

The missing half hour of class on 1/31 will be made up by not going over Homework #3 in class. Instead you will get an answer key.

This review sheet is intended to cover everything that could be on the exam; however, it is possible that I will have accidentally left something off. You are still responsible for everything in the chapters covered except anything that I explicitly say you are not responsible for. Therefore, if I left something off of this sheet, it can still be on the exam. There will be no multiple-choice questions. Most of the questions will be like the ones in the homework assignments, and possibly a few definition questions, but I am more likely to ask questions that make you use the definitions rather than recite them. I will probably ask one of the questions from the book at the end of the chapters.

The review session will be at a time to be determined in class, probably Wednesday 2/6.

Chapter 1: What are economics, macroeconomics, microeconomics, and wants? Know the difference between positive and normative statements. What is meant by **incentives**, **models**, **theories**, and **ceteris paribus**? What is important about them? From the appendix, know how to **plot a straight line**, **calculate the slope** of any line including curves, and know what we mean by **direct** and **inverse relationships**.

Chapter 2: What are scarcity, land, labor, physical capital, human capital, entrepreneurship, goods, and services? **“Opportunity costs” is the first of the great ideas in this course that helps this course qualify for fulfilling the Contemporary Society and Institutions requirement for graduation from Bethany College. Therefore, it is one of the most important parts of this course.** What are **opportunity costs**? How do we see them? Note that opportunity costs are what you would have done with the time and resources. What is the PPC (or as I prefer to call it, the **PPF**)? Why does it take its shape? How does it show the opportunity costs? Where do we see **efficiency**, **inefficiency**, and **unattainable** sections of the graph? What moves it? What explains the law of increasing relative costs? How does the trade off between current consumption and capital goods affect future output? What are **absolute advantage** and **comparative advantage**? What is the **law of comparative advantage**?

Chapter 3: **“Supply and demand analysis” is the second of the great ideas in this course that help this course qualify for fulfilling the Contemporary Society and Institutions requirement for graduation. Therefore, it is one of the most important parts of this course.** What determines demand? What is the **“law of demand”**? What do **“demand schedule”** (a.k.a. table) and **“demand curve”** represent? What moves the demand curve and what causes movements along the curve? Ignore inferior goods. Answer the **above questions for supply**. ***Note that one of the two most common errors students make on questions is to get confused between movements along a curve and movements of a curve. Price changes cause movements along the curve.*** Since the list of things that move supply and the list of things that move demand are almost mutually exclusive (excluding expected future prices), you should almost never move both curves. Move one and move along the other one. One note, the costs of production include the opportunity costs of producing another good. We called this the price of a substitute in production. For example, if the price of another good that they could produce goes up, then the cost of resources used to produce both go up and that reduces supply of the good you are analyzing. This is one way that the costs of inputs can go up. Also, a change in the selling

price of a complement in production will encourage or discourage production of the good, thus will move supply. A complement in production is something that you produce with it. *The other error common to students in this course, is to move the supply curve the wrong way. Note that because the graph has the dependent variable on the horizontal axis, it moves right and left.* Know what equilibrium is and how it is achieved. What are **shortages** and **surpluses**?

Chapter 4: What is a **price system**? Ignore voluntary exchange, transaction costs, and terms of exchange. Like most things we skip in these early chapters, they are important for microeconomics but not for macroeconomics. Be able to show movements of supply and demand on the same diagram. If you do not draw both supply and demand, then I will take off points. Also, label all axes and lines. How do we **ration goods**? What are other methods of rationing? What are the economic effects of **price ceilings, price floors, taxes, and quotas**? Be able to show them on the supply and demand graph. Use the graphs to explain the problems they cause, how those problems are solved without government action, and what the government can do to relieve those problems.

Chapter 5: What are **negative externalities** and **positive externalities**? How are they seen on the graph? What is the best way to offset them? Show that on the supply and demand diagram. Know the economic reasons for **providing a legal system, promoting competition, providing public goods, and income redistribution**. Know what **government sponsored** and **government deterred goods** are. What is the difference between **voting** and **spending**?

Non-graded Homework Assignment #3A to be reviewed with Assignment #3.

1) (25 points) Draw the S/D diagram for gasoline which creates a negative externality. Prove the market will not produce the socially optimal quantity of gasoline. Illustrate the method economists say is best for solving the problem. Explain why the diagram changes as drawn and why it creates the socially optimal point.

2) (10 points each) For each of the following, tell me what it means and explain why it is an economic argument for having a government. There is one which the book says is not an economic reason, but I gave an economic reason. I want the economic reason.

- A) Public goods
- B) Promoting competition
- C) Income redistribution.

3) (20 points) Suppose there is a project which will cost \$1000. It will enable the organization who does the project to sell 1 item to each of 500 people at \$3 profit per item. There is a negative externality which affects 400 people and it costs each of them \$2 each. Should the project be done? Explain your logic. Would the market provide it? Explain your logic. Would the government provide it? Explain your logic.

4) (20 points) Suppose there is a project which will cost \$800. It will enable the organization who does the project to sell 1 item to each of 300 people at \$2 profit per item. There is a positive externality which affects 200 people and it benefits each of them \$2 each. Should the project be done? Explain your logic. Would the market provide it? Explain your logic. Would the government provide it? Explain your logic.

5) (5 points) What is the main advantage of public choice over the market? Explain your logic.