

Ec151 Exam 1 Answers Sem. I, 2003-04

1. d 2. d 3. a 4. F 5. b 6. c 7. b 8. T 9. c 10. b

11. a 12. b 13. c 14. a 15. 60 16. 50/390 or about .128 17. a

18. T 19. F 20. c 21. a 22. c 23. $PV = \$250,000 / (1.08)^{15} \approx \$250,000 / 3.172 =$
 $\$78,815 < \$100,000$
Therefore, better to harvest today.

24. a 25. c 26. d 27. b 28. d 29. c 30. c 31. d 32. a

33a. A rent is a return earned by a factor or good above its opportunity cost. The prime example under discussion is of a good imports of which are restricted, causing the domestic market price to be above the world price. Anyone permitted to import the good earns a windfall profit which we call a rent. If licenses are distributed by the government, then the effort to get some of the licenses is what is called rent-seeking. The main reason rent-seeking is considered detrimental to developing countries is that the efforts and attentions of the entrepreneurs are on getting licenses, which is privately profitable but not beneficial to economic efficiency; these efforts would have been socially better expended on producing more goods, improving technical efficiency, cutting costs, etc. Notice that the rents come into being because of government controls, but they arise in controlled market economies, not in centrally planned economies; in the latter, there are (were) no private businessmen to engage in rent-seeking.

33b. The best-known hypothesis about the relationship between economic growth and inequality is based on the Kuznets curve. The curve plots a measure of inequality against income per capita of different countries at a common point in time. This cross-section data suggests an inverted U-shaped relationship: inequality is lower at low and high incomes, higher at middle incomes. There are theoretical reasons why this might be so, some coming from the labor surplus economy model. However, the relationship is not supported by time-series evidence: individual countries do not necessarily experience a rise in inequality as development proceeds. As for the question of how inequality affects growth, a number of recent growth regression studies suggest that countries with less inequality have experienced faster rates of growth. Possible reasons are that lower inequality facilitates more efficient (even) investment in human capital, broader access to credit, slower rates of population growth, and greater political stability.