

Answers to Test #2

- A. (1) False. After deregulation occurred, many new entrants came in, and even under deregulation, there were multiple firms operating profitably. Thus no reason to believe that the cost curve structure in this industry is consistent with the natural monopoly model.
- (2) True. This is an exact quote from Ch. 22, p. 493. If this holds, international productivity (and per capita output) differences will shrink over time
- (3) False. A decrease in net exports indicates a decrease in exports and/or an increase in imports, both of which cause national income to fall.
- (4) False. The aggregate supply curve would have to be vertical for this to happen. Instead, only output, not the price level, will change when aggregate supply is horizontal.
- B. (1) $PV = X/(1 + i)^N = \$100/(1.1) = \90.90
- (2) Cases where marginal social cost > marginal private cost if there is no intervention in the market. E.g., pollution (noise, air, water).
- (3) Any good that is rivalrous but nonexcludable. Examples given in class include Foss Hill and global warming.
- (4) multiplier = $1/(1 - b) = 1/(1 - MPC) = 1/(1 - .9) = 1/.1 = 10$
- C. (1) c (2) b (3) b (4) d (5) b
- D. (1) $AD = C + I + G + NX$ (2) C; NX
- (3) I; fluctuating business confidence, which is dependent on (changing) expectations about the future
- (4) $DI = Y - T$ (or = $GDP - Taxes + Transfers$); the government sets the tax and transfer amounts/rates
- E. (1) and (2) As in Figure 26-5 on p. 558, the economy is first at point F, then point E.
- (3) The price level rises (there is inflation) and real GDP drops.
- (4) The economy moves back to point F as wages are cut and the SRAS shifts back down.