant.

22. Is it possible for all goods to be inferior for a given individual? Explain.

23. A demand curve is described by the equation $Q = 20 – 2P$. Find the consumer surplus as a function of price. If this is too hard, find the consumer surplus when $P=5$ for partial credit.

24. Who benefits from higher interest rates? Why?

25. True/False/Depends, and explain: Because matter can neither be created nor destroyed, voluntary exchange makes one party better off and one party worse off.