

ECON 1a Fall 2010
Final Exam Study Guide

The final exam will consist of approximately 60 multiple choice questions (for which you will need a Scantron 882-E) plus four multi-part written questions from which you are to choose three. The exam will be comprehensive but will emphasize topics covered after the midterm exam.

This guide covers mostly topics covered after the midterm. Consult the midterm study guide regarding topics prior to the midterm.

I reserve the right to add to this study guide through May 17.

1. What is meant by “perfect competition” and why, according to your text, is it a meaningless concept?
2. What is a cartel? Name at least two reasons why cartels are unstable.
3. What is predatory pricing? Name at least two reasons why it is so difficult to make predatory pricing work.
4. What is the record of anti-trust policy? Has it really protected consumers or has it mainly punished productive firms that were serving consumers well?
5. What is the definition of gross domestic product?
6. Which of these are included in GDP?
 - (a) Corn to be fed to cattle
 - (b) Corn to be eaten by people
 - (c) Services provided by paid tutors
 - (d) Services provided by volunteer tutors
 - (e) An HP laptop made in Singapore and sold in the U.S.
7. What are the two main reasons for exclusion of a particular good or service from GDP?
8. Name at least two kinds of productive activities that are excluded from GDP.
9. If an underdeveloped country is to grow economically, which of these is most important, abundant natural resources or secure property rights?
10. Name two ways in which foreign aid is often misused.
11. Suppose that, out of a population of 300 million, 160 million are not in the labor force and 10 million are officially called unemployed. Calculate the unemployment rate in percent.
12. Which of these would be counted as unemployed?

- (a) An SJSU instructor who, after 30 years, had to be committed to a mental hospital.
 - (b) An SJSU instructor who still held his job but was actively searching for a “real job.”
 - (c) The nephew of the Mayor who was on the city payroll but never showed up for work.
 - (d) A twelve-year-old school child.
 - (e) An eighty-year-old man who had no job but was actively looking for work.
 - (f) A steelworker who had had no job for the past year and had given up looking for a new job.
13. U6 is a measure of unemployment which, unlike the standard definition, called U1, includes discouraged workers. If U6 falls during a time when standard unemployment rises, what does that suggest about discouraged workers?
 14. If in the course of one quarter GDP rises from one trillion to \$1,005 billion, what is its annualized growth rate?
 15. How does the Fed use open market operations to inject new money into the economy? Does it buy or sell Treasury securities?
 16. In conducting its open market operations, the Fed keeps an eye on one particular interest rate, and targets that rate. What rate?
 17. When the Fed buys bonds in its open market operations, what happens to interest rates, other things being equal? Do they rise or fall?
 18. Given real and nominal GDP values, calculate the GDP deflator.
 19. Given prices for turnips in 1950 and 2005, calculate the percentage price rise in both nominal and real terms. You would be given a table of GDP deflators to use in this calculation.
 20. Define real and nominal prices.
 21. True or false: in a period of price inflation, all nominal prices rise.
 22. True or false: in a period of price inflation, all real prices rise.
 23. The first age of globalization ended when?
 24. Which of these were factors that contributed to globalization and peace in the nineteenth century?
 - (a) All major currencies were tied to gold.
 - (b) The British Navy made shipping safe.

- (c) There were strong social security systems.
25. State the definition of money.
 26. State the definition of commodity money.
 27. True or false: all the world's money is currently fiat money.
 28. Name at least two attributes that make a particular commodity suitable as money.
 29. Distinguish required bank reserves from excess bank reserves.
 30. Name one of the two likely reasons why banks are currently holding enormous levels of excess reserves.
 31. What two kinds of assets count as reserves for a commercial bank?
 32. Which is higher, the interest banks pay on deposits or the interest they receive on loans?
 33. Under what circumstances may a bank dip into its required reserves?
 - (a) When, in the judgment of bank management, business conditions warrant it.
 - (b) When the bank receives permission from the Fed.
 - (c) Never.
 34. A bank holds \$5 million in reserves that back deposit liabilities of \$45 million.
 - (a) Calculate the amount of excess reserves it holds, if any, given a 10% reserve requirement.
 - (b) The bank wishes to fund a \$2 million new loan. How much additional money must it raise in order to do so?
 - (c) Suppose it decides to raise the funds by attracting new deposits. Find the minimum amount of additional deposits that it must attract so as to be able to fund the loan.
 35. Why do banks normally not like to hold excess reserves?
 36. Whose asset is each of these items? Whose liability?
 - (a) A Treasury bond owned by Wells Fargo Bank.
 - (b) A checking account held by the Pope at the Bank of Rome.
 - (c) Reserves held by the Fed for the account of the Bank of America.
 - (d) A mortgage loan issued to Julius Caesar by the Bank of Rome.
 - (e) My pickup truck, if I own it outright.

37. After goldsmiths entered the business of storing people's gold and issuing receipts, what temptation did the goldsmiths yield to?
38. What is fractional reserve banking?
39. Describe the process by which, under fractional reserve banking, private banks create money.
40. Where does the Fed get the money it uses to buy Treasury securities in its open market operations? What does it do with the money it receives when selling Treasury securities in its open market operations?
41. What is a discount loan? Who is loaning fund to whom and who sets the interest rate?
42. What is a federal funds loan? Who is loaning fund to whom and who sets the interest rate?
43. If the Fed sees the fed funds rate drifting above its target, does it increase or decrease its purchases of Treasury securities?
44. Who determines the Fed's operating budget?
45. Which of these is a fact about the Fed and which is a myth?
 - (a) It can create money out of nothing
 - (b) It has a great deal of control over private banks
 - (c) It sets its own budget
 - (d) The Chairman of the Fed is a very powerful man
 - (e) It is privately owned
 - (f) It enjoys a degree of independence from Congress and the president
 - (g) Its independence is being challenged by Ron Paul and others
46. What is free banking?
47. Under free banking, what would stop private banks from issuing too much money, thereby igniting price inflation?
48. What categories of money are included in M1? In M2?
49. Is currency part of M2?
50. About \$2,700 in currency has been issued for each man, woman and child in the U.S., and this is far more than most of us hold. Name two classes of people who are the most significant holders of the "excess" currency.
51. Categorize each of these assets as either part of M1, part of both M1 and M2, or not part of either:

- (a) Currency
 - (b) Treasury bonds
 - (c) Gold coins
 - (d) Checking account balances
 - (e) Small savings account balances
 - (f) Euro currency (in the U.S.)
52. True or false: there were some bank failures in 2009.
53. When lenders get burned by price inflation, what do they require in order to be persuaded to make new loans?
54. Name two means by which governments, after they got control of money, debased its value.
55. When is price inflation detrimental to creditors?
- (a) Always
 - (b) Only when price inflation exceeds expectations built into interest rates.
 - (c) Only when price inflation turns out lower than expectations built into interest rates.
56. Define money inflation. Define price inflation.
57. How is inflation like a narcotic drug?
58. The FDIC insures most bank deposits. How does deposit insurance affect the behavior of depositors? Of bank managers?
59. Why would bank managers want to keep some reserves to back their deposits even if they were not required to do so?
60. Arithmetic using millions, billions, trillions. Computing per capita figures
61. Understanding real and nominal prices:
- Real price have inflation taken out of them.
 - Real price changes are always less than nominal price changes during times of inflation.
62. Commodity money:
- definition
 - attributes that make particular commodities good candidates for use as money.

63. Fiat money. My definition differs from the books: money that is not backed by any commodity.
64. Interest rates and inflation. Lenders' demand for higher interest rates due to higher expected inflation.
65. Social security: surpluses "invested" in Treasury securities. Unfunded liabilities for future social security and Medicare payments.
66. For categories like demand deposits or loans, identify whose asset they are and whose liability.
67. The Fed:
 - Creates money out of nothing
 - Open Market Operations
 - Discount loans
 - Sets its own budget
68. What the FDIC does
69. The Great Depression. What happened:
 - 25% unemployment
 - Thousands of bank failures
 - Big declines in GDP
 - Confiscation of gold and termination of gold contracts
70. Define fiscal policy. Define monetary policy.
71. Name the prominent twentieth century economists who were associated with these viewpoints:
 - (a) Free markets are inherently unstable. The government can and should engage in countercyclical fiscal policy so as to stabilize markets.
 - (b) Knowledge is specialized and dispersed. Government central planners lack the ability to effectively coordinate the economic activity of a nation.
72. Austrian business cycle theory blames business cycles (booms and busts) on excessive money creation. According to the theory, excess money creation does what to interest rates: raise or lower them?
73. According to Austrian business cycle theory, artificially low interest rates tend to shift investment from what category of projects to what other category?