Wilfrid W. Csaplar Jr. Principles of Macroeconomics Review Sheet for Exam 1 & assignment #2A.

This review sheet is intended to cover everything that could be on the exam. However, it is possible that I may have inadvertently overlooked something. 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 on the homework assignments, and possibly a few definition questions. I am more likely to ask questions that make you use definitions rather than have you recite them.

The optional review session for this test will be Tuesday 2/10 at 7:00 in the normal room.

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 are 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? How does the trade-off between current consumption and capital goods affect future output? What is 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 <u>along</u> a curve and movements <u>of</u> a curve. Price changes cause movements <u>along</u> the curve.* Since the list of things that move supply and the list of things that move demand are almost mutually exclusive (excluding expected 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 ignored this, but should not have. 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. You will be responsible for knowing how taxes and subsidies affect supply in chapter 4, which is on this exam. *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 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. <u>If you do not draw both supply and demand, then I will take off points. Also, label all axes and lines.</u> 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 the following terms and why are they an argument for government intervention in markets? Negative externalities, public goods, merit goods, demerit goods, and inequitable distribution of income. For each of them, explain how the government can partially solve the problems. Why are free riders a problem? What are marginal tax rate, average tax rate, and tax bracket? How can we tell if a tax is progressive, regressive, or proportional? Do not worry about capital gains, capital loss, double taxation, retained earnings, or corporate taxes. Know what tax incidence is, and how to estimate it from a graph. Do not worry about how much government revenue comes from each source, or how it is spent.

Wilf Csaplar Jr. Economics 162 Homework #2A To be covered on 2/9

This is a non-graded homework assignment that will be covered during the class when we cover assignment #2. The purpose of this assignment is to give you sample questions for the material we covered after you handed in homework #2. This material will be on the exam.

The article below came from BBC News (http://news.bbc.co.uk/1/hi/magazine/3112320.stm) on 9/16. Use it to answer question #1.

1A) (25 points) The article says that Pigouvian taxes are designed to change behavior. Noting that Pigouvian taxes are excise taxes, show on a supply and demand diagram how they change behavior.
1B) (15 points) Given the economic logic in part A, what goods should be taxed? Explain your logic.

2) (15 points) Use the tax rates in the book to calculate the taxes that would be paid by a person earning $80,000. (I wish I could earn that much.) Show all work.

3) (25 points) Illustrate on the supply and demand for cigarettes the negative externality caused by cigarettes. Given your diagram, what should the government do to reduce the problem? Why did you choose that and how would that reduce the problem?

4) (20 points) What are public goods? Explain why they require government intervention.

Grounds for a new tax
By Jonathan Duffy
BBC News Online

Is a latte a luxury? As voters in Seattle decide whether to slap a tax on espresso-style coffee, the Irish have plans to tax chewing gum and bank receipts, having already done the same for plastic bags. Get used to it - new taxes probably aren't going away.

When you've seen one, you've just about seen them all. The inside of a Starbucks coffee shop is a modest affair, a lumpy sofa here, a chiller cabinet there.

Many would see having a coffee there as an ordinary thing to do.

But in the city which unleashed this multinational enterprise on the rest of the world, the lawmakers at least are inclined to disagree.

To the burghers of Seattle, Starbucks' coffee, and that peddled by the myriad similar chains and independent coffee shops, is a luxury.

And as such, consumers should have to pay a tax on it.

That's the idea behind Initiative 77, on which Seattleites are voting on Tuesday.

It proposes a 10 cent (6p) tax on all "espresso beverages", which, incidentally, are legally classified as "coffee brewed by forcing steam through ground coffee beans".

The money raised will go to help some 3,000 children, many from poor families, get pre-school education.

Apart from giving rise to the prospect of coffee apartheid - lattes, espressos, cappuccinos would be included, but filter coffee exempt - the idea has split a city which spawned the 90s coffee revolution.

"If people are willing to pay $3 for a triple grande mocha, they're willing to pay an extra 10 cents for a good cause," says John Burbank, head of the non-profit Economic Opportunity Institute.

Too random?

Critics, however, decry the randomness of it all. What has coffee got to do with children's education, they say?

Jonathan Leape, of the London School of Economics, predicts trouble ahead if the proposal is ratified.

"Anything which is specific like this is open to distortions, in tax avoidance - for example if someone invented a latte-style filter coffee drink.

"It also raises the prospect of tax evasion - the shop owner who pretends in his accounts he is selling filter coffee."

Rather than put a high tax on a single item, the prevailing trend is to levy a (generally low) tax across a broad range of goods - such as VAT in Britain.

It means cost-conscious shoppers are not forced to choose between a taxed product and non-taxed one.

Yet the idea of earmarking tax receipts for a specific need - in this case pre-school learning - has enjoyed a resurgence of interest in the last five years, says Dr Leape.

The theory is widely scorned by economists for being too rigid. And, often as not, says Carl Emmerson of the Institute for Fiscal Studies, politicians can't be trusted not to shuffle the finances around, making a mockery of the theory.

The BBC licence fee is a rare example of a hypothecated tax that operates effectively, says Mr Emmerson, since it is totally transparent - the Treasury cannot dip into the BBC pot when it's short of cash.

On the plus side, says Dr Leape, ear-marking reminds us of the direct link between tax and a civil society.

In the US, the idea has been mooted of a "download tax" on computers, MP3 players and ISP accounts, to offset the industry costs of computer users downloading music for free.

Ireland's recent plastic bag tax - supermarkets charge customers 15 cents per bag - has earned the Exchequer 11m euros and the respect of environmentalists.

Dublin is now drawing up plans for taxes on chewing gum, cash-till receipts and polystyrene fast-food boxes, all of which present a litter problem.

These Pigouvian taxes - named after the economist AC Pigou - are about changing behaviour, as well as raising money, and are more widely associated with tobacco.

"These sort of taxes are win-win-win," says Dr Leape. "They get people to do a bit less of what you don't want, they raise money to tackle the remaining problem and they free up other taxes to be spent on other things."

This points to why these creative taxes seem to enjoy a degree of popularity.

So are we likely to see these "creative taxes" in the UK? The Congestion Charge in London is a tax by another name, and one which other cities in the UK look set to impose. The current appetite for targeting anti-social behaviour, such as littering, further raises the likelihood of such levies.

How long will it be before Gordon Brown wakes up and smells the coffee?