

ARE 201 Spring 2009 Exam #1 Answer Sheet

MULTIPLE CHOICE (3 points each)

1. a
2. c
3. a
4. a
5. b
6. c
7. d
8. a
9. b
10. a
11. d
12. a
13. d
14. c
15. c
16. a
17. d
18. c
19. d
20. c

TRUE/FALSE (2 points each)

1. F
2. T
3. F
4. T
5. T
6. F
7. T
8. F
9. F
10. F

SHORT ANSWER

APPLICATION/SCENARIO (8 points for first and 12 points for second)

1. ANSWER: Efficiency is the property of society getting the most it can from its scarce resources. Equity is defined as the property of distributing economic prosperity fairly among the members of society. Often, these two goals conflict. When the government redistributes income from the rich to the poor, it reduces the reward for working hard. Fewer goods and services are produced and the economic pie gets smaller. When the

government tries to cut the economic pie into more equal slices, the pie gets smaller. Policies aimed at achieving a more equal distribution of economic well-being, such as the welfare system, try to help those members of society who are most in need. The individual income tax asks the financially successful to contribute more than others to support the government.

2. ANSWER:

- a. If George and Martha divide their time equally, George would be able to produce 2 brownies and 4 cupcakes and Martha would be able to produce 4 brownies and 2 cupcakes.
- b. George has a comparative advantage in and would produce cupcakes. With 8 hours, he can produce 8 cupcakes. Martha has a comparative advantage in and would produce brownies. With 8 hours, she can produce 8 brownies.
- c. Since George is producing 8 cupcakes and no brownies, if he trades 3 cupcakes, he would be left with 5 cupcakes and would expect to receive 3 brownies from Martha in return. Since Martha is producing 8 brownies and no cupcakes, if she trades 3 brownies, she would be left with 5 brownies and would expect to receive 3 cupcakes from George in return.
- d. We know that both George and Martha are better off with trade because both are able to consume both more brownies and more cupcakes in case c than in case a.