

ECO1104G, University of Ottawa
Midterm: February 12, 2014
Answer Key

Multiple Choice (80 points; 2 points each)

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

Short Answer (30 points)

41. (8 points; 2 points per situation) Name and briefly describe four situations in which government intervention in an economy might improve the market outcome.

[Note: There are more examples below than required to obtain full points.]

- If there is a market failure, such as an externality (e.g., pollution imposes costs on society) or monopoly (a single seller that exerts substantial influence on market price), government regulation might improve the well-being of society by promoting efficiency.
- If there is an illegal market, for example, for drugs, government might design policies to reduce activity in that market.
- If the distribution of income or wealth is considered to be unfair by society, government intervention through a minimum wage or rent control might achieve a more equitable distribution of economic well-being.

42. (8 points; 2 points per part) Suppose that one worker in Taiwan can make 2 TVs or 10 pairs of shoes per week, and one a worker in Korea can make 3 TVs or 20 pairs of shoes per week.

a) In what sense do TVs and shoes cost less in Korea than in Taiwan?

In terms of labour time spent making TVs and shoes, both goods cost less in Korea than in Taiwan, 0.33 weeks per TV and 0.05 weeks per pair of shoes in Korea, and 0.5 weeks per TV and 0.1 weeks per pair of shoes in Taiwan. Korea possesses an absolute advantage in producing both goods.

b) In what sense do TVs cost less in Taiwan than in Korea?

In terms of opportunity cost, TVs cost less in Taiwan than in Korea: 5 pairs of shoes per TV in Taiwan and 6.67 pairs of shoes per TV in Korea. Taiwan possesses a comparative advantage in TV production.

c) If Taiwan and Korea were to engage in trade, which country would export which good?

Since Taiwan has a comparative advantage in TVs, it will export TVs. Since Korea has a comparative advantage in making shoes, it will export shoes.

d) How would the answer to the above question change if a worker in Korea could make 4 TVs per week?

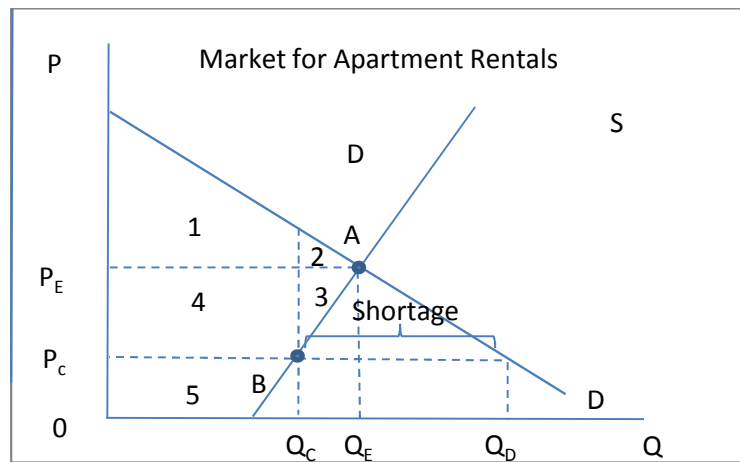
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No country would have a comparative advantage since opportunity costs will be the same for both countries and therefore engaging in trade would benefit neither country.

43. (14 points) Suppose the government introduces a binding price ceiling on apartment rentals.

- a) Using a supply and demand diagram, show how this will affect the market for apartment rentals. What will happen to the quantity of apartments rented? Will renters be able to satisfy their demand? [6 points]

As shown in the diagram below, a binding price ceiling, P_C , would reduce the rental price of apartments below its market clearing level, P_E . Equilibrium would move from point A to point B. The quantity of apartments supplied would fall from Q_E to Q_C , and a shortage of apartments would arise equal to $Q_D - Q_C$.



- b) What mechanisms might buyers and sellers use to respond to rent controls in the short run? What are the long-term effects of rent control on the housing market? [8 points]

In the short run:

- The price ceiling would cause only a small change in the quantity supplied, because the supply and demand curves for apartments are relatively inelastic.
- The primary effect of the price ceiling is to reduce rents.

In the long run:

- Both supply and demand would be more elastic.
 - Landlords would respond to low rents by not building new apartments and by failing to maintain existing ones.
 - More people would be encouraged to find an apartment and move into cities.
- The shortage would become larger.
- The available apartments would be rationed in a number of ways: waiting lists, discrimination based on family type or race, and bribes.
 - Policy makers might need to impose and enforce additional laws to deal with these problems.