

**ARE 201
Fall 2009
Test 1**

Name KEY

- I. Complete the sentence or provide the short answer on the "answer sheet".
1. An economy in which a central authority decides what is produced and who receives what amount of products and services is called a command economy.
 2. An economy that relies on individual self-interest to decide how resources are used and who received what amount of products and services is called a market (or price) economy.
 3. In the economy described in question #2, prices are the signals, or "invisible hand", that guide resource allocation.
 4. A demand curve shows how much of something (product or service) buyers purchase as the price of the product or service varies.
 5. On the curve describe in question 4, when the price of the product or service falls, the amount purchased increases.
 6. The field of economics that studies the decisions of individual households and businesses and their interactions in the marketplace is called microeconomics.
 7. The field of economics that studies the national economy and government economic policy is called macroeconomics.
 8. People are sometimes criticized for only being concerned with money. However, in economics money is simply a convenient way to measure the amount of resources available to someone.
 9. In *Micro Mischief*, George argues that growing kudzu is "free" because it grows wild and requires no fertilizer or watering. Dia disagrees, saying growing kudzu is not free because the land on which it grows could be used for some other purpose, and therefore some alternative benefits are given up. These alternative benefits that are given up by growing kudzu are a (an) opportunity cost of kudzu.
 10. "Ray's Pizzeria" notices sales of his pizzas decrease when the price of beer increases. This would mean pizza and beer are complements.
 11. Farmer Jones, who raises beef, keeps an eye on the hog market, because he knows from experience that when hog prices fall, sales of his beef drop. This relationship would indicate that beef and hogs are substitutes.

12. To protect himself against economic recessions when consumer income falls, “Pizza Ray” is considering opening a used furniture store. If sales of used furniture increase when consumer income falls, then used furniture is a (an) inferior good.
13. When dollars from past years are adjusted to make their purchasing power equivalent to present day dollars, we call them real dollars.
14. A major determinant of what a person is paid by a company is the revenue (or purchase or money) the person is responsible for earning for the company.
15. Katie Couric is paid an annual salary of \$15 million by CBS for anchoring the network's evening news. If CBS determines that she is responsible for earning more than \$15 million in revenues (or money) to CBS, then her salary will be justified in the eyes of the corporation.
16. High salaries will result in labor markets where demand for the worker is high and where few people can do the work.
17. Low salaries will result in labor markets where demand for the worker is low and where many people can do the work.
18. A benefit of minimum wage legislation is that it increases the wage rate paid to low skilled workers who continue to work. A disadvantage of minimum wage legislation is that often results in fewer low skilled workers being employed.
19. The major reason for investing is to transfer resources to the future and to at least keep pace with inflation.
20. Investments where the investor effectively buys ownership in a company are called stock investments.
21. Investments with more risk pay a higher interest rate.
22. The type of investment that earns a fixed interest rate for a long period of time is called a long term bond.
23. Allocating money among many different types of investments ("putting your investment eggs in many baskets") is called diversification.
24. The investment strategy that tries to predict what stage the economy is in and then moves money into the type of investment that typically does well in that stage is called active management.

25. A mutual fund is a way of investing, where many investors pool their monies and hire a manager to pick the specific investments.
26. To convert a dollar amount in the future to today's dollars (in today's purchasing power), you calculate the present value of the future dollars.
27. The interest rate used to make "present value" calculations is called the discount rate.

II. Work the problems and put the answer on the "answer sheet". Use the attached tables if necessary. **Give answers in dollars and cents.**

28. Use the Consumer Price Index (CPI) values to calculate the *real* value in 2009 (in 2009 purchasing power dollars) of rent of \$350 per month in 1990.

$$\mathbf{\$350 \times (216/130.7) = \$578.42}$$

29. Use the Consumer Price Index (CPI) values to calculate the *real* value in 2009 (in 2009 purchasing power dollars) of a car costing \$15,000 in 1992.

$$\mathbf{\$15,000 \times (216/140.3) = \$23,093.37}$$

30. Use the Consumer Price Index (CPI) values to calculate the *real* value in 2009 (in 2009 purchasing power dollars) of bread selling for 50 cents a loaf in 1989.

$$\mathbf{50 \text{ cents} \times (216/124.0) = 87 \text{ cents}}$$

31. Use the Consumer Price Index (CPI) values to calculate the *real* value in 2009 (in 2009 purchasing power dollars) of someone's \$50,000 salary in 1998.

$$\mathbf{\$50,000 \times (216/163.0) = \$66,257.67}$$

32. If the interest rate on an investment is 7% and the expected inflation rate is 3%, then the "real" interest rate is:

$$\mathbf{7\% - 3\% = 4\%}$$

33. What is the present value of \$10,000 paid 10 years from today using a discount rate of 3%?

$$\mathbf{\$10,000 \times 0.744 = \$7440}$$

Consumer Price Index Values

1985	107.6
1986	109.6
1987	113.6
1988	118.3
1989	124.0
1990	130.7
1991	136.2
1992	140.3
1993	144.5
1994	148.2
1995	152.4
1996	156.9
1997	160.5
1998	163.0
1999	166.6
2000	172.2
2001	177.1
2002	179.9
2003	184.0
2004	188.9
2005	195.3
2006	203.5
2007	208.4
2008	210.5
2009	216.0

Present Value Converters

Future Year	Annual Interest Rate (Discount Rate)		
	3%	5%	7%
1	0.971	0.952	0.935
5	0.863	0.784	0.713
10	0.744	0.614	0.508
20	0.554	0.377	0.258
30	0.412	0.231	0.131