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Economics 202

Midterm #1: Old Exam Solutions

1. d
2. c
3. a
4. e
5. b
6. c
7. e
8. a
9. b
10. d
11. c
12. d
13. c
14. a
15. c
16. b
17. d
18. b
19. d
20. b
21. d
22. a
23. b
24. c
25. d
26. c
27. a
28. c
29. d
30. b
31. e
32. a
33. d
34. a
35. c
36. d
37. b
38. a
39. c
40. c

Part 2. Solutions to the Short Answer Questions

Question 1. There is no shift in the PPC, simply movement from point to point along the curve, toward tractors and away from automobiles.

Question 2. There is an inward shift in the curve, but only for one tractors. The shift (decrease) shows lower levels of tractor production for every unit of automobile produced, until you get to the point where you would be specializing in automobiles. We also refer to this as a pivot, where all points but the intercept point on the automobiles axis will shift inward.

Question 3. There is an outward shift in the curve, but only for one good (automobiles). The shift (increase) shows higher levels of potential in automobile production for each unit of tractor produced, until you get to the point where only tractors are produced. Again, we refer to this as a pivot, and in this case, a pivot outward for automobiles.

Question 4. There is an outward shift in the curve for both automobiles and tractors. More factors implies a greater potential, but for both goods.

Question 5. From the sound of this situation, it would appear that Country A has a comparative advantage in producing tractors. This would be true if their opportunity cost of producing tractors is lower than that of other countries. According to the Law of Comparative Advantage, once Country A finds a country with a comparative advantage in producing automobiles, not tractors, then each country should specialize in producing the good where they have that comparative advantage.

After specializing, both countries can trade amongst themselves. This allows each country to consume at a point located outside of their PPC and make it possible for Country A to consume more of both tractors and automobiles.

Question 6. When it comes to loans, the bank is a creditor (i.e., a lender). Borrowers are always better off with inflation and creditors worse off, because inflation erodes the value or purchasing power of the money being repaid. As a creditor, the bank would typically have an incentive to raise interest rates, so that when borrowers pay back their loans, this money will have the same "real value" or purchasing power as before the inflation. However, when inflation changes unexpectedly, the bank does not realize that inflation has occurred, and they are unable to increase interest rates at the moment inflation first takes place.